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

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

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

Synovus Bank, Appellant,

v.

South Carolina Department of Revenue, Respondent.

RECORD ON APPEAL
VOLUME II

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STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

Synovus Bank, Petitioner, vs. South Carolina Department of Revenue, Respondent.	)	DOCKET NO. 17-ALJ-17-0418-CC **RESPONDENT'S MOTION FOR SUMMARY JUDGMENT**

TO: THE PETITIONERS

The South Carolina Department of Revenue (the "Department" or "DOR") respectfully moves this Court for summary judgment against Synovus Bank ("Synovus" or "Taxpayer") pursuant to Rules 19 and 68, SCALC and Rule 56(c), SCRCP.

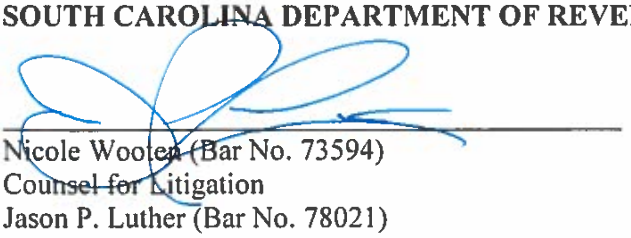
This Motion is based on the grounds that there is no genuine issue of material fact and the Department is entitled to judgment as a matter of law that Synovus is not entitled to deduct net operating loss carryforwards when computing its bank tax liability.

The parties have stipulated to the material facts related to the Taxpayer's net operating losses, and the Department contends that it is entitled to summary judgment as a matter of law for the reasons more fully explained in the supporting memorandum filed with this motion.

<signature page to follow>

Respectfully submitted,

SOUTH CAROLINA DEPARTMENT OF REVENUE



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STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

Synovus Bank, Petitioner, vs. South Carolina Department of Revenue, Respondent.	)	DOCKET NO. 17-ALJ-17-0418-CC **RESPONDENT'S MEMORANDUM OF LAW IN SUPPORT OF ITS MOTION FOR SUMMARY JUDGMENT**

The Respondent, South Carolina Department of Revenue, ("Department" or "DOR") by and through the undersigned counsel, respectfully submits this Memorandum in Support of the Department's Motion for Summary Judgment against Petitioner Synovus Bank ("Synovus" or "Taxpayer").

INTRODUCTION

The sole, dispositive legal question in this contested case is whether Synovus, a bank, is statutorily permitted to utilize net operating loss (NOL) carryforwards in computing its bank tax liability in South Carolina—despite over 80 years of well-settled law and administrative guidance that do not permit NOL deductions for banks.

Chapter 11 of Title 12 imposes a tax of 4.5% on the "entire net income" of a bank doing business in the State (the "bank tax"). S.C. Code Ann. § 12-11-20. Banks are defined in § 12-11-10 as any person "engaged in a banking business, whether incorporated under the law of this State, any other state or the United States or whether unincorporated, except cash depositories." *Id.* Since the inception of the bank tax in 1937, the Department, other South Carolina authorities, and the

banking industry itself have all consistently interpreted and applied the *corporate income tax* differently from the *bank tax*, whose tax base is calculated differently from the corporate income tax and for which net operating losses (NOLs) are not deductible.[1]

Prior to 2014, and consistent with the longstanding interpretation and application of the bank tax, Synovus (and its predecessor corporations) had never claimed an NOL deduction in calculating its bank tax liability. However, beginning in 2014, and for the first time ever, Synovus suddenly reversed course and began filing amended bank tax returns claiming NOL carryforward deductions in computing its bank tax liability.

Notwithstanding the clear provisions of Chapter 11 and over eight decades of longstanding Department policy to the contrary, Synovus contends that the NOLs it incurred in 2009 can be carried forward and claimed as deductions on its South Carolina bank tax returns for tax years 2011–2014, offsetting its income and resulting in no tax liability for those years. However, as explained more fully below, because there is no statutory authority for Synovus to claim such a deduction, the Department is entitled to summary judgment as a matter of law.

MATERIAL FACTS NOT IN DISPUTE

For the purposes of this Motion, the parties have filed a joint Stipulation of Facts that are not in dispute. The Department incorporates by reference those Stipulation of Facts as if set forth fully herein. *See* Stipulation of Facts ("Stip. Facts"), attached hereto as Exhibit A.

[1] A net operating loss (NOL) is the amount—for corporate income tax purposes—by which deductions exceed income in a particular income tax year. Under federal law and for *federal income tax* purposes, NOLs may be carried back and carried forward. I.R.C. § 172(b)(1)(A) (West 2016).

In 2010, the National Bank of South Carolina (NBSC) merged with Columbus Bank and Trust Company (CB&T) and was renamed Synovus Bank. (Stip. Facts, ¶ 10–12). CB&T reported losses for bank tax purposes for 2009; NBSC reported losses for 2009 and 2010; and Synovus reported losses for 2010. (Stip. Facts, ¶ 14). The total South Carolina losses reported by the three banks for 2009 and 2010 was $391,050,990. (Stip. Facts, ¶ 14–15).

Following the merger, Synovus filed a South Carolina Bank Tax Return for tax years 2011–2014. (Stip. Facts, ¶ 13). On its original bank tax returns, Synovus did not claim any deduction for the 2009 and 2010 losses. (Stip. Facts, ¶ 16). However, Synovus subsequently filed amended returns in which it claimed—for the first time—that it was entitled to deduct the losses from 2009 and 2010. (Stip. Facts, ¶¶ 17–18, 20–22).

On its amended returns for 2011, 2012, and 2013, Synovus offset its net South Carolina taxable income for bank tax purposes by a portion of these 2009 and 2010 losses, resulting in no bank tax liability for tax years 2011–2013. (Stip. Facts, ¶¶ 17–18, 20–21). On its original bank tax return for 2014, Synovus reported book income of $229,295,962 but also claimed NOL carryforwards of $291,331,561. As a result of claiming NOL deductions, Synovus reported no bank tax liability in South Carolina for 2014; instead, it claimed a refund from South Carolina in the amount of $968,585. (Stip. Facts, ¶ 22).

The Department conducted an audit of the returns for the periods at issue. (Stip. Facts, ¶ 23–26). The Department ultimately issued a Proposed Notice of Adjustment in which it disallowed Synovus' claim for NOL deductions for 2011–2014. (Stip. Facts, ¶ 26). This contested case hearing followed.

ARGUMENT

I. SUMMARY JUDGMENT STANDARD

Summary judgment is appropriate if there is "no genuine issue as to any material fact and . . . the moving party is entitled to judgment as a matter of law." Rule 56, SCRCP; *see also Henderson v. Allied Signal, Inc.*, 373 S.C. 179, 644 S.E.2d 724 (2007). "The purpose of summary judgment is to expedite disposition of cases which do not require the services of a fact finder." *George v. Fabri*, 345 S.C. 440, 452, 548 S.E.2d 868, 874 (2001). The Supreme Court has recognized that motions for summary judgment are appropriate in matters before the ALC. *See, e.g., Media Gen. Communications, Inc. v. S. Carolina Dept. of Revenue*, 388 S.C. 138, 152, 694 S.E.2d 525, 532 (2010) (affirming summary judgment by ALC).

II. SYNOVUS IS NOT ENTITLED TO DEDUCT NET OPERATING LOSSES IN COMPUTING ITS BANK TAX LIABILITY IN SOUTH CAROLINA.

A. The Legislature has never explicitly authorized banks to claim a deduction for NOLs when computing bank tax liability.

1. Deductions are a matter of legislative grace.

South Carolina law is well-settled that tax deductions are a matter of legislative grace and that a taxpayer may not claim a tax deduction unless the governing law specifically allows it. *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). "In order for a taxpayer to avail himself of a deduction in the calculation of a tax, the taxpayer must bring himself squarely within the terms

of that statute authorizing such deduction." *AVCO Corp. v. Wasson*, 267 S.C. 581, 588, 230 S.E.2d 614, 617 (1976).

Under standard rules of statutory construction, a tax exemption statute must be given its plain, ordinary meaning. *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 Supreme Court has repeatedly noted that where a statute allowing a deduction is ambiguous, the statute is 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.

2. There is no statute that explicitly grants banks the authority to claim an NOL deduction.

Both Synovus and the Department agree on one important issue: Title 12 does not contain a single statute that specifically authorizes banks to claim a deduction for NOLs when calculating their bank tax liability. In fact, the provisions of Chapter 11 (bank tax) never mention NOLs or conformity with the Internal Revenue Code (IRC) (which includes NOL deductions for federal income tax purposes). In fact, in its protest Synovus concedes that the bank tax statutes are "silent on the topic of *any* deductions, including a taxpayer's ability to deduct NOLs." (Stip. Facts, ¶ 1).

No corporation, whether bank or otherwise, is inherently granted a deduction for NOLs (carrybacks or carryforwards) for a bank tax or corporate income tax. Instead, deductions for NOLs must be authorized by statute. Chapter 6 of Title 12 specifically authorizes NOL deductions for corporate income tax purposes:

> South Carolina taxable income is computed by making modifications to deductions provided in the Internal Revenue Code as follows:

***

(4) A net operating loss deduction is computed in accordance with the Internal Revenue Code except that:

(a) All items of income and deductions used in computing the net operating loss deduction are adjusted as provided in this article.

(b) No carrybacks are allowed.

(c) A federal election to carryback a net operating loss deduction does not affect the computation of this deduction for South Carolina income tax purposes.

(d) A net operating loss is subject to allocation and apportionment under Article 17 of this chapter in the year the loss is incurred.

See S.C. Code Ann. § 12-6-1130 (Supp. 2007).

Significantly, there is no similar statutory provision—either in Chapter 6 (income tax) or Chapter 11 (bank tax)—that explicitly grants ***banks*** the ability to deduct NOL carryforwards. In this contested case, Synovus bears the burden of proving that Title 12 specifically authorizes banks to deduct NOLs for purposes of computing their bank tax liability. As explained below, the Legislature has never specifically authorized banks to be able to deduct NOL carryforwards when calculating their tax liability in South Carolina, and Synovus (a bank) cannot squarely bring itself within the terms of the statute authorizing corporations to deduct NOLs for corporate income tax purposes. Moreover, even if the statutes addressing NOLs may be ambiguous, the Department is entitled to summary judgment as a matter of law because the statutes are construed strictly against Synovus as the taxpayer in this case.

B. The bank tax is different from the corporate income tax, so the provisions of South Carolina's corporate income tax cannot be construed to implicitly authorize NOL deductions for banks in the absence of an explicit statutory grant.

Because South Carolina law is silent on whether banks can deduct NOL carryforwards, Synovus argues that banks should be entitled to deduct NOLs just like corporations because the bank tax and corporate income tax are inextricably linked and the provisions of the corporate

income tax apply for purposes of interpreting and applying the bank tax. In particular, Synovus relies heavily on the fact that the corporate income tax and the bank tax, when originally enacted, both used "entire net income" as their base.[2]

However, as explained below, the legislative history of the corporate income and bank taxes, case law, and longstanding Department policy demonstrate a consistent and uniform treatment of the bank tax as wholly distinct and separate from the corporate income tax. Accordingly, because the bank tax is different from the corporate income tax, allowing banks to deduct NOLs simply because corporations are permitted such deductions would contravene the clear intent of the General Assembly and ignore the Department's longstanding interpretation and application of the bank tax.

1. The history of both taxes demonstrates that the bank tax is different from the corporate income tax.

a. *Income Tax Act of 1926*

In 1927, the South Carolina General Assembly adopted the Income Tax Act of 1926 (1926 Act), which imposed an income tax on corporations organized in South Carolina and foreign corporations doing business in South Carolina, including for-profit banks. *See* Act No. 1, 1927 S.C. Acts 1–13, a copy of which is attached hereto as Exhibit B. The corporate income tax was 4% of "entire net income," and was not based on the Internal Revenue Code. *See* Income Tax Act of 1926, 1927 S.C. Acts p. 3.

[2] The phrase "entire net income" is used in only two sections of the current version of the South Carolina code. *See* S.C. Code Ann. § 12-6-2210(A) ("If the entire business of a taxpayer is transacted or conducted within this State, the income tax as provided in this chapter is measured by the *entire net income* of the taxpayer for the taxable year."); S.C. Code Ann. § 12-11-20 ("A tax is imposed upon every bank engaged in business in the State . . . computed at the rate of four and one half per cent of the *entire net income* of such bank or taxpayer.").

For corporate income tax purposes, the 1926 Act defined "net income" as "gross income" less allowed deductions. *Id.* at p. 6. The net income was computed "in accordance with the method of accounting regularly employed in keeping the books of such taxpayer." *Id.* at p. 7.

b. *The Bank Tax*

In 1937, the General Assembly enacted a separate tax on banks, thereby specifically removing banks from the corporate income tax. *See* Act No. 349, 1937 S.C. Acts 565–66, a copy of which is attached hereto as Exhibit C. Like the 1926 Act, the 1937 Act imposed a bank tax on "the *entire net income* of the taxpayer doing a banking business within this State." *Id.* (emphasis added). The bank tax rate was higher than the corporate income tax rate—4.5% of the entire net income of the bank. *Id.* However, unlike corporations subject to the corporate income tax, the 1937 Act exempted banks from all other taxes, except taxes on real property. *Id.* Since 1937, banks have remained exempt from the corporate income tax. *See* S.C. Code Ann. § 12-6-550(1) (2014) (exempting certain corporations from the corporate income tax, including banks, building and loan associations, insurance companies).

Thus, although banks were originally taxed as corporations under the 1926 Act, for over 80 years the corporate income tax and the bank tax have been separate taxes and have existed in separate chapters in South Carolina's taxation laws: the income tax in Chapter 6 of Title 12, and the bank tax in Chapter 11 of Title 12.[3]

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

c. Subsequent Statutory Amendments to the Corporate Income Tax

Amendments to South Carolina's corporate income tax code since its enactment in 1926 further demonstrate the difference between the corporate income and bank taxes.

In 1955, the South Carolina corporate income tax provisions were amended to increase the corporate tax rate to 5% and to include a provision permitting corporations to deduct NOLs. *See* Act No. 234, 1955 S.C. Acts 437, § 6 (amending S.C. Code § 65-259 (1952), now codified at § 12-6-1130), a copy of which is attached hereto as Exhibit D; *see also Chronicle Publishers, Inc. v. S.C. Tax Comm'n*, 244 S.C. 192, 136 S.E.2d 261 (1964) (allowing deduction for net operating loss carry-over only for taxpayers who established a new business or industry in the State during the calendar year 1955 and thereafter). Initially, the deduction was only for taxpayers that "established a new business or industry" in the State during the tax year, but it was subsequently expanded to all corporate income taxpayers. However, the General Assembly never included a similar NOL deduction provision in the bank tax.

In 1985, the General Assembly enacted the South Carolina Income Tax Federal Conforming Amendments of 1985, which repealed the 1926 Act and completely changed the tax base on which the corporate income tax and certain other income taxes were calculated. *See* Act No. 101, 1985 S.C. Acts 280–314 ("1985 Amendments"), a copy of which is attached hereto as Exhibit E. Relevant to this case, the 1985 Amendments added § 12-7-415 (now § 12-6-580), which changed the tax base for the corporate income tax from "entire net income" to "taxable income as determined under the [IRC] with the modifications specified." *Id.*; S.C. Code Ann. § 12-6-580 (2014).

The 1985 Amendments made wholesale changes to the entire income tax section of the South Carolina code, *id.* at 280–81 (amending numerous sections of Chapter 7, "all relating to the Income Tax Act of 1926"), including how to compute the taxable income of corporations. However, the legislation made no changes whatsoever to the provisions of the bank tax code, including how the tax base for the bank tax was determined. In other words, by leaving the tax base for bank tax purposes as the "entire net income" while changing the tax base for the corporate income tax to the taxable income based on a partially adopted IRC, the General Assembly confirmed what had already been the practice for nearly 50 years: that the tax base for the bank tax differs entirely from the tax base for the corporate income tax.

2. The bank tax has long been recognized as a franchise tax that is treated differently than an income tax.

Even though the bank tax chapter is titled "Income Tax on Banks," South Carolina authorities have long recognized the bank tax as a franchise tax that is separate and distinct from the income tax.

In 1948, just a decade after the bank tax was first enacted, the South Carolina Attorney General rendered an Opinion that differentiated the bank tax from the corporate income tax, declaring that the bank tax is "a franchise tax for the privilege of operating, or doing business, in this State, the amount thereof being measured by the entire net income." 1947-48 Op. S.C. Att'y Gen. 294 (March 12, 1948), a copy of which is attached hereto as Exhibit F. In addition, the Attorney General opined that the bank tax imposes a tax on "all income from whatever source derived, even income from non-taxable securities." *Id.* This is a key difference between the bank tax and the corporate income tax because a state may not impose a direct income tax (e.g., the corporate income tax) on interest income earned from government obligations. *See, e.g.*, Richard

D. Pomp, *State and Local Taxation*, 10-12 (8th ed. 2015) (noting that interest on federal securities can be included in the income of a corporation and taxed under a franchise tax, but that such interest cannot be taxed under an income tax "unless Congress so provides—which it has not yet done").

Subsequent regulations approved by the General Assembly are consistent with the Attorney General's Opinion. Current regulations recognize the bank tax as a franchise tax—not an income tax—that is based on the net income of banks. *See, e.g.*, S.C. Reg. BA-R-1 (December 6, 1967) (defining "entire net income" to include "income derived from any source whatsoever including interest on obligations of the United States, the United States Government or its possessions or of any state and any political subdivision thereof."); *see also* S.C. Code Ann. Regs. 117-1500.1 (same); S.C. Code Ann. Regs. 117-1500 ("Chapter 11 of Title 12 imposes a franchise tax on banks."), copies of which are attached hereto as Exhibit G. Notably, the General Assembly had knowledge of these regulations in 1985, but chose not to repeal them, thereby implicitly signaling that the legislature agreed that entire net income was applied differently for bank tax purposes and corporate income tax purposes.

Although there is a dearth of South Carolina case law addressing the bank tax, there is at least one decision of the South Carolina Tax Commission (Tax Commission) that also differentiated the bank tax from the corporate income tax. In a matter concerning First National Bank of South Carolina regarding its 1971 to 1973 bank taxes, the Tax Commission noted there are "special rules in this State applicable to the taxation of banks." The Tax Commission further noted that

> the bank tax "has **always been construed to be a franchise tax** measured by the bank's entire net income. The phrase "entire net income" has been construed to

> mean "all income from whatever source derived, less all expenses incurred". See BA–OAG–1 (March 12, 1948). **The special base of this tax is, therefore, economic income rather than taxable income.**

See Re: Bank Tax, 1975 WL 23740, at *1 (S.C. Tax. Comm. January 24, 2975).

Moreover, as recently as 2010, the South Carolina Taxation Realignment Commission (TRAC)—a statutorily created body—recognized 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, pp. 74–75, 140–41 (Dec. 2010) (emphasis added), relevant portions of which are attached hereto as Exhibit H.

Finally, the Department itself has long-differentiated the bank tax from the corporate income tax. *See* S.C. Revenue Ruling #92-9 ("Code Section 12-11-20 provides for a franchise tax based on net income on banks . . ."), a copy of which is attached hereto as Exhibit I. In light of the fact that the bank tax is calculated on the net income of the bank, rather than the taxable income of the bank, the Department-issued instructions to Form SC 1101 B, the South Carolina Bank Tax Return, clearly advise banks that they are not allowed an NOL deduction for South Carolina bank tax purposes. *See* Form SC 1101 B, a copy of which is attached hereto as Exhibit J.

3. A bank's tax base is calculated differently from a corporation.

As discussed above, the South Carolina bank tax is calculated based on a bank's entire net income, which includes all income from whatever source derived, even income from non-taxable securities, less all expenses incurred. *See Re: Bank Tax*, 1975 WL 23740, at *1 (S.C. Tax. Comm. January 24, 2975); S.C. Code Ann. § 12-11-20 (2014).[4] By contrast, since 1985 the South Carolina

[4] Entire net income is also sometimes referred to as "book income." *See e.g.*, Final Report of

corporate income tax has been calculated based on a corporation's *taxable income*. Taxable income as defined by the IRC excludes certain income from taxation (e.g., interest income on government obligations) and disallows a deduction for certain expenses (e.g., federal income taxes).

Entire net income, or book income, means that a bank may deduct all of its expenses from all of its revenues to calculate entire net income. *See* S.C. Code Ann. Regs. 117-1500.1, 117-1500.3 (West 2017); *see also* I-D-189 (Jan. 24, 1975) (stating that the bank tax has a special tax base that is economic income rather than taxable income). A bank may use either the cash or accrual method of accounting. S.C. Code Ann. Regs. 117-1500.2 (West 2017). The Department's longstanding administrative policy is that the bank tax is based on financial accounting rather than federal income tax accounting. *Id.* Thus, the bank tax is based on financial reporting income and should generally be computed using Generally Accepted Accounting Principles (GAAP). Under GAAP, entire net income, or book income, does not include a net operating loss deduction.

Allowing a bank to record and offset its income by "all expenses incurred" is entirely different from the corporate income tax and identifies a critical and longstanding difference between the bank tax and the corporate income tax. While the 1975 Tax Commission decision and the 1948 Attorney General's Opinion support a bank's ability to deduct all of its expenses allowed under GAAP, both the 1926 Act and the IRC place limitations on the amount of deductions that a corporation (or other taxpayer) may claim.

For example, under the 1926 Act, the General Assembly limited deductions that a corporation could take. Thus, a corporation could not deduct state and federal income taxes, but

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S.C. Taxation Realignment Commission, pp. 75-76, 140-41 (Dec. 2010) (stating that the entire net income of a bank is based on its ***book*** income).

could deduct only ordinary and necessary business expenses. *See* Income Tax Act of 1926, 1927 S.C. Acts page no. 9–10. Similarly, the IRC imposes certain limitations on deductions that a corporation may claim. Thus, the IRC limits business deductions to those that are ordinary and necessary, I.R.C. § 162(a) (West 2017), and limits the deduction for corporate charitable contributions to only those that are substantiated and to only 10% of the corporation's taxable income, I.R.C. § 170(a), (b)(2) (West 2017). Banks are not subject to these same limitations.

The tax base for the bank tax has been the "entire net income" of the bank since its inception. Although the 1926 Act also used "entire net income" to define the tax base for corporate income tax purposes, from 1937 to 1985 the tax base of "entire net income" for bank tax purposes was calculated differently from the tax base of "entire net income" for corporate income tax purposes. If the General Assembly had intended to change the tax base for the bank tax from "entire net income," like it did for the corporate income tax, it would have explicitly done so in 1985. It chose not to.

In sum, the legislative and other history of the bank tax demonstrate that the bank tax and the corporate income tax are distinctly different taxes with different tax bases that exist for different purposes. Because they are different taxes, the corporate income tax provisions should not be imposed on the bank tax to allow a NOL deduction for bank tax purposes, especially where the lengthy history of the bank tax has not allowed such a deduction.

C. The "conformity provisions" in Chapter 6 (the Income Tax Act) do not change the provisions of Chapter 11 (the Bank Tax) to allow a bank to deduct NOLs because the conformity provisions do not apply to banks.

When the General Assembly amended the income tax act in 1985, it adopted certain portions of the IRC. *See, e.g.*, S.C. Code Ann. § 12-6-40 (defining "Internal Revenue Code" to

mean the Internal Revenue Code of 1986); § 12-6-50(6) (2014) (noting that I.R.C. § 172 relating to net operating loss carrybacks is specifically ***not*** adopted by this State). By not adopting the IRC provisions that permit a deduction for NOL carrybacks, the General Assembly presumably permitted NOL carryforwards for corporations that are taxed in South Carolina under the IRC conformity provisions.

Synovus contends that the current statutory framework in Chapter 6 of Title 12 (i.e., the IRC conformity provisions) also permits banks to deduct NOLs on their South Carolina bank tax returns. However, South Carolina does not tax banks under the IRC conformity provisions, *see* S.C. Code Ann. §§ 12-6-550(1) (2014), 12-6-580 (2014), so Synovus's reliance on section 12-6-50(6) is misplaced.

The General Assembly adopted the IRC for only certain categories of taxpayers, and banks do not fit into any of the categories of taxpayers for which the General Assembly adopted the IRC. The IRC conformity provisions apply to the corporate income tax, S.C. Code Ann. § 12-6-580 (2014), the individual income tax of a resident, S.C. Code Ann. § 12-6-560 (2014), the gross income and taxable income of S Corporations and their shareholders, S.C. Code Ann. § 12-6-590 (2014), the gross income and taxable income of partnerships and their partners, S.C. Code Ann. § 12-6-600 (2014), and resident estates and trusts, S.C. Code Ann. § 12-6-610 (2014). The General Assembly also partially adopted the IRC for all other entities, except those entities specifically excluded from the corporate income tax by section 12-6-550. S.C. Code Ann. § 12-6-630 (2014).

Banks, including Synovus, do not fall into any of the categories of taxpayers for which the General Assembly adopted the IRC. Banks are generally organized as corporations in South Carolina, *see* S.C. Code Ann. §§ 34-3-10(A), 34-3-210 (West 2017), so they are not subject to the

IRC conformity provisions related to residents filing individual income taxes, partnerships, and resident estates and trusts. Second, although banks like Synovus are typically organized as a corporation, the General Assembly specifically excluded banks from the corporate income tax. S.C. Code Ann. § 12-6-550(1) (2014). Therefore, when the General Assembly applied the IRC to the corporate income tax under § 12-6-580, the General Assembly did not apply the IRC to banks. Moreover, section 12-6-630 applies the IRC to all other entities but specifically excludes entities, including banks, that the General Assembly excluded from the corporate income tax by § 12-6-550. Therefore, this catchall provision specifically excluded banks from IRC adoption.

Because banks do not fall into any of the categories of taxpayers for which the General Assembly adopted the IRC, the IRC conformity provisions of Chapter 6 are not applicable to banks; hence, banks do not use the IRC to determine their South Carolina tax base. Accordingly, this court should reject Synovus's argument that the IRC conformity provisions in Chapter 6 (including §12-6-50(6)) allow it to deduct NOLs.

D. The Department's longstanding interpretation of the bank tax is entitled to deference.

Under the cardinal rules of statutory construction, an administrative agency's longstanding interpretation of a statute is generally entitled to deference and should not be overruled by a reviewing court in the absence of cogent reasons. *Media Gen. Commc'ns, Inc. v. S.C. Dep't of Revenue*, 388 S.C. 138, 147–48, 694 S.E.2d 525, 529–30 (2010).

As discussed above, it has been the longstanding policy of the Department, and previously the SC Tax Commission, that the bank tax is an annual privilege tax, which calculates its tax base differently from the corporate income tax and which does not allow deductions for NOLs.

This longstanding policy is further confirmed by the 1948 Attorney General's Opinion, the 1975 Tax Commission decision, bank tax regulations, and the instructions to Form SC 1101 B. Moreover, the findings of the Taxation Realignment Commission support the Department's longstanding interpretation of the corporate income and bank taxes and subsequent amendments. Even the banking industry itself has long-interpreted the bank tax in a manner consistent with the Department's interpretation.[5]

Accordingly, the Department's longstanding policy regarding the bank tax should be afforded great deference, and the Department should be granted summary judgment as a matter of law that Synovus may not deduct NOL carryforwards in its 2011 through 2014 bank tax returns.

CONCLUSION

Although the Legislature has enacted specific statutory authority for corporations to deduct NOLs for corporate income tax purposes, it has never adopted a similar provision for the bank tax.

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[5] As part of the TRAC study, the President and CEO of the South Carolina Bankers Association acknowledged that

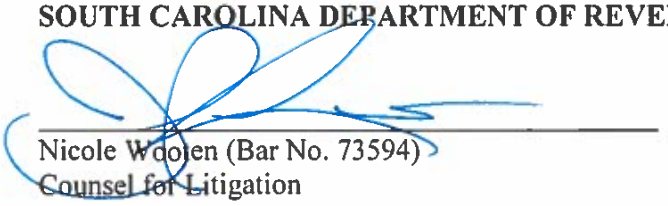
> In South Carolina, **banks pay an income tax that is not calculated in the same manner as for a C corporation. The bank tax is a franchise tax.** Banks are taxed pursuant to Chapter 11 of Title 12. S.C. Code § 12-11-20 provides that the entire net income of a bank in South Carolina is to be taxed at 4 1/2% rate annually. This income is "book income" not "taxable income" which is what C Corps are taxed on. As a result all income and expenses are included in the tax calculation for a bank. And **the entire net income is calculated without regard to the majority of the book/tax differences considered for federal income tax purposes, including the NOL carryforward.**

Lloyd Hendricks, Bank Tax – TRAC Testimony Give[n] by Lloyd Hendricks (June 8, 2010), last accessed on June 1, 2017 at www.scstatehouse.gov/Archives/CitizensInterestPage/TRAC/060810Meeting/Bank%20Tax.pdf, a copy of which is attached hereto as Exhibit K.

Since the inception of the bank tax in 1937, the Department and other South Carolina authorities have interpreted and applied the bank tax to be a franchise tax, not an income tax, whose tax base is calculated differently than the corporate income tax and for which NOLs are not deductible. This longstanding interpretation is entitled to deference. Further, the IRC conformity statutes adopted by the General Assembly starting in 1985 do not apply to the bank tax, so the IRC conformity provision in §12-5-50(6) that implicitly permits a deduction for NOL carryforwards do not apply to banks. Thus, because the bank tax of Chapter 11 of Title 12 does not authorize a bank to deduct NOL carryforwards, the Department respectfully requests this Court grant summary judgment in its favor and find as a matter of law that Synovus may not deduct NOL carryforwards in bank tax years 2011 through 2014.

Respectfully submitted,

SOUTH CAROLINA DEPARTMENT OF REVENUE



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Columbia, South Carolina
July 25, 2018

Exhibit A

STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

Synovus Bank, Petitioner, vs. South Carolina Department of Revenue, Respondent.	)	Docket No. 17-ALJ-17-0418-CC **STIPULATION OF FACTS AND TO THE ADMISSIBILITY OF CERTAIN DOCUMENTS**

For purposes of cross-motions for summary judgment, Petitioner Synovus Bank (Synovus or Taxpayer) and Respondent South Carolina Department of Revenue (Department) stipulate to the following facts:

1. The Parties incorporate by reference the Department's Proposed Assessment, Taxpayer's Protest and the Department Determination into this Stipulation.

2. In the Income Tax Act of 1926, the South Carolina General Assembly adopted a corporate income tax of 4% of a corporation's "entire net income."

3. Initially, banks were subject to the 1926 Act's corporate income tax. However, in 1937, the General Assembly enacted a separate tax on banks and excluded banks from the corporate income tax. The bank tax was 4.5% of the entire net income of the bank.

4. In 1985, the General Assembly through Act No. 101 enacted the South Carolina Income Tax Federal Conforming Amendments of 1985, which revised the South Carolina Code to conform to certain Internal Revenue Code (IRC) provisions. The conformity provisions were included in Chapter 7 of Title 12.

5. On December 20, 1994, the South Carolina Tax Commission issued SC Information Letter #94-35.

6. In 1995, the General Assembly re-codified the conformity provisions in Chapter 7 of Title 12 into Chapter 6 of Title 12.

7. On August 28, 1995, the Department issued SC Private Letter Ruling #95-10.

8. In 2005, the General Assembly amended S.C. Code § 12-6-40 and S.C. Code § 12-6-50.

9. In 2016, the Department of Revenue issued SC Revenue Ruling # 16-7.

10. On February 28, 1995, Synovus Financial Corp. acquired NBSC Corporation, the parent company of National Bank of South Carolina (NBSC).

11. On November 15, 1997 Columbus Bank and Trust Company (CB&T) began filing a SC tax return.

12. On May 6, 2010, NBSC was merged into CB&T and was renamed Synovus Bank. Each of these entities is or was, as the case may be, organized as corporations.

13. Synovus Bank filed Form SC 1101 B titled "Bank Tax Return" for years ending December 31, 2011, 2012, 2013, and 2014.

14. On its respective South Carolina Bank Tax Return, NBSC reported losses for South Carolina bank tax purposes for 2009 and 2010. CB&T reported a loss for South Carolina bank tax purposes for 2009. Synovus reported a loss for South Carolina bank tax purposes for 2010.

15. The total South Carolina losses reported by NBSC, CB&T, and Synovus for 2009 and 2010 was $391,050,990, as amended. Later, the total South Carolina losses were increased by $91,000,000 for a total of $482,050,990 through a proposed audit adjustment by the Department.

16. For bank tax years 2011, 2012, and 2013, Synovus filed its original South Carolina Bank Tax Returns without claiming any net operating loss (NOL) carryforwards from 2009 or 2010.

17. For bank tax year 2011, Synovus filed its original Bank Tax Return on September 14, 2012, an amended return on June 27, 2013, and a second amended return on December 20, 2013. On all three returns, the Taxpayer reported net income apportioned to South Carolina and reported taxes under the South Carolina bank tax.

18. On December 19, 2014, Synovus filed a third amended return for tax year 2011 on which it claimed, for the first time, that it was entitled to deduct the losses from 2009 in the form of NOL carryforwards. As a result, Synovus reported no bank tax liability for 2011 on its third amended return.

19. In its filings, Synovus provided an explanation to the Department as to why it filed the amended Bank Tax Returns

20. For bank tax years 2012 and 2013, Synovus filed original Bank Tax Returns reporting net income apportioned to South Carolina. In 2015, Synovus filed amended Bank Tax Returns for 2012 and 2013. On the amended returns, Synovus claimed NOL carryforwards, which resulted in no bank tax liability for bank tax years 2012 and 2013. These claimed NOL deductions also reduced the alleged NOL carryforwards from 2009.

21. Synovus then filed second amended bank tax return for 2013, in which it claimed that it had NOLs that could be carried forward to 2014 in the amount of $291,331,561.

22. For bank tax year 2014, Synovus filed an original Bank Tax Return in South Carolina reporting company-wide book income of $229,295,962 but offsetting its South Carolina

net taxable income by a portion of the 2009 net operating losses. As a result, Synovus reported no bank tax liability in South Carolina and claimed a refund of $968,585 from South Carolina.

23. For tax years 2012, 2013 and 2014, the Department initially granted the refunds requested by Synovus.

24. The 2012 refund was approved but not paid due to a procedural problem in requiring the 2012 refund to be "held for verification."

25. The refund requests for tax years 2013 and 2014 were paid by the Department to Synovus.

26. 27. Therefore, the Department conducted an audit of the Synovus Bank returns for 2011 – 2014.On March 14, 2016, the Department issued a Proposed Notice of Adjustment with related "Report of Field Audit" (PNOA) to Synovus. In this PNOA, the Department confirmed and corrected the amount of NOLs at issue, but disallowed Synovus' claims for NOL deductions in 2011 through 2014. The Department also assessed penalties and interest through April 15, 2016. On or about April 6, 2016, the Department revised the PNOA to Synovus deleting the penalties that it had originally assessed and updating the interest amount. The total assessment on the revised PNOA to Synovus is $2,076,325.

27. Synovus filed a written protest on both PNOAs on June 7, 2016.

Respectfully submitted,

SOUTH CAROLINA DEPARTMENT OF REVENUE

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July 25, 2018
Columbia, S.C.

Exhibit B

Acts and Joint Resolutions

OF THE

GENERAL ASSEMBLY

OF THE

State of South Carolina

PASSED AT THE REGULAR SESSION OF 1927

PRINTED BY ORDER OF THE GENERAL ASSEMBLY AND DESIGNED TO FORM A PART OF THE THIRTY-FIFTH VOLUME OF THE STATUTES AT LARGE, COMMENCING WITH THE ACTS OF THE REGULAR SESSION OF 1927

PRINTED UNDER THE DIRECTION OF THE
JOINT COMMITTEE ON PRINTING
GENERAL ASSEMBLY OF SOUTH CAROLINA

List of Acts and Joint Resolutions
1927

PART I.—GENERAL AND PERMANENT LAWS

No. 1. An Act to raise revenue for the support of the State Government by the levy and collection of a tax upon income.

No. 2. An Act to amend an Act entitled an Act "Directing the County Treasurer of Lexington County to require of any bank or trust company with which he shall deposit county funds to execute and deliver to Lexington County an indemnity bond in double the amount for such deposits, or deliver marketable securities in an equal amount, and to provide penalties for the violation of the provisions of this Act," designated as Act Number 514, approved on the 12th day of March, A. D. 1926, by reducing the amount of bond required.

No. 3. An Act to amend Section 9 of an Act to provide for the construction of highways in the State Highway System pursuant to reimbursement agreements, etc., known as Act No. 559, of the Acts of 1926, approved the second day of April, 1926, so that the provisions of said Act may apply to Marion County.

No. 4. An Act to amend Section 4362, Volume 3 of the Code of South Carolina of 1922, so as to permit railroad corporations to elect fifteen directors.

No. 5. An Act to amend the fifth subdivision of Section 4359 and to amend Section 4312 of Volume III of the Code of South Carolina of 1922, so as to permit railroad corporations to issue common stock in shares having no par value and to fix the charter fees to be paid thereon, and to validate and confirm certain charters heretofore granted by the Secretary of State authorizing the issuance of such stock.

No. 6. An Act to fix the expenses of the County Superintendent of Education for Colleton County.

No. 7. An Act to amend an Act entitled "An Act to provide for the election of trustees of Clover School District No. 37, York County," so as to further provide for the manner of election.

No. 8. An Act to ratify an amendment to Article VIII, Section 7, and Article X, Section 5, of the Constitution relating to municipal bonded indebtedness, by adding a proviso thereto as to the bonded debt of the City of Charleston.

No. 9. An Act to decrease the number of County Commissioners for Lee County, and to provide compensation therefor.

No. 10. An Act to provide a system of County Government for Colleton County.

No. 11. An Act to amend an Act entitled "An Act to provide for the election of Master for Kershaw County, to define his qualifications and fix his compensation," appearing in Acts of 1924 as No. 612, by striking out all of Section 2 after the word "law" on line three.

No. 12. An Act to ratify an amendment to Section 5 of Article X of the Constitution relating to bonded indebtedness of counties, townships, school districts, etc., by adding a proviso permitting the County of Spartanburg to incur bonded indebtedness to an amount not exceeding fifteen per centum of the assessed value of all taxable property therein.

Acts and Joint Resolutions
OF THE
GENERAL ASSEMBLY
OF THE
State of South Carolina

JOHN G. RICHARDS, Governor; T. BOTHWELL BUTLER, Lieutenant Governor and *ex officio* President of the Senate; JOHN K. HAMBLIN, Speaker of the House of Representatives; JAS. H. FOWLES, Clerk of the Senate; J. WILSON GIBBES, Clerk of the House of Representatives.

Passed at the Regular Session, which was begun and held at the City of Columbia on the 11th day of January, A. D. 1927, and was adjourned without day on the 23rd day of April, A. D. 1927.

PART I

GENERAL AND PERMANENT LAWS

No. 1

AN ACT to Raise Revenue for the Support of the State Government by the Levy and Collection of a Tax upon Income.

Section 1. Article 1—Short Title and Definitions.—Be it enacted by the General Assembly of the State of South Carolina: This Act shall be known and may be cited as the Income Tax Act of 1926.

§ 2. **Definitions.**—For the purposes of this Act and unless otherwise required by the context:

(1) The words "tax commission" mean the South Carolina Tax Commission.

(2) The word "taxpayer" means any individual, fiduciary, or corporation subject to the tax imposed by this Act.

(3) The word "fiduciary" means a guardian, trustee, executor, administrator, receiver, conserver, or any person, whether individual or corporate, acting in any fiduciary capacity for any person, estate or trust.

(4) The word "person" includes individuals, fiduciaries, partnerships or corporations.

(5) The word "corporation" includes joint-stock companies or associations and insurance companies.

(6) The word "business" includes trade, profession, occupation or employment.

(7) The words "tangible property" mean real property and corporeal personal property and do not mean money, bank deposits, shares of stocks, bonds, credits, evidences of debt, choses in action or evidences of an interest in property.

(8) The words "intangible property" mean all property other than tangible property.

(9) The words "income year" mean the calendar year or the fiscal year, upon the basis of which the net income is computed under this Act; if no fiscal year has been established they mean the calendar year.

(10) The words "fiscal year" mean an income year ending on the last day of any month other than December.

(11) The word "paid" for the purpose of the deductions under this Act, means "paid or accrued" or "paid or incurred," and the words "paid or accrued," "paid or incurred" and "incurred" shall be construed according to the method of accounting upon the basis of which the net income is computed under this Act. The word "received" for the purpose of the computation of the net income under this Act means "received or accrued," and the words "received and accrued" shall be construed according to method of accounting upon the basis of which the net income is computed under this Act.

(12) The words "foreign corporation" mean any corporation other than a domestic corporation.

(2)

§ 3. Article II—Imposition of the Tax—Tax on Individuals.—A tax is hereby imposed upon every individual residing in the State of South Carolina, which tax shall be levied, collected, and paid annually, with respect to the entire net income of the taxpayer, as hereinafter defined, and upon income earned within the jurisdiction of this State of every non-resident having a business of agency in the State, or from the sale or rentals of property within this State, computed at the following rates, after deducting the exemptions provided by this Act:

On the excess over the amount legally exempted up to twenty-five hundred dollars, one per cent.

On the excess above twenty-five hundred dollars and up to five thousand dollars, one and one-half per cent.

On the excess above five thousand dollars and up to seven thousand five hundred dollars, two and one-half per cent.

On the excess above seven thousand five hundred dollars and up to ten thousand dollars, three and one-half per cent.

On the excess above ten thousand dollars and up to fifteen thousand dollars, four and one-half per cent.

On the excess over fifteen thousand dollars, five per cent.

§ 4. (a) Tax on corporations.—Every corporation organized under the laws of this State shall pay annually an income tax, with respect to carrying on or doing business equivalent to four per cent of the entire net income of such corporation, as herein defined, received by such corporation during the income year; and every foreign corporation doing business within the jurisdiction of this State shall pay annually an income tax equivalent to four per cent. of a proportion of its entire net income, to be determined as hereinafter provided in this Act.

(b) Railroads and public service corporations. basis of ascertaining net income.—The basis of ascertaining the net income of every corporation engaged in the business of operating a steam or electric railroad, express service, telephone or telegraph business, or other form of public service, when such company is required to keep records according to the standard classification of accounting of the Interstate Commerce Commission, shall be the "net operating income" of such corporation as shown by their

Amended 1930 to provide "whether or not"
" 1943 " " " " and/or FCC

records kept in accordance with that standard classification of accounts, when their business is wholly within the jurisdiction of this State, and when their business is in part within and in part without the State their net income within the jurisdiction of this State shall be ascertained by taking their gross "operating revenues" within this State, including in this gross "operating revenues" within the jurisdiction of this State the equal mileage proportion within the jurisdiction of this State of their interstate business and deducting from their gross "operating revenues" the proportionate average of "operating expenses," or "operating ratio," for their whole business, as shown by the Interstate Commerce Commission standard classification of accounts. From the net operating income thus ascertained shall be deducted "uncollectible revenue," and taxes paid in this State for the income year, other than income taxes, and the balance shall be deemed to be their net income taxable under this Act: *Provided*, That interest paid or accrued and rentals may be deducted from gross operating revenues in the event that they have not been deducted by the above provisions.

(c) Car hire considered.—In determining the taxable income of a corporation engaged in the business of operating a railroad under the preceding section (Section (b)), in the case of a railroad located entirely within the jurisdiction of this State, the net income shall be increased or decreased to the extent of any credit balance received or paid, as the case may be, on account of car hire; and when a railroad is located partly within and partly without the jurisdiction of this State, then said net operating income shall be increased or decreased to the extent of an equal mileage proportion within the jurisdiction of this State of any credit or debit balance received or paid, as the case may be, on account of car hire.

(d) Tax on fiduciaries.—The tax imposed by this Act shall be imposed upon resident fiduciaries and upon non-resident fiduciaries having in charge funds or property for the benefit of a resident of this State, which tax shall be levied, collected, and paid annually with respect to:

(1) That part of the net income of estates or trusts which has not been distributed. (2) The net income received during the income year by deceased individuals who, at the time of death were residents and who have died during the tax year or income year without having made a return. (3) The entire net income of resi-

dent insolvent or incompetent individuals whether or not any portion thereof is held for the future use of the beneficiaries, where the fiduciary has complete charge of such net income. (4) The tax imposed upon a fiduciary by this Act shall be a charge against the estate or trust.

§ 5. **Exemptions.**—There shall be deducted from net income the following exemptions:

(a) In the case of a single individual, a personal exemption of fifteen hundred ($1,500.00) dollars.

(b) In the case of a married individual, living with husband or wife or the head of a household, twenty-five hundred ($2,500.00) dollars.

(c) Four hundred ($400.00) dollars for each individual other than husband or wife dependent upon and receiving his chief support from the taxpayer if such dependent individual is under twenty-one years of age or is incapable of self support because mentally or physically defective.

(d) In the case of a fiduciary if taxable under clause (a) supra, a personal exemption of one thousand ($1,000.00) dollars; if taxable under clause (b) supra, the same exemption as would be allowed the deceased if living; if taxable under clause (c) supra, the same exemptions to which the beneficiary would be entitled.

§ 6. **Organizations that are exempt.**—The following organizations shall be exempt from taxation under this Act:

(1) Fraternal beneficiary societies, orders or associations, (a) operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system and, (b) providing for the payment of life, sick, accident or other benefits to the members of such society, order or association or their dependents.

(2) Building and loan associations and co-operative banks without capital stock, organized and operated for mutual purposes and without profits, and insurance companies.

(3) Cemetery corporations and corporations organized for religious, charitable, scientific, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earn-

(5)

ings of which inures to the benefit of any private stockholder or individual.

(4) Business leagues, chambers of commerce, or boards of trade, not organized for profit and no part of the net earnings of which inures to the benefit of any private stockholder or individual.

(5) Civic leagues or organizations not organized for profit, but operated exclusively for the promotion of social welfare.

(6) Farmers' or other mutual hail, cyclone, or fire insurance companies, mutual ditch or irrigation companies, mutual or co-operative telephone companies or like organizations of a purely local character, the income of which consists solely of assessments, dues, and fees collected from members for the sole purpose of meeting expenses.

(7) Farmers', fruit growers' or like organizations, organized and operated as sales agent for the purpose of marketing the products of members and turning back to them the proceeds of sales, less the necessary selling expenses, on the basis of the quantity of produce furnished by them.

(8) Labor, agricultural or horticultural organizations, no part of the net earnings of which inures to the benefit of any private stockholder or member.

§ 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.

§ 8. (1) The words "gross income" mean the income of a taxpayer derived from salaries, wages or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, business, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property, also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains, or profits, and income derived from any source whatever. The amount of all such items shall be included in the gross income of the income year in which received by the taxpayer, unless, under the methods of accounting permitted under this Act, any such amounts are to be properly accounted for as of a different period.

Exhibit C

Acts and Joint Resolutions

OF THE

GENERAL ASSEMBLY

OF THE

State of South Carolina

REGULAR SESSION OF 1937

First Part of Fortieth Volume of Statutes at Large

PRINTED UNDER DIRECTION OF
JOINT COMMITTEE ON PRINTING
GENERAL ASSEMBLY OF SOUTH CAROLINA

(619)

No. 349.

AN ACT to Raise Revenue for the Support of the State Government by the Levy and Collection of a Tax Upon the Income of Banks in Lieu of All Other Taxes Except Taxes on Real Property.

Section 1. "Banks and taxpayers" defined.—Be it enacted by the General Assembly of the State of South Carolina: For the purpose of this Act and unless otherwise required by the context, the words "banks and taxpayers," wherever used in this Act, shall mean any person, firm or corporation, engaged in a banking business whether incorporated under the laws of this State, any other State, or the United States, or whether unincorporated except cash depositories.

§ 2. Tax on banks.—A tax is hereby imposed upon every bank engaged in business in the State of South Carolina, which tax shall be levied, collected and paid annually, with respect to the entire net income of the taxpayer doing a banking business within this State, or from the sales or rentals of property within this State, computed at the following rate:

Four and one-half (4½%) per centum of the entire net income of such bank or taxpayer.

§ 3. In lieu of other taxes except taxes on real property.—The income taxes herein provided shall be in lieu of all other taxes, except taxes on real property. The real property of any such bank, or banking association, shall be taxed in the place where the same may be located, the same as the real property of individuals.

§ 4. Enforcement—administration.—That for the purpose of administration, enforcement, collection, liens, penalties, and other provisions of enforcement, all of the provisions of Sections 2435-2479, inclusive, Code of Laws of South Carolina, 1932, that may be appropriate or applicable are hereby adopted and made a part of this Section for the enforcement and administration of this Act.

§ 5. Invalidity.—In case the first provision (contained in the first sentence) of Section 3 hereof should for any reason be declared to be invalid by a Court of competent jurisdiction, then and in that event, the taxes provided in Section 2663-2667, inclusive, Code of Laws of South Carolina, shall be and remain in full force and effect, and the income tax provided herein shall not be effective.

§ 6. **Payment of tax—distribution.**—The taxes herein provided for shall be paid to South Carolina Tax Commission as is provided in Section Four (4) of this Act and the income taxes paid under the provisions of this Act shall be distributed between the general fund of the State, the County and Municipality in which the bank is located as follows:

Ten (10) per cent to the general fund of the State

Sixty (60) per cent to the County

Thirty (30) per cent to the Municipality in which the Bank is located.

The Tax Commission is authorized and directed to draw warrants on the State Treasurer for such distribution on or before May 15 of each year and the State Treasurer is authorized and directed to honor said warrants.

For the purpose of and in the distribution of the taxes paid under this Act by a bank having one or more branches, each branch of the bank shall be deemed to have paid such portion of the entire tax as its deposits on January 1st of each taxable year bear to the total of the deposits of all branches and the tax distributed accordingly.

§ 7. **Repeal.**—All Acts or parts of Acts inconsistent with this Act are hereby repealed except as hereinabove provided.

§ 8. **Time effective.**—This Act shall take effect immediately upon its approval by the Governor and shall be retroactive so as to apply during the year 1937.

Approved the 19th day of May, 1937.

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(623) **No. 350.**

AN ACT Abolishing the Governing Board (Advisory Board) and Devolving All the Powers, Duties, Responsibilities and Functions Thereof on the Supervisor of Union County, Abolishing the Salaries of Members of Governing Board (Advisory Board) of Union County, and Making It Unlawful for the Supervisor to Issue Vouchers in Payment of the Same After July 1st, 1937, and Making It Unlawful for the Treasurer of Union County to Honor and/or Pay the Same After July 1st, 1937, with the Exception of Salaries Aforesaid Members of Governing Board (Advisory Board) Earned Prior to July 1st, 1937.

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Exhibit D

C. Section 1359, of Article 1, of Chapter 15, of Title 65, Code of Laws of South Carolina for 1952, as amended, is hereby amended by adding thereto Sub-division (5), which shall read as follows:

"(5). Every person engaged in the business of renting or leasing or otherwise furnishing any tangible personal property for a consideration, either by lease or rental or other form of agreement."

Notwithstanding any other provision of law, the license and the sales and/or use tax imposed by Chapter 15, of Title 65, Code of Laws for 1952, as amended, is hereby imposed upon the fair market value of tangible personal property manufactured within South Carolina or imported into South Carolina by the manufacturer thereof for the purpose of renting or leasing the same or for storage, use or consumption within South Carolina by said manufacturer.

This section shall become effective on the first day of the first month following the approval of this Act by the Governor.

SECTION 5

Section 65-222, 1952 Code, amended—tax on corporations increased:

That Section 65-222, Code of Laws of South Carolina for 1952, be and the same is hereby amended by striking out all of said Section 65-222 and inserting in lieu thereof the following which shall be Section 65-222:

"Section 65-222. Every corporation organized under the laws of this State shall make a return and shall pay annually an income tax equivalent to five percent of the entire net income of such corporation received by such corporation during the income tax year and, except as otherwise provided, every foreign corporation doing business or having an income within the jurisdiction of this State shall make a return and shall pay annually an income tax equivalent to five percent of a proportion of its entire net income to be determined as provided in this chapter; provided, that the amount of such tax shall not be less than would be produced by applying a rate of three per cent to a base consisting of the entire net income plus salaries and other compensation paid to all elective and appointed officers and to any stockholder owning in excess of five per cent of the issued capital stock of the corporation, after deducting from the base six thousand dollars and any deficit reported for the year."

This section shall be effective as to income tax accounting periods ending after June 30, 1955.

Section 65-259, 1952 C additional deduction f industry:

Section 259 of Chapt amended, is hereby ame be known as Subsection

"(13) With respect o business or industry in S and thereafter, in add Chapter, there shall be a net operating loss carr

(A). The net operati on or after December 3 succeeding taxable year three years next succeed such net operating loss able income of a succee herein allowed shall be the operation of the said

(B) As used herein shall be deemed to be t tion of income taxes, pe The net income of the t deduction as adjusted is deduction of income ta pendents, and such inco used to increase the net other taxable period.

(C). As used in this hereby defined as the e come for the taxable y business or industry. In tion, deductions, includi pendents and income ta trade or business shall l allowable for the taxabl income not derived fron

(D). Notwithstanding Commission discovers fr

SECTION 6

Section 65-259, 1952 Code, amended—subsection (13) added—additional deduction for persons establishing a new business or industry:

Section 259 of Chapter 5 of Title 65, Code of Laws for 1952, as amended, is hereby amended by adding thereto a new Subsection to be known as Subsection 13.

"(13) With respect only to taxpayers who have established a new business or industry in South Carolina during the calendar year 1955 and thereafter, in addition to other deductions allowed by this Chapter, there shall be allowed as a deduction from gross income a net operating loss carry over under the following rules:

(A). The net operating loss as herein defined for any year ending on or after December 31, 1955, may be carried forward to the next succeeding taxable year and annually thereafter for a total period of three years next succeeding the year of such operating loss, or until such net operating loss has been exhausted or absorbed by the taxable income of a succeeding year. The net operating loss deduction herein allowed shall be allowable only for the first three years of the operation of the said new business or industry in South Carolina.

(B) As used herein the term "taxable income" or "net income" shall be deemed to be the net income computed without the deduction of income taxes, personal exemption, and credit for dependents. The net income of the taxable period to which the net operating loss deduction as adjusted is carried shall be the net income before the deduction of income taxes, personal exemption, and credit for dependents, and such income taxes, exemption, and credits shall not be used to increase the net operating loss which may be carried to any other taxable period.

(C). As used in this Subsection the term "net operating loss" is hereby defined as the excess of allowable deductions over gross income for the taxable year arising from the operation of such new business or industry. In the case of a taxpayer other than a corporation, deductions, including personal exemptions and credit for dependents and income taxes, not attributable to the operation of a trade or business shall be eliminated from the deductions otherwise allowable for the taxable year to the extent that they exceed gross income not derived from such trade or business.

(D). Notwithstanding any other provision of Law, if the Tax Commission discovers from the examination of the return or other-

wise that the income of any taxpayer or any portion thereof has not been assessed with respect to any return in which a net operating loss is sustained or is claimed as a deduction, in whole or in part, it may at any time within five years from the date of the return which finally absorbs the net operating loss deduction is filed, assess such income and give notice to the taxpayer of such assessment and the taxpayer shall thereupon have an opportunity within thirty days to confer with the Commission as to the proposed assessment. After the expiration of thirty days from such notification the Commission shall assess the income of such taxpayer or any portion thereof which it believes has not theretofore been assessed and shall give notice to the taxpayer so assessed of the amount of the tax and interest and penalty, if any, and the amount thereof shall be due and payable within ten days from the date of such notice. The provisions of this Chapter with respect to revision and appeal shall apply to a tax so assessed. The limitation herein provided for shall not apply to the assessment of additional taxes upon fraudulent returns, nor shall it apply to the assessment of taxes with respect to returns not filed in accordance with requirements of Law."

SECTION 7

Delinquent taxpayers—employers to withhold compensation upon notice from Tax Commission:

Notwithstanding any other provision of law, South Carolina Tax Commission may give notice to any employer doing business or having an income within this State or having an employee rendering a service within this State, to the effect that a taxpayer employed by said employer is delinquent with respect to income taxes or has failed to pay income taxes, penalties or interest with respect to income taxes. Notice may be served either by mail or by delivery by any duly authorized representative of the Tax Commission. Upon receipt of the notice of the delinquency or failure to make payment, the employer and the person having control of compensation of the taxpayer shall withhold from compensation due or to become due to the taxpayer the total amount shown by the notice, provided that the Tax Commission or its duly authorized representative in their discretion may arrange between employer and employee for a deduction of an amount not less than twenty (20%) percent of the total amount due the employee each pay period until the total amount as shown by the notice has been withheld. In the event that the taxpayer leaves the employ of employer or gives notice of his intention so to do, employer

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Exhibit E

ACTS and JOINT RESOLUTIONS

OF THE

GENERAL ASSEMBLY

OF THE

STATE of SOUTH CAROLINA

REGULAR SESSION OF 1985

First Part
of Sixty-fourth Volume of Statutes at Large

(The Acts and Joint Resolutions of 1986
Will Constitute the Second Part)

PRINTED UNDER DIRECTION OF
THOMAS S. LINTON
CODE COMMISSIONER

When rules conflict with statutory provisions

SECTION 3. In event of conflict between any provision of the South Carolina Rules of Civil Procedure and any other statutory provisions as to practice and procedure not repealed in this act, the provision of the rules shall control. However, neither the promulgation of the rules nor this act may be construed to affect the substantive legal rights of any party to any civil litigation in the courts of this State but shall affect only matters of practice and procedure.

Time effective

SECTION 4. This act shall take effect on July 1, 1985.

Approved the 21st day of May, 1985.

No. 101

(R146, S351)

AN ACT 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, TO AMEND SECTIONS 12-9-10, AS AMENDED, 12-9-110, AS AMENDED, 12-9-310, AS AMENDED, AND 12-9-315, AS AMENDED, ALL RELATING TO INCOME TAX WITHHOLDING, SO AS TO CORRECT CROSS REFERENCES AND TO REQUIRE WITHHOLDING BY FIDUCIARIES MAKING DISTRIBUTIONS TO OUT-OF-STATE BENEFICIARIES, TO

AMEND SECTION 12-37-220, AS AMENDED, RELATING TO PROPERTY EXEMPT FROM AD VALOREM TAXATION, SO AS TO CORRECT A CROSS REFERENCE, TO AMEND SECTIONS 21-37-20, 46-47-20, AND SECTION 3 OF ACT 76 OF 1977, AS AMENDED, RELATING RESPECTIVELY TO DISCLAIMER OF PROPERTY INTERESTS, THE FAMILY FARM DEVELOPMENT AUTHORITY ACT, AND THE STATE HOUSING AUTHORITY, SO AS TO CORRECT CROSS REFERENCES, TO AMEND THE 1976 CODE BY ADDING SECTIONS 12-7-618, 12-7-1625 AND ARTICLES 4 AND 12 IN CHAPTER 7 OF TITLE 12, SO AS TO ADOPT FOR SOUTH CAROLINA INCOME TAX PURPOSES THE FEDERAL DEFINITIONS OF TAXABLE INCOME FOR INDIVIDUALS, CORPORATIONS, ESTATES, AND TRUSTS, TO PROVIDE FOR FILING STATUS FOR INDIVIDUAL SOUTH CAROLINA TAXPAYERS, TO PROVIDE MODIFICATIONS FOR SOUTH CAROLINA PURPOSES OF THE FEDERAL DEFINITIONS OF TAXABLE INCOME, TO ADOPT FOR SOUTH CAROLINA INCOME TAX PURPOSES THE FEDERAL PROVISIONS RELATING TO ACCOUNTING PERIODS AND METHODS, AND TO AUTHORIZE THE SOUTH CAROLINA TAX COMMISSION TO REQUIRE TAXPAYERS TO FILE COPIES OF FEDERAL TAX RETURNS WITH THE COMMISSION AND TO REPEAL SECTIONS 12-7-90, 12-7-211, 12-7-220, 12-7-260, 12-7-270, 12-7-280, 12-7-285, 12-7-300, 12-7-310, 12-7-320, 12-7-330, 12-7-510, 12-7-520, 12-7-530, 12-7-535, 12-7-540, 12-7-550, 12-7-560, 12-7-580, 12-7-600, 12-7-610, 12-7-660, 12-7-670, 12-7-680, 12-7-685, 12-7-690, 12-7-700, 12-7-705, 12-7-710, 12-7-720, 12-7-730, 12-7-740, 12-7-750, 12-7-760, AND 12-7-770 OF THE 1976 CODE, AND ARTICLES 7 AND 11 OF CHAPTER 7 OF TITLE 12 OF THE 1976 CODE, AND SECTION 23, PART II OF ACT 517 OF 1980, AND ACT 424 OF 1978, ALL RELATING TO THE INCOME TAX ACT OF 1926.

Be it enacted by the General Assembly of the State of South Carolina:

Act may be cited

SECTION 1. This act may be cited as the South Carolina Income Tax Federal Conforming Amendments of 1985.

Definitions

SECTION 2. Section 12-7-20 of the 1976 Code is amended to read:

"Section 12-7-20. For the purposes of this chapter, unless otherwise required by the context:

(1) The word 'taxpayer' means and includes an individual, a trust, estate, partnership, association, company, or corporation subject to the tax imposed by this chapter.

(2) The word 'business' includes trade, profession, occupation, or employment.

(3) The words 'tangible property' mean real property and corporeal personal property and do not mean money, bank deposits, shares of stock, bonds, credits, evidences of debt, choses in action, or evidences of an interest in property.

(4) The words 'intangible property' mean all property other than tangible property.

(5) The words 'income year' mean the calendar year or the fiscal year upon the basis of which the net income is computed under this chapter; if no fiscal year has been established they mean the calendar year.

(6) The words 'fiscal year' mean an income year ending on the last day of any month other than December.

(7) The word 'paid' for the purpose of the deductions under this chapter means 'paid or accrued' or 'paid or incurred'.

(8) The word 'received' for the purpose of the computation of net income under this chapter means 'received or accrued' and the words 'received and accrued' must be construed according to the method of accounting upon the basis of which the net income is computed under this chapter.

(9) The words 'foreign corporation' mean any corporation other than a domestic corporation.

(10) The phrase 'property having an actual situs in this State' includes real property physically located within this State and personal property of a bona fide resident of this State wherever situate.

(11) 'Internal Revenue Code' means the Internal Revenue Code of 1954 as amended through December 31, 1984.

(12) All of the various terms defined in Sections 7701 and 7702 of the Internal Revenue Code have the same meaning for South Carolina income tax purposes, unless a different meaning is clearly required.

(13) 'Resident individual' means any individual who is domiciled in this State. A 'nonresident individual' means an individual other than a resident individual or a part-year resident.

(14) 'Part-year resident' means any individual who is a resident individual for part, but not all of the tax year.

(15) 'Resident estate' means the estate of a decedent who at his death was domiciled in this State. 'Nonresident estate' means an estate other than a resident estate.

(16) 'Resident trust' means a trust which is being administered in this State. 'Nonresident trust' means a trust other than a resident trust.

(17) 'Resident partner' means a partner who was during the tax year a resident individual, a resident estate, a resident trust, or a resident corporation. 'Nonresident partner' means a partner other than a resident partner.

(18) 'Resident beneficiary' means a beneficiary of an estate or trust which beneficiary is a resident individual, a resident estate, a resident trust, resident partnership, or a resident corporation. 'Nonresident beneficiary' means a beneficiary other than a resident beneficiary.

(19) 'Resident corporation' means a corporation whose principal place of business, as defined in Section 12-7-1110, is located within this State. 'Nonresident corporation' means any corporation other than a resident corporation.

(20) For purposes of Internal Revenue Code Sections 85, 165, 170, 213, 219, and 631, 'Adjusted Gross Income' for South Carolina tax purposes means a taxpayer's adjusted gross income for federal income tax purposes without regard to the

adjustments required by Sections 12-7-430 and 12-7-435."

Income tax imposed

SECTION 3. Section 12-7-210 of the 1976 Code is amended to read:

"Section 12-7-210. A tax is imposed on the South Carolina taxable income of Individuals, Estates, and Trusts computed at the following rates:

(a) Married Individuals filing jointly, Surviving Spouses, and Heads of Household:

Not over $3,400	no tax
over $3,400 but not over $5,400	2 percent of the excess over $3,400
over $5,400 but not over $7,400	$40 plus 3 percent of the excess over $5,400
over $7,400 but not over $9,400	$100 plus 4 percent of the excess over $7,400
over $9,400 but not over $11,400	$180 plus 5 percent of the excess over $9,400
over $11,400 but not over $13,600	$280 plus six percent of the excess over $11,400
over $13,600	$412 plus 7 percent of the excess over $13,600.

(b) Unmarried Individuals (not including Surviving Spouses and Heads of Households):

Not over $2,300	no tax

over $2,300 but not over $4,300	2 percent of the excess over $2,300
over $4,300 but not over $6,300	$40 plus 3 percent of the excess over $4,300
over $6,300 but not over $8,300	$100 plus 4 percent of the excess over $6,300
over $8,300 but not over $10,300	$180 plus 5 percent of the excess over $8,300
over $10,300 but not over $12,300	$280 plus 6 percent of the excess over $10,300
over $12,300	$400 plus 7 percent of the excess over $12,300.

(c) Married Individuals filing separately:

Not over $1,700	no tax
over $1,700 but not over $3,700	2 percent of the excess over $1,700
over $3,700 but not over $5,700	$40 plus 3 percent of the excess over $3,700
over $5,700 but not over $7,700	$100 plus 4 percent of the excess over $5,700
over $7,700 but not over $9,700	$180 plus 5 percent of the excess over $7,700
over $9,700 but not over $11,700	$280 plus 6 percent of the excess over $9,700
over $11,700	$400 plus 7 percent of the excess over $11,700.

(d) Estates and Trusts and Nonresident Individuals:

Not over $2,000	2 percent of taxable income
over $2,000 but not over $4,000	$40 plus 3 percent of the excess over $2,000
over $4,000 but not over $6,000	$100 plus 4 percent of the excess over $4,000
over $6,000 but not over $8,000	$180 plus 5 percent of the excess over $6,000
over $8,000 but not over $10,000	$280 plus 6 percent of the excess over $8,000
over $10,000	$400 plus 7 percent of the excess over $10,000.

(e) The amount not subject to tax in items (a) through (c) of this section must be adjusted annually effective for taxable years beginning after 1984 as provided in Internal Revenue Code Section 1(f) and the minimum and maximum amount of each tax bracket in those items must be adjusted by the same dollar amount that the amount not subject to tax is adjusted. The Commission annually shall prescribe tables reflecting the adjustments which shall apply in lieu of the amounts in items (a) through (c).

(f) The Commission may issue tax tables consistent with the rates set pursuant to this section for taxpayers with taxable incomes of less than fifty thousand dollars."

Individual making return

SECTION 4. Section 12-7-212 of the 1976 Code, as added by Section 3 of Act 69 of 1981, is amended to read:

"Section 12-7-212. An individual making a return under Section 12-7-210 for a period of less than twelve months on account of a change in his accounting period may not use any tax table prescribed by the Commission pursuant to item (f) of Section 12-7-210."

Corporations exempt

SECTION 5. Section 12-7-235 of the 1976 Code, as added by Section 1 of Act 480 of 1984, is amended to read:

"Section 12-7-235. (a) The following corporations are exempt from the tax imposed by Section 12-7-230:

(1) Banks as defined in Section 12-11-10;

(2) Associations as defined in Section 12-13-10;

(3) Insurance companies;

(4) Nonprofit corporations organized pursuant to Sections 33-35-10 through 33-35-170 for the purpose of providing water supply and sewerage disposal or a combination of those services;

(5) Farmers' or other mutual hail, cyclone, or fire insurance companies, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or like organizations of a purely local character, the income of which consists solely of assessments, dues, and fees collected from members for the sole purpose of meeting expenses;

(6) Organizations exempt from income taxes pursuant to Section 33-49-120.

(b) If a small business corporation makes a valid election under the provisions of Subchapter S of the Internal Revenue Code to be exempt from federal income taxes to the extent provided in Subchapter S of the Internal Revenue Code, the small business corporation is similarly exempt from the tax imposed

by Section 12-7-230. The shareholders shall include in their South Carolina taxable income their proportionate share of the corporation's South Carolina taxable income. Nonresident shareholders of an electing small business corporation are taxable on their share of the corporation's South Carolina taxable income as a nonresident, as provided in Section 12-7-450. For South Carolina income tax purposes, an electing small business corporation and the shareholders are treated in the same manner provided in Subchapter S of the Internal Revenue Code and applicable federal regulations and the corporation shall file with the Commission any information return as may be required by the Commission.

(c) The privilege of filing a consolidated income tax return is allowed as provided in Section 12-7-1570."

Taxpayers partially within and without the State

SECTION 6. Section 12-7-250 of the 1976 Code is amended to read:

"Section 12-7-250. If any taxpayer, except those defined in former 1962 Code Section 65-256, is transacting or conducting his business partly within and partly without this State, the income tax as provided in this chapter is imposed upon a base which reasonably represents the proportion of the trade or business carried on within this State. The taxpayer subject to taxation under this section is considered to have been transacting or conducting his business partly within and partly without the State if the taxpayer is subject to a net income tax or a franchise tax measured by net income in any other state, the District of Columbia, a territory or possession of the United States, or any foreign country, or would be subject to the net income tax in any other taxing jurisdiction if the other taxing jurisdiction adopted the net income tax laws of this State. Nothing in this section operates to deny any

taxpayer affected by this section and Sections 12-7-230, 12-7-240, and 12-7-1110 to 12-7-1200 the benefits of the net operating loss deduction where the taxpayer suffers a net loss, but as to the apportionment of net operating losses carried forward, the provisions of those sections apply as if the taxpayer had a net income."

Returns must be made

SECTION 6A. Section 12-7-1510 of the 1976 Code is amended to read:

"Section 12-7-1510. Returns with respect to income taxes must be made by the following:

(1) (A) Every individual having for the taxable year a gross income of the exemption amount or more, except that a return is not required of an individual, other than an individual referred to in subitem (C):

(i) who is not married, is not a surviving spouse, and for the taxable year has a gross income of less than the sum of the exemption amount plus the zero bracket amount applicable to such an individual,

(ii) who is a surviving spouse and for the taxable year has a gross income of less than the sum of the exemption amount plus the zero bracket amount applicable to such an individual, or

(iii) who makes a joint return and whose gross income, when combined with the gross income of his spouse, is, for the taxable year, less than the sum of twice the exemption amount plus the zero bracket amount applicable to a joint return, but only if the individual and his spouse, at the close of the taxable year, had the same household as their home.

Clause (iii) does not apply if for the taxable year the spouse makes a separate return or any other taxpayer is entitled to an exemption for the spouse.

(B) The amount specified in clause (i) or (ii) of subitem (A) must be increased by the exemption amount in the case of an individual entitled to an

additional personal exemption under Internal Revenue Code Section 151(c)(1), and the amount specified in clause (iii) of subitem (A) must be increased by the exemption amount for each additional personal exemption to which the individual or his spouse is entitled under Internal Revenue Code Section 151(c).

(C) The exception under subitem (A) does not apply to:

(i) a nonresident individual;

(ii) an individual making a return under Internal Revenue Code Section 443(a)(1) for a period of less than twelve months on account of a change in his annual accounting period;

(iii) an individual who has income, other than earned income, of the exemption amount or more and who is described in Internal Revenue Code Section 63(e)(1)(D); or

(iv) an estate or trust.

(D) For purposes of this item:

(i) The term 'zero bracket amount' has the meaning given to that term by Internal Revenue Code Section 63(d).

(ii) The term 'exemption amount' has the meaning given to that term by Internal Revenue Code Section 151(f).

(2) Every corporation subject to taxation.

(3) Every estate the gross income of which for the taxable year is six hundred dollars or more.

(4) Every trust having for the taxable year any taxable income, or having gross income of six hundred dollars or over, regardless of the amount of taxable income.

(5) Every estate or trust of which any beneficiary is a nonresident.

(6) Every political organization within the meaning of Internal Revenue Code Section 527(e)(1), and every fund treated under Internal Revenue Code Section 527(g) as if it constituted a political organization, which has political organization taxable income within the meaning of Internal Revenue Code Section 527(c)(1) for the taxable year.

(7) Every homeowners association within the meaning of Internal Revenue Code Section 528 (c)(1) which has homeowners association taxable income within the meaning of Internal Revenue Code Section 528(d) for the taxable year.

(8) Every estate of an individual under Chapters 7 or 11 of Title 11 of the United States Code relating to bankruptcy the gross income of which for the taxable year is two thousand seven hundred dollars or more."

Determination of income

SECTION 7. Chapter 7, of Title 12 of the 1976 Code is amended by adding:

"Article 4

Section 12-7-410. The South Carolina gross income, adjusted gross income, and taxable income of an individual is the individual's gross income, adjusted gross income, and taxable income as determined under the Internal Revenue Code with the modifications specified in Sections 12-7-430 and 12-7-435.

Section 12-7-415. The South Carolina gross income and taxable income of a corporation, including the unrelated business income of a corporation exempt from taxation under Internal Revenue Code Section 501 et seq., is the corporation's gross income and taxable income as determined under the Internal Revenue Code with the modifications specified in Section 12-7-430.

Section 12-7-420. A partnership is not subject to tax under this chapter. All of the provisions of the Internal Revenue Code apply to determine the gross income, adjusted gross income, and taxable income of a partnership and its partners, subject to the modifications provided in Section 12-7-430.

Section 12-7-425. The South Carolina gross income and taxable income of an estate or a trust is the estate's or trust's gross income and taxable income as determined under the Internal Revenue Code including the provisions of Internal Revenue

Code Section 584, with the modifications provided in Section 12-7-430.

Section 12-7-430. The South Carolina taxable income of individuals, estates, trusts, partnerships, and corporations is modified as provided in this section.

(a) The gross income of a taxpayer is determined without application of Internal Revenue Code Sections 78, 86, and 87.

(b) The determination of gross income as provided in the following Internal Revenue Code Sections is made with the following modifications:

(1) The exclusion from gross income authorized by Internal Revenue Code Section 103 is modified to exempt only interest upon obligations of this State, any of its political subdivisions and to include obligations of the United States.

(2) In any and all Internal Revenue Code Sections that make reference to Internal Revenue Code Section 103, the modification provided in subitem (1) of item (b) of this section similarly applies.

(3) If a taxpayer has included a state income tax refund in federal gross income, South Carolina gross income is computed without regard to such state income tax refund.

(4) No exclusion from gross income is permitted for South Carolina income tax purposes as permitted by Internal Revenue Code Sections 911, 912, 931 through 936.

(c) Adjusted gross income and taxable income are computed without the deductions authorized by Internal Revenue Code Section 196.

(d) The deductions used in computing adjusted gross income and taxable income are modified as follows:

(1) The deduction permitted by Internal Revenue Code Section 164 must be computed in the same manner except there is no deduction for state and local income taxes, or state and local franchise taxes measured by net income, or any income taxes, or any taxes measured by or with respect to net income.

(2) Any net operating loss deduction is computed in accordance with Internal Revenue Code Section 172, except that all items of income and deductions used in computing the net operating loss deduction are adjusted as provided in this section and in Section 12-7-435 and no carrybacks are allowed.

(3) For purposes of computing the depletion deduction pursuant to Internal Revenue Code Sections 611 through 613, a taxpayer who allocates or apportions income under the provisions of Article 9 of this chapter has the option of adjusting taxable income to eliminate the allowance for depletion otherwise allowable, and to deduct as an allowance for depletion from South Carolina taxable income subject to tax after allocation and apportionment depletion computed in accordance with Internal Revenue Code Sections 611 through 613 with respect to mines, oil and gas wells, and other natural deposits located in this State, except that the allowance may not exceed fifty percent of the net income apportioned to South Carolina by Sections 12-7-1140 through 12-7-1190.

(4) The disallowance of deductions required by Internal Revenue Code Section 265 shall apply for South Carolina income tax purposes if the related income is exempt for South Carolina income tax purposes, whether or not the income is exempt for federal purposes.

(5) The limiting provisions of Internal Revenue Code Section 280C are not applied.

(6) For purposes of computing the deduction allowed by Internal Revenue Code Section 691(c) the term 'estate tax' means the taxes imposed under Chapter 15 of Title 7 including any South Carolina generation-skipping transfer tax.

(7) If for federal income tax purposes a taxpayer claims a credit for which Internal Revenue Code Section 48(q) requires a reduction of basis, the taxpayer may reduce his South Carolina taxable income by the amount of the reduction in basis in the tax year in which basis is so reduced for

federal income tax purposes. If a taxpayer makes an election pursuant to Internal Revenue Code Section 48(q)(4) to reduce the credit and not the basis, this subitem does not apply.

(8) A corporation that has a net capital loss for a tax year may not carry back the loss to a prior tax year as permitted by Internal Revenue Code Section 1212(a), but it may carry forward the net capital loss to future years to the extent provided in Internal Revenue Code Section 1212(a).

(e) If the income of a taxpayer is subject to allocation or apportionment, or both, pursuant to Article 9 of this chapter then South Carolina taxable income is modified as provided in that article.

(f) A beneficiary of a trust shall exclude from South Carolina taxable income any excess distributions by trusts included in the beneficiary's federal taxable income by reason of Internal Revenue Code Sections 665 through 669 or any comparable provisions.

Section 12-7-435. There is allowed as a deduction from South Carolina taxable income of an individual the following amounts:

(a) Any retired person, or his surviving spouse, who receives a federal civil service retirement annuity is allowed to deduct from taxable income three thousand dollars of the annuity received each taxable year exclusive of any other exemption. The provisions of this item do not apply to retired persons who are now exempt from payment of taxes on federal civil service retirement annuities.

(b) Any person retired from the uniformed services of the United States with twenty or more years active duty service, or his surviving spouse, is allowed to deduct from taxable income three thousand dollars of his uniformed services retirement pay received each taxable year.

(c) Any retired person, or his surviving spouse, who attains the age of sixty-five before the close of the taxable year and who receives income under one or more qualified pension programs is allowed

to deduct from taxable income three thousand dollars of the pension income received in each taxable year. If the pension income also qualifies for a deduction from taxable income under the provisions of items (a) or (b) of this section, no deduction from taxable income is permitted under the provisions of this item.

(d) All amounts received from the South Carolina Retirement System as provided in Chapter 1 of Title 9.

(e) Retirement pay received by police officers or firemen from a municipality or county which has a group retirement plan.

(f) Amounts received and excludable from income by Sections 12-7-565 and 12-7-570.

(g) The amount received for disability retirement due to permanent and total disability by any person who could qualify for the homestead exemption under Section 12-37-250 by reason of being classified as totally and permanently disabled.

(h) A taxpayer may deduct from South Carolina taxable income those expenses incurred while conducting business as provided in Internal Revenue Code Section 162(h) without regard to limitations in Internal Revenue Code Section 162(h)(4).

Section 12-7-440. (a) In all cases where a husband and wife file a joint South Carolina income tax return, the determination of South Carolina taxable income must, unless otherwise provided, be made as if husband and wife were one individual taxpayer.

(b) If the federal taxable income of a husband and wife are determined on separate federal returns, their South Carolina taxable income must be separately reported and taxed.

(c) If both a husband and wife are residents, and if their federal taxable income is determined on a joint federal return, their South Carolina taxable income must be reported and taxed on the basis of a joint South Carolina income tax return.

(d) If both a husband and wife are nonresidents, and if their federal taxable income is determined on a joint federal return, their South Carolina

taxable income must be reported and taxed on the basis of a joint South Carolina return.

(e) If either a husband or wife is a resident and the other is a nonresident, and if their federal taxable income is determined on a joint federal return, their South Carolina taxable income must be reported and taxed on the basis of a joint South Carolina return as provided under the nonresident provisions of Section 12-7-450.

(f) If neither a husband or wife files a federal return, their South Carolina taxable income must be determined on a separate basis unless both elect to have their South Carolina taxable income determined on the basis of a joint South Carolina tax return.

Section 12-7-445. An individual who is a resident of South Carolina for part of a year may elect to:

(a) Report and compute his South Carolina tax as if he were a resident for the entire year and take the applicable credit as provided in Section 12-7-2410; or

(b) Report and compute his South Carolina tax as if he were a nonresident for the entire year, except that for purposes of this computation the South Carolina taxable income for that period during which the individual was a resident includes all items of income, gain, loss, or deductions whether or not derived from sources within South Carolina with the modifications specified in Sections 12-7-430 and 12-7-435.

Section 12-7-450. The South Carolina taxable income of a nonresident individual, a nonresident trust, a nonresident estate, and a nonresident beneficiary is the same as if he were a resident individual or resident trust or resident estate or a resident beneficiary with the following modifications:

(a) South Carolina taxable income as determined in Sections 12-7-410, 12-7-420, or 12-7-425 only includes income from the following sources:

Income, gains, losses, or deductions attributable to:

(1) The ownership of any interest in real or tangible personal property located in South Carolina;

(2) A business, trade, profession, or occupation carried on in South Carolina or compensation for services performed in South Carolina;

(3) A business, trade, profession, or occupation carried on or compensation for services performed partly within and partly without South Carolina to the extent allocable and apportionable to South Carolina as determined under Article 9 of this chapter;

(4) The distributive share of the South Carolina part of partnership income, gains, losses, or deductions;

(5) The distributive share of the South Carolina part of estate or trust income, gains, losses, or deductions;

(6) Income from intangible personal property, including annuities, dividends, interest, and gains from the disposition of intangible personal property to the extent that such income is from property employed in a trade, business, profession, or occupation carried on in South Carolina. A nonresident individual, nonresident partnership, nonresident trust, or nonresident estate, other than a dealer holding property primarily for sale to customers in the ordinary course of his or its trade or business, is not considered to carry on a business, trade, profession, or occupation in South Carolina solely by reason of the purchase and sale of property for his or its own account;

(7) The distributive share of the South Carolina taxable income or loss of a corporation defined in Subchapter S of the Internal Revenue Code.

(b) The South Carolina taxable income of a nonresident individual, nonresident estate, or nonresident trust must be adjusted as follows:

(1) The personal exemptions of a nonresident individual, nonresident estate, or nonresident trust must be reduced to an amount which is the same

proportion as South Carolina adjusted gross income is of federal adjusted gross income.

(2) If a nonresident individual itemizes deductions, the excess itemized deductions must be reduced to an amount which is the same proportion as South Carolina adjusted gross income is of federal adjusted gross income.

(3) In addition, all nonresident individuals are permitted an additional deduction from South Carolina taxable income equal to the applicable 'zero bracket amount' as defined in Internal Revenue Code Section 63(d), depending on filing status, reduced to an amount by which the South Carolina adjusted gross income is of federal adjusted gross income.

(4) The itemized deductions of a nonresident estate or nonresident trust must be reduced by an amount which is the same proportion as South Carolina adjusted gross income is of federal adjusted gross income.

(5) For purposes of the computations required in subitems (1) through (4) of this item, the term South Carolina adjusted gross income means the adjusted gross income of the taxpayer, computed based solely on the income taxable in South Carolina as provided in item (a) of this section and in accordance with the provisions of the Internal Revenue Code, with the adjustments provided in Section 12-7-430, where applicable. Adjustments to gross income authorized by Internal Revenue Code Section 62 must be apportioned based on the ratio of South Carolina gross income to federal gross income unless the adjustment is directly connected with an item of gross income and in such event the adjustment is allowed in computing South Carolina adjusted gross income only to the extent the item of income is taxable in South Carolina.

(6) The Commission may issue rules and promulgate regulations to effectuate the provisions of this item.

(c) The South Carolina taxable income of a nonresident estate or nonresident trust as determined in items (a) and (b) of this section must be allocated among the estate or trust and its beneficiaries (including solely for purposes of this allocation, resident beneficiaries) in proportion to their respective shares of distributable net income. The amounts so allocated shall have the same character under this chapter as under the Internal Revenue Code. If for the taxable year the estate or trust does not have distributable net income for federal tax purposes, the taxable income must be allocated between the estate or trust and its beneficiaries in proportion that the income is retained by the estate or trust and distributable or distributed by the estate or trust.

(d) The nonresident beneficiary of any estate or trust is taxable on his share of South Carolina taxable income as determined under items (a), (b), and (c) of this section.

Section 12-7-455. (a) If a taxpayer was receiving an annuity prior to January 1, 1985, that is subject to tax pursuant to Internal Revenue Code Section 72, the annuitant shall continue to report income from the annuity in the manner provided in item (2) of Section 12-7-560 as in effect on December 31, 1984.

(b) If as of January 1, 1985, a taxpayer is for federal income tax purposes amortizing a capital expense paid or incurred prior to January 1, 1985, as provided in Internal Revenue Code Sections 169, 171, 174, 177, 184, 185, 188, 189, 194, 195, 248, or 709, the taxpayer is allowed to deduct for South Carolina income tax purposes the amount amortized and deducted for federal income tax purposes. At the expiration of the amortization for federal income tax purposes, the taxpayer may continue to amortize, for South Carolina income tax purposes, the balance of the capital expense using the same rate of amortization until the cost of the item has

been fully amortized for South Carolina income tax purposes.

(c) If prior to January 1, 1985, a taxpayer has made an election pursuant to Internal Revenue Code Section 83(b), the election is not effective for South Carolina income tax purposes unless the taxpayer reported on his South Carolina income tax return for the year of the election, income in a manner consistent with the election. If a taxpayer has not so reported income, then he is taxed under the provisions of Internal Revenue Code Section 83 when income is otherwise realized and recognized as though no Section 83(b) election had been made.

(d) For purposes of the exemptions authorized by Internal Revenue Code Section 151, a taxpayer who utilizes the provisions of Internal Revenue Code Section 152(e)(2), must similarly attach to his South Carolina income tax return a copy of the written declaration of the custodial spouse releasing the exemption or exemptions.

(e) Except as provided in subsection (o) of this section, if, as of January 1, 1985, a taxpayer is deducting the cost of personal property placed in service prior to 1983, as provided in Internal Revenue Code Section 168, the taxpayer is allowed for South Carolina income tax purposes a similar annual deduction. At the expiration of the deductions for federal tax purposes the balance of the deductible cost may be deducted for South Carolina income tax purposes at the rate of fifty percent a year, until the entire deductible cost has been deducted for South Carolina income tax purposes. In no event may the deduction authorized by this subsection exceed the taxpayer's depreciable basis.

(f) Except as provided in subsection (o) of this section, if, as of January 1, 1985, a taxpayer is deducting the cost of improvements to real property paid or incurred prior to January 1, 1985, as provided in Internal Revenue Code Section 168, the taxpayer is allowed for South Carolina income tax purposes a similar annual deduction for the

improvements. At the expiration of the deductions for federal tax purposes the balance of the deductible cost may be deducted for South Carolina income tax purposes at the rate of twenty percent a year, until the entire deductible cost of the improvements has been deducted for South Carolina income tax purposes. In no event may the deduction authorized by this section exceed the taxpayer's depreciable basis.

(g) If prior to January 1, 1985, a taxpayer has made an election pursuant to Internal Revenue Code Section 341(f), the election is effective for South Carolina income tax purposes as though the election were made in a year that South Carolina had a statute similar to Internal Revenue Code Section 341.

(h) If a taxpayer complies with the provisions of Internal Revenue Code Section 367 for federal income tax purposes, then it is not necessary for the taxpayer to seek the approval of the South Carolina Tax Commission, but it is considered to have received the approval of the Commission so long as approval is received from the Internal Revenue Service. A taxpayer utilizing the provisions of Internal Revenue Code Section 367 shall attach to its next annual income tax return a copy of the approval received from the Internal Revenue Service.

(i) The provisions of Internal Revenue Code Section 383 are applicable to all income tax credits available to a corporation for South Carolina income tax purposes.

(j) Any incentive stock option issued under Internal Revenue Code Section 422A is considered a qualified option or incentive stock option for South Carolina income tax purposes whether or not granted before or after January 1, 1985.

(k) Any taxpayer who is reporting income or deducting expenses over a time period as a result of a change of accounting method or accounting year, shall continue to report income or deduct expenses in the manner provided in the Internal Revenue Code and approved by the Internal Revenue

Service. At the expiration of the authorized adjustment period, the balance of the income or expense must be reported or deducted in the same manner and amount for South Carolina income tax purposes until all of the income or expenses have been fully reported or deducted.

(l) Any election for federal income tax purposes automatically applies for South Carolina income tax purposes and a taxpayer may not elect differently for South Carolina income tax purposes.

(m) If a taxpayer is reporting income from the distribution from the liquidation of a corporation under Internal Revenue Code Section 337 using the installment method of reporting or from an installment sale under Internal Revenue Code Section 453, and the taxpayer has previously reported all the gain for South Carolina income tax purposes, then South Carolina taxable income must be reduced by the amount of the installment gain. If a taxpayer has elected installment sale reporting for South Carolina purposes and not federal purposes, the taxpayer shall continue to report gain in his South Carolina tax return in addition to income otherwise taxable.

(n) If prior to January 1, 1985, a taxpayer has maintained a vacation pay accrual account as permitted by Internal Revenue Code Section 463, the taxpayer shall use the provisions of subsection (w) of this section in order to establish the reserve for South Carolina income tax purposes. If the taxpayer does not elect to use the provisions of subsection (w), the taxpayer may establish a vacation pay accrual account for South Carolina income tax purposes and is allowed as additions to the reserve the amounts provided in Internal Revenue Code Section 463.

(o) If a taxpayer has a higher basis in assets as the result of a taxable corporate liquidation prior to January 1, 1985; or an exchange of property prior to January 1, 1985, that qualified under Internal Revenue Code Section 1031, but did not similarly qualify under Section 12-7-930, as in

effect on December 31, 1984, as a result of the property received in the exchange not having a situs in South Carolina; or as a result of electing Internal Revenue Code Section 179 prior to January 1, 1985; the taxpayer may continue to depreciate the assets, to the extent depreciable, in the manner in which the assets were being depreciated prior to January 1, 1985.

(p) If a taxpayer is subject to the provisions of Internal Revenue Code Sections 483 or 1271 through 1288 as a result of a contract entered into prior to 1985, then no recomputation of principal and income is required.

(q) Any organization described in Internal Revenue Code Sections 501 through 528 and 1381 having taxable income shall compute its tax using the rates set forth in Section 12-7-230.

(r) For purposes of determining gain, the basis of an asset acquired prior to January 1, 1921, is its fair market value on that date and not cost, if fair market value was higher than cost.

(s) If a taxpayer has a capital loss carryover, as permitted by Internal Revenue Code Section 1212, from a tax year prior to January 1, 1985, the taxpayer is not allowed to deduct the capital loss carryover for South Carolina income tax purposes.

(t) If for South Carolina income tax purposes a taxpayer utilizes the provisions of Internal Revenue Code Section 1341 the phrase 'taxes paid in this chapter' means taxes imposed by this Chapter.

(u) Except as hereinafter provided, all elections made under the provisions of Internal Revenue Code Sections 1361 through 1378 automatically apply for South Carolina purposes. If a taxpayer had a valid 'S' election in effect for federal tax purposes prior to January 1, 1985, but has not elected that treatment for South Carolina income tax purposes, the taxpayer may at its option continue to be subject to the tax provided in Section 12-7-230 or it may affirmatively elect in the manner described in Internal Revenue Code Section 1362 to be exempt from the South Carolina tax. Once made, a South

Carolina 'S' election may not be revoked or terminated unless the 'S' election is similarly revoked or terminated for federal income tax purposes. The approval of an 'S' election by the Internal Revenue Service is approval for South Carolina income tax purposes as of the effective date of the federal election. Any termination or revocation of an 'S' election for federal purposes automatically revokes or terminates the election for South Carolina income tax purposes as of the effective date of the federal revocation or termination. An 'S' election can be made for South Carolina income tax purposes only if it is made for federal purposes or there is an existing 'S' election for federal purposes. No termination occurs under Internal Revenue Code Section 1362(d)(3) for South Carolina income tax purposes unless a termination similarly occurs for federal tax purposes. If Internal Revenue Code Section 1374(c) is effective for federal tax purposes, then the exception provided in the section is similarly applicable whether or not an 'S' corporation meets the requirements of Internal Revenue Code Section 1374(c) for South Carolina income tax purposes. The rules of Internal Revenue Code Section 1378 concerning tax year changes do not apply for South Carolina income tax purposes unless the section is similarly applicable for federal purposes (that is, a change in year is not mandated for South Carolina income tax purposes unless mandated for federal purposes also). A taxpayer shall give the Commission notice of its intent to be an 'S' corporation by filing with the Commission a copy of the election it files with the Internal Revenue Service although, the failure to file the notice does not void the corporation's 'S' election for South Carolina tax purposes.

(v) If a taxpayer disposes of an asset that has a different South Carolina basis and federal basis the taxpayer shall adjust South Carolina gain or loss to reflect the difference in basis.

(w) If any taxpayer has different South Carolina and federal amounts of an item of prepaid income or deferred expense or other similar balance sheet item as of January 1, 1985, the taxpayer is entitled, at his option, to make an application to the Commission for a change in accounting method and shall include in the change of accounting method all items in paragraph (1) of this subsection whether resulting in an increase or decrease in the transitional adjustment.

(1) items subject to adjustment are only those which:

(A) Have been treated differently in determining amounts subject to tax under South Carolina and federal income tax laws which were applicable in a period prior to January 1, 1985;

(B) Have been an element in determining South Carolina income subject to tax in periods with respect to which South Carolina income tax was paid;

(C) Except for the required change in reporting income, would have produced in a subsequent taxable period an adjustment to income subject to tax on account of the differences in federal and South Carolina tax reporting.

(2) Items subject to adjustment may consist of deductions taken or not taken in prior years, or amounts of income required to be included or excluded in such years, but the items must be disregarded to the extent it can be shown that the prior treatment of the items had no actual effect on the amount of South Carolina income tax paid. In making the showing, no items other than the items subject to this transitional adjustment may be considered.

(3) The net income reportable or net deduction allowable under this subsection must be reported or deducted in equal amounts of one-tenth each over the first ten taxable periods ending after the approval of a change of accounting method, except that if the net income or deduction is less than twenty-five thousand dollars (A) the income is reportable in full in the first taxable period

ending after the approval of the change or (B) the income is deductible in the first taxable period after the approval of the change to the extent of the taxpayer's taxable income and to each taxable period thereafter to the extent not previously taken in the earliest successive taxable period.

(x) Any net operating loss carryforward under Section 12-7-705 as in effect on December 31, 1984, is allowed for South Carolina income tax purposes before any loss carryforwards pursuant to Internal Revenue Code Section 172 as modified by subparagraph 2 of item (d) of Section 12-7-430, but in no event is the same loss deductible more than once.

(y) If for a tax year prior to the January 1, 1985, a taxpayer has previously reported income on a South Carolina income tax return which was excluded from federal taxable income as a result of Internal Revenue Code Sections 921 through 927 or Sections 970 through 997, the taxpayer may exclude from his South Carolina taxable income the previously reported income for the year in which the income is taxable for federal income tax purposes.

(z) For purposes of computing tax, a 'Head of Household' as defined in Internal Revenue Code Section 2(b), shall use the rates provided in item (a) of Section 12-7-210. For purposes of Internal Revenue Code Section 63(d), the 'Zero Bracket Amount' for a 'Head of Household' as defined in Section 2(b) is the maximum amount of taxable income on which no tax is paid in item (a) of Section 12-7-210.",

Distribution to a nonresident beneficiary

SECTION 8. Section 12-9-310 of the 1976 Code, as last amended by Section 21, Part II, of Act 512 of 1984, is further amended by adding a new item to read:

"(4) Making any distribution to a nonresident beneficiary of any estate or trust shall withhold from the distribution seven percent of the

beneficiary's South Carolina taxable income attributable to the distribution. The amounts withheld must be paid over each year to the Commission with the annual tax return of the estate or trust. The nonresident beneficiary may claim the amount withheld as a credit against any South Carolina income tax liability and shall receive a refund of any excess."

Credit

SECTION 9. Article 5, Chapter 7, of Title 12 of the 1976 Code is amended by adding:

"Section 12-7-618. For South Carolina income tax purposes, an individual may claim a credit for expenses related to a dependent as provided in Internal Revenue Code Section 21, except that the term 'applicable percentage' means seven percent and is not reduced if a taxpayer's adjusted gross income exceeds ten thousand dollars for a taxable year."

Accounting methods and periods

SECTION 10. Chapter 7 of Title 12 of the 1976 Code is amended by adding:

"Article 12
Accounting Methods and Periods

Section 12-7-1410. (a) A taxpayer's taxable year under this chapter must be the same as his taxable year for federal income tax purposes.

(b) If a taxpayer's taxable year is changed for federal income tax purposes, his taxable year for purposes of this chapter is similarly changed without applying to the Commission, but the taxpayer must provide the Commission with a copy of the written permission received from the Internal Revenue Service. If a taxable year of less than twelve months results from a change of taxable year, the South Carolina zero bracket amount and the South Carolina personal exemptions must be prorated in a manner determined by the Commission.

(c) A taxpayer's method of accounting under this chapter must be the same as his method of accounting for federal income tax purposes.

(d) (1) If a taxpayer's method of accounting is changed for federal income tax purposes, his method of accounting for purposes of this chapter is similarly changed without application to the Commission, but the taxpayer must provide the Commission with a copy of the written permission received from the Internal Revenue Service.

(2) If a taxpayer's method of accounting is changed in compliance with this section, any additional income or deduction which results from adjustments determined to be necessary solely by reason of the change must be included in income or deducted from income as provided in the Internal Revenue Code."

Verification of information

SECTION 11. Article 13, Chapter 7, of Title 12 of the 1976 Code is amended by adding:

"Section 12-7-1625. The Commission may require any taxpayer to provide it with copies of any returns the taxpayer files with the Internal Revenue Service and verify the information contained thereon."

Internal Revenue Code sections specifically not adopted

SECTION 12. For purposes of Chapter 7, of Title 12 of the 1976 Code, notwithstanding any other provisions contained in the Chapter, the following enumerated Internal Revenue Code sections are specifically not adopted:

(a) Sections 1(a) through (e), 3, 11, and 1201 relating to federal tax rates.

(b) Sections 21 through 52, 515, 853, 901 through 908, and 960 relating to tax credits.

(c) Sections 55 through 58 relating to minimum taxes.

(d) Sections 78, 86, 87, 196, and 280C which are specifically excluded by Section 12-7-430 of the 1976 Code.

(e) Sections 72(m)(5)(B), 72(o), and 72(q) relating to penalty taxes on certain retirement plan distributions.

(f) Section 172(b)(1) relating to net operating loss carrybacks.

(g) Sections 531 through 565 relating to certain special taxes on corporations.

(h) Sections 581, 582, and 585 through 597 relating to the taxation of banking institutions.

(i) Sections 665 through 668 relating to taxation of certain accumulation distributions from trusts.

(j) Sections 801 through 845 relating to the taxation of insurance companies.

(k) Sections 861 through 912 and 931 through 971 relating to the taxation of foreign income.

(l) Sections 1301 through 1305 relating to income averaging.

(m) Sections 1401 through 1494 relating to various miscellaneous provisions.

(n) Sections 1501 through 1505 relating to consolidated tax returns.

(o) Sections 2001 through 7655, 7801 through 7871, and 8001 through 9602.

Credit

SECTION 13. Subsection (1) of Section 12-7-2418, of the 1976 Code, as added by Act 512 of 1984, Part II, Section 9, Division III(I)(1), is amended to read:

"(1) Any resident individual who was domiciled in this State for the entire applicable tax year and who, during that year, was not in the custody of a state or federal penal, mental health, or retardation institution, required by law to file and who has filed a South Carolina Income Tax return is allowed a credit against taxes due under Section 12-7-210 equal to the amount of twelve dollars and fifty cents for the taxpayer, and the

taxpayer's spouse if they file a joint tax return and for any dependent for which the taxpayer claims an exemption on his federal income tax return pursuant to Section 151(d) of the Internal Revenue Code as defined in item (11) of Section 12-7-20. If a taxpayer claims the credit for a dependent on his South Carolina income tax return, the dependent may not claim the credit on any South Carolina income tax return the dependent is required to file. If the amount of the credit exceeds the income taxes otherwise due on the taxpayer's income or if there are no South Carolina income taxes due on the taxpayer's income, the amount of the credit not used as an offset against income taxes, after certification by the Commission, must be paid to the taxpayer by the State Treasurer from the state general fund. No interest is allowed on any payment made to a taxpayer pursuant to this section."

Deduction

SECTION 14. Subsections (E), (F), (G), and (H) of item (4) of Section 12-9-10 of the 1976 Code, as added by Section 1 of Act 372 of 1984, are respectively amended to read:

"(E) for a payment to a self-employed retirement fund (Keogh Plans) or to an individual retirement account or program as permitted under the IRC as defined in item (11) of Section 12-7-20 if, at the time of the payment, it is reasonable to believe that the employee is entitled to a deduction under the section for the payment;

(F) for premiums on group-term life insurance on the life of an employee that are not included in South Carolina taxable income as defined in Article 4, Chapter 7, of Title 12;

(G) to or on behalf of an employee for moving expenses if the renumeration is not included in South Carolina taxable income as defined in Article 4, Chapter 7, of Title 12;

(H) to or under an employee benefit plan not included in South Carolina taxable income as defined in Article 4, Chapter 7, of Title 12;".

Exemption

SECTION 15. Item (2) of Section 12-9-110 of the 1976 Code, as amended by Section 2 of Act 372 of 1984, is further amended to read:

"(2) One additional exemption for himself if, on the basis of facts existing at the beginning of the day, there may reasonably be expected to be allowed an exemption under Internal Revenue Code Section 151(c) and (d) as defined in item (11) of Section 12-7-20;".

Requirements of full-time students

SECTION 16. Section 12-9-315 of the 1976 Code, as amended by Section 7 of Act 372 of 1984, is further amended to read:

"Section 12-9-315. An employee who certifies that he meets the requirements of a full-time student at a bona fide educational institution and further certifies that he anticipates no income tax liability for the current year may request waiver of the withholding requirements set forth in item (1) of Section 12-9-310."

Property exempt from federal income tax

SECTION 17. The unnumbered item added to subsection B of Section 12-37-220 of the 1976 Code added by Act 39 of 1981, is amended to read:

"(25) All personal property loaned or leased on a nonprofit basis to a state agency, county, municipality, or other political subdivision, or to an organization exempt from federal income tax under Internal Revenue Code Sections 501 through 514 as defined in item (11) of Section 12-7-20, for at least thirty days during the tax year, so long as such personal property is used solely for the

purpose of public display and not for the use of such state agency, county, municipality, or other political subdivision, or exempt organization."

Definition

SECTION 18. Item (e) of Section 21-37-20 of the 1976 Code is amended to read:

"(e) 'Retirement plan' means a defined benefit plan, defined contribution plan, self-employed retirement plan, individual retirement account, or simplified employee pension plan, as provided in the Internal Revenue Code as defined in item (11) of Section 12-7-20 and any other type of employee benefit plan."

Definition

SECTION 19. Item (p) of Section 3 of Act 76 of 1977, as last amended by Section 2 of Act 283 of 1982, is amended to read:

"(p) 'Persons and families of moderate to low income' means those individuals who are members of households whose gross income falls between seventy-five percent and one hundred fifty percent of the 'median gross income' of all households in South Carolina as determined on the basis of the latest available statistics furnished to the Authority by the Divison of Research and Statistical Services of the State Budget and Control Board. Gross income means income derived from any source whatsoever. An allowance for each member of the family equal to an amount for personal exemptions as defined by Internal Revenue Code Section 151, as defined in item (11) of Section 12-7-20, must be deducted from gross income in order to qualify a person or family as a member of the 'beneficiary class'."

Definition

SECTION 20. Item 9 of Section 46-47-20 of the 1976 Code is amended to read:

"9. 'Farmers and farm families of low and moderate income' means those farmers and households engaged in farming on a family farm from which their adjusted gross income is less than or falls between seventy-five and one hundred and twenty-five percent of the 'median gross income' of all households in South Carolina as determined on the basis of the latest available statistics furnished to the authority by the Division of Research and Statistical Services of the State Budget and Control Board. Adjusted gross income is defined as in the Internal Revenue Code as defined in item (11) of Section 12-7-20. A deduction for each member of the family equal to an amount for personal exemptions as defined by Internal Revenue Code Section 151, as defined in item (11) of Section 12-7-20, is allowed in order to qualify a person or family as a member of the 'beneficiary class'."

Tax Commission may issue rules and promulgate regulations

SECTION 21. To carry out the purposes of the South Carolina Income Tax Federal Conforming Amendments of 1985, the South Carolina Tax Commission may issue rules and promulgate regulations necessary to implement the adoption of the Internal Revenue Code provisions adopted by this act.

Repeal

SECTION 22. Sections 12-7-90, 12-7-211, 12-7-220, 12-7-260, 12-7-270, 12-7-280, 12-7-285, 12-7-300, 12-7-310, 12-7-320, 12-7-330, 12-7-510, 12-7-520, 12-7-530, 12-7-535, 12-7-540, 12-7-550, 12-7-560, 12-7-580, 12-7-600, 12-7-610, 12-7-660, 12-7-670, 12-7-680, 12-7-685, 12-7-690, 12-7-700, 12-7-705,

12-7-710, 12-7-720, 12-7-730, 12-7-740, 12-7-750, 12-7-760, and 12-7-770, all of the 1976 Code, are repealed. Articles 7 and 11 of Chapter 7 of Title 12 of the 1976 Code are repealed. Section 23, Part II, of Act 517 of 1980 and Act 424 of 1978 are repealed.

Provisions effective

SECTION 23. The provisions of the South Carolina Income Tax Federal Conforming Amendments of 1985 are effective for tax years beginning after December 31, 1984.

Time effective

SECTION 24. This act shall take effect upon approval by the Governor.

Approved the 21st day of May, 1985.

No. 102

(R147, S315)

AN ACT TO AMEND SECTION 60-11-40, CODE OF LAWS OF SOUTH CAROLINA, 1976, RELATING TO THE SOUTH CAROLINA COMMISSION ON ARCHIVES AND HISTORY, SO AS TO INCREASE THE NUMBER OF EX OFFICIO MEMBERS OF THE COMMISSION FROM FOUR TO FIVE BY ADDING THE HEAD OF THE DEPARTMENT OF POLITICAL SCIENCE AND HISTORY OF SOUTH CAROLINA STATE COLLEGE AS AN EX OFFICIO MEMBER.

Be it enacted by the General Assembly of the State of South Carolina:

Department of Archives and History

SECTION 1. Subsections (1) and (2) of Section 60-11-40 of the 1976 Code are amended to read:

Exhibit F

BANK TAX

OPINIONS OF ATTORNEY GENERAL

BA–OAG–1 EXPENSES

I have been requested by you to give you my opinion as to my construction of the Section of the Code levying the so-called income tax on Banks.

Section 2676 of the Code of 1942 levies a tax upon, or with respect, to the entire net income of banks. This language includes all income from whatever source derived, even income from nontaxable securities. This is for the reason that the bank tax is a franchise tax for the privilege of operating, or doing business in this State, the amount thereof being measured by the entire net income.

For the above reason, it is my opinion that banks in this State filing returns required under this Section of the Code, are permitted to deduct all expenses incurred in the operation of their banks including Federal and State income taxes. (March 12, 1948)

Claude K. Wingate
Assistant Attorney General
SOUTH CAROLINA TAX COMMISSION

SC 1626

Exhibit G

BA–R–1 ENTIRE NET INCOME – AMENDED

The term "entire net income" as used in Section 65–401 shall include income derived from any source whatsoever including interest on obligations of the United States, the United States Government or its possessions or of any state and any political subdivision thereof. (December 6, 1967)

BA–R–2 METHOD OF REPORTING

The net income of the taxpayer as provided for in Section 65–402 shall be computed on either a cash or an accrual basis. A bank may request permission to change from a cash to an accrual basis or from an accrual basis to a cash basis over a ten year period. (December 6, 1967)

BA–R–3 FEDERAL INCOME TAX DEDUCTION

Effective January 1, 1975 (1976 Bank Tax Returns), banks reporting on a cash basis may deduct Federal income estimated tax payments in the year in which they are paid.

Cash basis banks using a method other than above may convert by using ten year conversion period as permitted under BA–R–2. (January 15, 1975)

BA–R–4

The following Income Tax Rules and Regulations are herewith adopted and made a part of the Rules and Regulations pertaining to banks: (October 1, 1975)

I–R–1	ACCUMULATION OF DEPRECIATION
I–R–6	PRIZES
I–R–17	GAIN OR LOSS FROM THE DEMOLITION OF BUSINESS PROPERTY – AMENDED
I–R–21	CASUALTY LOSS
I–R–26	DEPRECIATION
I–R–29	SALES AND USE TAX DEDUCTION
I–R–30	TREATMENT OF REPOSSESSIONS – AMENDED
I–R–31	TRAVELING EXPENSES AS AN ALLOWABLE DEDUCTION – AMENDED
I–R–32	RESERVE FOR BAD DEPTS
I–R–56	CASUALTY LOSSES
I–R–70	COST BASIS OF PROPERTY
I–R–73	GAIN OR LOSS ON EXCHANGES – GENERALLY
I–R–74	GAIN OR LOSS ON INVOLUNTARY CONVERSION OF PROPERTY
I–R–81	TAXIBILITY OF EASEMENTS & RIGHT OF WAYS
I–REG–1	PERTAINING TO DEPRECIATION OBSOLESCENCE AND DEPLETION
I–REG–8	PERTAINING TO THE FILING OF INCOME TAX RETURNS ON FORMS FURNISHED BY THE COMMISSION – AMENDED JANUARY 2, 1974
I–REG–12	EXPENSES INCURRED OR SUM PAID TO INFLUENCE LEGISLATION
I–REG–24	TO PROVIDE A DEFINITION OF THE TERM "RELATED EXPENSES"

BA–R–5 MERGERS

A bank which merges into another bank or consolidates with one or more banks, must file a final return for a portion of the year prior to the merger or consolidation and pay the tax shown to be due thereon.

The liability for filing the final return for the bank or banks ceasing to exist shall vest in the surviving bank since it assumes all assets and liabilities of the bank or banks merging or consolidating. (October 1, 1975)

SC 1439

South Carolina Code of State Regulations Annotated
Regulations
Chapter 117. Department of Revenue (Refs & Annos)
Article 24. Miscellaneous Taxes

S.C. Code of Regulations R. 117-1500

117-1500. Bank Tax.

Currentness

Chapter 11 of Title 12 imposes a franchise tax on banks. The following subsections address various aspects of this franchise tax as administered by the South Carolina Department of Revenue.

117-1500.1. Entire Net Income.

The term "entire net income" as used in Section 12-11-10 shall include income derived from any source whatsoever including interest on obligations of the United States, the United States Government or its possessions or of any state and any political subdivision thereof.

117-1500.2. Method of Reporting.

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. A bank may request permission to change from a cash to an accrual basis or from an accrual basis to a cash basis over a ten year period.

117-1500.3. Federal Income Tax Deduction.

Banks reporting on a cash basis may deduct Federal income estimated tax payments in the year in which they are paid. Cash basis banks using a method other than above may convert by using ten year conversion period as permitted under SC Regulation 117-1500.2.

117-1500.5. Mergers.

A bank which merges into another bank or consolidates with one or more banks, must file a final return for a portion of the year prior to the merger or consolidation and pay the tax shown to be due thereon.

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The liability for filing the final return for the bank or banks ceasing to exist shall vest in the surviving bank since it assumes all assets and liabilities of the bank or banks merging or consolidating.

Credits

HISTORY: Added by State Register Volume 27, Issue No. 6, Part 2, eff June 27, 2003.

Current through State Register Volume 42, Issue 6, eff June 22, 2018.

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S.C. CODE REGS. 117-1500, SC ADC 117-1500

End of Document

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Exhibit H

Final Report of the

South Carolina Taxation Realignment Commission

December 2010

Note: This report, along with other pertinent TRAC documents, can be found by visiting: www.scstatehouse.gov/citizensinterestpage/TRAC/TRAC.html

SC 1334

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SC 1335

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SC 1336

Members of the South Carolina Taxation Realignment Commission (TRAC), appointed by the Governor and specific members of the General Assembly, must have substantial academic or professional experience (or specialization) in one or more of the following areas:

1. Public finance,
2. Government budgeting and administration,
3. Tax administration,
4. Economics,
5. Accounting,
6. Business,
7. Tax law.

Furthermore, members of TRAC must have been a resident of South Carolina since January 1, 1997 and cannot be members of the General Assembly. Commissioners will serve without compensation, and are not eligible for the usual mileage, subsistence, and per diem sometimes allowed for members of state boards, committees, and commissions.

Members of TRAC are as follows:

Burnet Maybank III, JD, Chairman	Appointed by Sen. Leatherman
Bob Steelman, Vice Chairman	Appointed by Rep. Cooper
Ken Wingate, CPA, JD	Appointed by Gov. Sanford
Brian Moody, CPA	Appointed by Gov. Sanford
Don Weaver	Appointed by Sen. McConnell
Ben Kochenower, CPA	Appointed by Sen. Peeler
Charles S. Way, Jr.	Appointed by Sen. Land
Jimmy Addison	Appointed by Rep. Harrell
Jack Shuler	Appointed by Rep. Harrell
Kenneth Cosgrove	Appointed by Rep. Cooper
Ray N. Stevens, Director of DOR	Ex Officio

Staff:

Craig H. Parks, MPA, Sr. Research Analyst, Senate Finance Committee
Rena Grant, Legislative Director, House Ways and Means Committee
Katie Owen, Budget Analyst, House Ways and Means Committee
Kevin M. Sayed, Law Intern for Burnet Maybank, III
Campbell Irving, Law Intern for Burnet Maybank, III

SC 1337

July 1, 2012: $1,000 cap
July 1, 2013: $1,200 cap
July 1, 2014: No cap

Dealer Tags

TRAC recommends repealing the sales tax exemption for cars with "dealer tags". Today there are approximately 3,300 dealers in the state, but currently over 18,000 dealer tags; the number of dealer tags has reached nearly as high as 22,000 in the last 5 years. That equates to roughly 5.56 dealer tags per dealership.[66] As more cars are sold, a dealer is allocated new dealer tags to repeat this process. It is interesting to note the ratio of used versus new car dealerships in the state of South Carolina versus the state of California. South Carolina has a ratio of approximately 8.77 used/new car dealerships (2500/285 used/new).[67] Compare that to California which has a ratio 4.61 used/new car dealerships (6785/1470 used/new).[68] This ratio is important because a major area of concern is individuals setting up so called "straw dealerships", which are used car dealerships that meet minimum legal requirements, but do not have the legitimate intention to competitively enter the business of selling used vehicles (and avoid licensing difficulties of working with new car manufacturers). These straw dealerships are easy to set up because of minimum legal requirements, so the dealerships and the subsequent dealer tags granted provide a great mechanism for creating sales tax shields.

Banking Exemption

TRAC recommends repealing the sales tax exemption for banks. Banks are defined as any person "engaged in a banking business, whether incorporated under the laws of this State, any other state or the United States or whether unincorporated, except cash depositories." This definition is generally viewed as being limited to persons who are regulated by federal or state banking regulators. Banks are exempt from South Carolina income taxes, however, SC Code Title 12, Chapter 11, imposes a franchise tax based upon the "entire net income" of banks. The

[66] South Carolina Dept. of Motor Vehicles: http://www.scdmvonline.com.
[67] *Id.*
[68] California Dept. of Motor Vehicles: www.dmv.ca.gov.

tax rate is 4.5 percent of the "entire net income" of the bank doing business in South Carolina or from the sales or rentals of property within South Carolina. Although the chapter is entitled "Income Tax on Banks" and several of its sections refer to it as an income tax, this tax has always been considered a franchise tax based upon net book income. Banks are not subject to any taxes in South Carolina except this tax, use taxes, deed recording fees, and property taxes on real property. The State's sales tax base should be broadened by removing the sales tax exemption for banks.

Savings and Loan Association Exemption

TRAC recommends repealing the sales tax exemption for savings and loans. A savings and loan association includes any mutual or stock-chartered corporation insured by the Federal Savings and Loan Insurance Corporation or any corporation subject to regulatory supervision by the Federal Home Loan Bank, or the Savings and Loan Division of the South Carolina Board of Financial Institutions, other than banks taxed under Chapter 11 of Title 12 of the SC Code, or employees' credit unions. Associations are exempt from South Carolina's corporate income tax. However, SC Code Chapter 13 of Title 12 imposes an income tax (not a franchise tax) on associations. The tax rate is 6 percent of the net income from all sources, except for income from municipal, state, or federal bonds or securities exempted by law from the tax, including interest earned on deposits at the Federal Home Loan Bank of Atlanta, or its successors, for those savings and loan associations which meet the qualified thrift lender test set forth in the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (Public Law 101-73), as amended. Associations are exempt from this tax for the first three years of their operation. This savings and loan income tax is imposed in lieu of all other taxes on associations, except use taxes, deed recording fees, and property taxes on real property.

Vendor discounts for Retailers

While many states no longer allow for this type of tax discount, TRAC does not recommend a total repeal of the discount (as described in greater detail above), but instead recommends lowering the percent discount from 2 percent to 1 percent, and the maximum

Partnerships, or Limited Liability Companies, reduced the top marginal rate from 7 percent to a flat 5 percent for income passed through from these businesses. Furthermore, as some businesses would owe less under the former marginal rate structure, the General Assembly went the extra "business friendly" step by allowing these firms to choose each year which tax structure would provide them the lowest tax burden.

As an aside, it is important to note, that similar to our State's positive rankings regarding "business friendliness" for larger corporations, South Carolina also ranks well as a place for small businesses too, having ranked seventh best "small business climate" in the US according to the "2009 Small Business Survival Index" published by Small Business and Entrepreneurial Council.[163]

Financial Institutions

Banks

Banks are defined as any person "engaged in a banking business, whether incorporated under the laws of this State, any other state or the United States or whether unincorporated, except cash depositories."[164] This definition is generally viewed as being limited to persons who are regulated by federal or state banking regulators.

Banks are exempt from South Carolina income taxes,[165] however, SC Code Title 12, Chapter 11, imposes a franchise tax based upon the "entire net income" of banks. The tax rate is 4.5 percent of the "entire net income" of the bank doing business in South Carolina or from the sales or rentals of property within South Carolina.[166] Although the chapter is entitled "Income Tax on Banks" and several of its sections refer to it as an income tax,[167] this tax has always been

[163] The Small Business and Entrepreneurial Council's "Small Business Survival Index 2009" - http://www.sbecouncil.org/uploads/SBSI2009.pdf.
[164] SC Code §12-11-10.
[165] SC Code §12-6-550(1).
[166] SC Code §12-11-20.
[167] SC Code §§12-11-30, 12-11-50, and 12-11-60.

considered a franchise tax based upon net book income.[168] Banks are not subject to any taxes in South Carolina except this tax, use taxes, deed recording fees, and property taxes on real property.[169]

For purposes of administration, allocation and apportionment, enforcement, collection, liens, penalties, and other similar provisions, all provisions of the South Carolina's income tax[170] that may be appropriate or applicable are adopted and made a part of the bank franchise tax for the purposes of enforcement and administration, including the requirement to make declarations of estimated tax and make estimated tax payments.[171]

Savings and Loan Associations

A savings and loan association includes any mutual or stock-chartered corporation insured by the Federal Savings and Loan Insurance Corporation or any corporation subject to regulatory supervision by the Federal Home Loan Bank, or the Savings and Loan Division of the South Carolina Board of Financial Institutions, other than banks taxed under Chapter 11 of Title 12 of the SC Code, or employees' credit unions.[172]

Associations are exempt from South Carolina's corporate income tax,[173] however, SC Code Chapter 13 of Title 12 imposes an income tax (not a franchise tax) on associations. The tax rate is 6 percent of the net income from all sources, except for income from municipal, state, or federal bonds or securities exempted by law from the tax, including interest earned on deposits at the Federal Home Loan Bank of Atlanta, or its successors, for those savings and loan associations which meet the qualified thrift lender test set forth in the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (Public Law 101-73), as amended.[174]

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[168] See South Carolina Attorney General's Opinion dated March 12, 1948, Commission Decision I-D-189 (1975), and SC Form 1101B and instructions.
[169] SC Code §12-11-30.
[170] Chapter 6 of Title 12 of the SC Code.
[171] SC Code §12-11-40 and Commission Decision I-D-189 (1975).
[172] SC Code §§12-13-10 and 12-13-40.
[173] SC Code §12-6-550(2).
[174] SC Code §12-13-30.

Exhibit I

301 Gervais Street, P.O. Box 125, Columbia, South Carolina 29214

SC REVENUE RULING #92-9

SUBJECT:	Administration of Bank Taxes (Bank Taxes)
TAX ANALYST:	Deana West
SUPERSEDES:	All previous documents and any oral directives in conflict herewith.
REFERENCE:	S.C. Code Ann. Section 12-11-20 (1976) S.C. Code Ann. Section 12-11-40 (Supp. 1991) S.C. Code Ann. Section 12-11-50 (Supp. 1991) S.C. Code Ann. Section 12-7-1410 (Supp. 1991) S.C. Code Ann. Section 12-54-30 (Supp. 1991) S.C. Code Ann. Section 12-54-70 (Supp. 1991) S.C. Code Ann. Section 12-54-190 (Supp. 1991)
AUTHORITY:	S.C. Code Ann. Section 12-4-320 (Supp. 1991) SC Revenue Procedure #87-3
SCOPE:	A Revenue Ruling is the Commission's official interpretation of how tax law is to be applied to a specific set of facts. A Revenue Ruling is public information and remains a permanent document until superseded by a Regulation or is rescinded by a subsequent Revenue Ruling.

Questions:

1. May an extension of time be requested for filing a South Carolina bank tax return?

2. May a bank file a South Carolina bank tax return on a basis other than a calendar year?

3. May a bank request a refund of tax overpayments made in tax years prior to 1991?

Facts:

As a result of a recent amendment to Code Section 12-11-50, questions have arisen concerning administrative procedures with respect to banks. The purpose of this document is to set forth guidelines that will assist the Commission and taxpayers in the interpretation of the amended law.

1

SC 1325

Prior to July 1, 1991, the tax collected from banks was distributed directly to the counties and municipalities based on the formula contained in Code Section 12-11-50. The vouchers detailing this distribution were prepared by the Tax Commission's Corporate Section and provided to the State Treasurer by May 1 of each year. Because of the time involved in analyzing the bank return and preparing the vouchers, the Tax Commission (1) required banks to file returns on a calendar year basis, (2) did not allow an extension of time to file a bank tax return, and (3) provided banks non-refundable "paper" credits to offset future tax due instead of refunds which resulted from an amended return or audit.

Pursuant to the newly enacted State Aid to Subdivisions Act, the taxes collected from banks are now deposited to the credit of the State's general fund and amounts are distributed to the counties and municipalities based on a formula contained in the Act.

Discussion:

Code Section 12-11-20 provides for a franchise tax based on net income on banks and reads:

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

Code Section 12-11-40 governs enforcement and administration of the franchise tax on banks and provides:

> For the purpose of administration, enforcement, collection, liens, penalties, and other similar provisions, all of the provisions of Chapter 7 of this Title [Income Tax Act of 1926] that may be appropriate or applicable are adopted and made a part of this chapter for the enforcement and administration of this chapter, including the requirement to make declarations of estimated tax and make estimated tax payments.

The law, therefore, imposes a franchise tax based on net income on banks engaged in business in South Carolina and its administration and enforcement is governed by appropriate income tax provisions contained in Chapter 7 of Title 12.

Additionally, in addressing the questions at hand, we must also consider Chapter 54 of Title 12, entitled "Uniform Method of Collection and Enforcement of Taxes Levied and Assessed by South Carolina Tax Commission". Specifically, Code Section 12-54-190 provides that "[u]nless otherwise specified, the provisions of this chapter take precedence over all other related statutory provisions".

EXTENSION FOR FILING RETURN

Code Section 12-54-70 provides for an extension of time for filing a return and reads, in part:

> (a) The Commission may, for good cause, allow further time for the filing of returns or remitting of tax due, required under the provisions of law administered by the Commission. The request for an extension may be granted only if the request is filed with the Commission on or before the day the return of the tax is due. A tentative return is required reflecting one hundred percent of the anticipated tax to be paid for the taxable period, to be accompanied by a remittance for the tentative tax liability....

In summary, the law allows the Tax Commission, for good cause, to grant extensions of time to file tax returns.

TAXABLE YEAR FOR FILING RETURN

As previously stated, appropriate income tax provisions contained in Chapter 7 of Title 12 govern the enforcement and administration of bank taxes. Code Section 12-7-1410 provides rules for the acceptable accounting methods and periods of taxpayers and reads, in part:

> (a) A taxpayer's taxable year under this chapter must be the same as his taxable year for federal income tax purposes.
>
> (b) If a taxpayer's taxable year is changed for federal income tax purposes, his taxable year for purposes of this chapter is similarly changed without applying to the Commission, but the taxpayer must provide the Commission with a copy of the written permission received from the Internal Revenue Service....

The law, therefore, provides that a taxpayer's South Carolina tax year be the same as the tax year used for federal income tax purposes.

REFUNDS OF OVERPAYMENTS

Code Section 12-11-50 provides for the payment of franchise tax on banks and reads:

> The taxes provided for in this chapter must be paid to the commission as provided in Section 12-11-40 and the income tax paid under the provisions of this chapter must be deposited to the credit of the general fund of the State.

Code Section 12-54-30 provides for a refund or credit to the taxpayer in the event of an overpayment and reads, in part:

> If the commission discovers on examination of a return or otherwise that the tax, penalty, or interest paid by any person is in excess of the amount legally due, the commission may order a refund or give credit for the overpayment.

Prior to its amendment in 1991, Code Section 12-11-50 specified how taxes provided for in this chapter would be distributed between the general fund, counties and municipalities. As a result,

it was administratively impractical for the Tax Commission to allow refunds once the tax was distributed. The recent amendment to Code Section 12-11-50, however, has relieved this administrative burden. Therefore, the Commission, when deemed appropriate, may order refunds of bank tax overpayments.

In light of the South Carolina Supreme Court case Bass v. State of South Carolina, 395 S.E. 2d 171 (1990), taxpayers seeking a claim for refund should refer to SC Revenue Ruling #91-10 for a discussion of their appeal rights.

Conclusions:

1. An extension of time may be requested for filing a South Carolina bank tax return, in accordance with Code Section 12-54-70. An extension form must be filed with the Tax Commission on or before the original due date of the return. South Carolina does not recognize a corporate extension issued by the Internal Revenue Service or any other State.

2. The accounting period for which the South Carolina bank tax return is filed must be the same as that used for federal income tax purposes, as provided in Code Section 12-7-1410.

3. The non-refundable "paper" credit system will be discontinued, therefore, banks may request a refund of tax overpayments made in tax years prior to 1991, pursuant to Code Section 12-54-30. These refund requests are subject to the provisions set forth in SC Revenue Ruling #91-10.

For further information, contact the Tax Commission's Corporate Section at 803-737-4705.

SOUTH CAROLINA TAX COMMISSION

s/A. Crawford Clarkson Jr.
A. Crawford Clarkson, Jr., Chairman

s/T. R. McConnell
T. R. McConnell, Commissioner

s/James M. Waddell Jr.
James M. Waddell, Jr., Commissioner

Columbia, South Carolina
July 21, 1992

Exhibit J

1350

STATE OF SOUTH CAROLINA

BANK TAX RETURN

Return is due on or before the 15th day of the 3rd month following the close of the taxable year.

SC 1101 B
(Rev. 6/8/15)
3089

SC FILE # _____ - ____

ACCORDING TO OR MEASURED BY ENTIRE NET INCOME
FOR THE PERIOD ENDING ____/____/____
FEIN _____
NAME _____
MAILING ADDRESS _____
CITY _____ STATE _____ ZIP CODE _____

Change of ▶ ☐ Address ☐ Accounting Period

☐ Check here if you filed a federal or state extension.

Attach complete copy of Federal Return

County or Counties in SC Where Property Is Located:

Audit Location Street

City State

Audit Contact Telephone Number

Check if ☐ Initial Return ☐ Amended Return

If Filing a Final Return, Indicate Whether:

▶ ☐ Merged ▶ ☐ Reorganized ▶ ☐ Final

Date organized _____ Under the laws of _____
Books are in care of _____ Located at _____
If not incorporated in SC, enter date qualified to do business in SC. _____

COMPUTATION OF BANK TAX LIABILITY

1.	Federal Taxable Income per federal tax return ▶ **S Corporations, see General Information in Instructions.**	1.	00
2.	Net Adjustment from line 19, Schedule A and B	2.	00
3.	Total Net Income As Reconciled (line 1 plus or minus line 2)	3.	00
4.	If Multi-state Bank, enter amount from line 6, Schedule D; otherwise enter amount from line 3 ▶ *** Line 4 Must Be Completed By All Taxpayers.**	4.	00
5.	Tax (multiply line 4 by .045 (4.5%)	5.	00
6.	Non Refundable Credits Taken This year from SC 1120-TC ▶	6.	00
7.	Balance of Tax (line 5 less line 6)	7.	00
8.	**Payments:** (a) Tax Withheld (Attach 1099s, I-290s, and/or W-2s) 00 (b) Paid by Declaration 00 (c) Paid with Tentative Return 00	8.	00
9.	Balance of Tax Due (line 7 less line 8) ▶	9.	00
10.	Penalty for Underpayment of Estimated Tax (See Instructions)	10.	00
11.	Total Tax and Penalty Due (add lines 9 and 10) **BALANCE DUE**	11.	00
12.	Overpayment (line 8 less line 7) 00 To be applied as follows: (a) Estimated tax ▶ 00 (b) **REFUNDED** ▶	14-0101	00

Make check payable to: South Carolina Department of Revenue. Include Business Name, FEIN and SC File #.

Mail this return to: SC DEPARTMENT OF REVENUE
CORPORATE RETURN
COLUMBIA, SC 29214-0100

30891022

SC 1422

SC1101 B

SCHEDULE A AND B ADDITIONS TO FEDERAL TAXABLE INCOME

Income recorded on books but not included in federal taxable income

1. Interest on State and Local Obligations ..... 1.
2. _____ 2.
3. _____ 3.
4. Other items (attach schedule) ..... 4.

Deductions on the federal return but not charged against book income

5. Federal net operating loss deduction ..... 5.
6. _____ 6.
7. _____ 7.
8. _____ 8.
9. Total Additions (add lines 1 through 8) ..... 9.

DEDUCTIONS FROM FEDERAL TAXABLE INCOME

Income subject to federal income tax but not recorded on the books.

10. _____ 10.
11. _____ 11.
12. _____ 12.
13. _____ 13.

Expenses recorded on the books but not deducted on the federal return.

14. Federal Income Tax ..... 14.
15. _____ 15.
16. _____ 16.
17. _____ 17.
18. Total Deductions (add lines 10 through 17) ..... 18.
19. Net Adjustment (line 9 less line 18) Also enter on line 2, Page 1, SC1101 B ..... 19.

Please Sign Here

I, the undersigned, a principal officer of the corporation for which this return is made declare that this return, including accompanying Annual Report, statements and schedules, has been examined by me and is to the best of my knowledge and belief, a true and complete return.

Signature of officer	Officer's title	Email
Officer's printed name	Date	Telephone Number

I authorize the Director of the Department of Revenue or delegate to discuss this return, attachments and related tax matters with the preparer. Yes ☐ No ☐ | Preparer's Printed Name

Paid Preparer's Use Only

Preparer's signature	Date	Check if self-employed ☐	Preparer's Telephone Number
Firm's name (or yours if self-employed) and address		PTIN or FEIN	
		ZIP Code	

30892020

SC 1423

SC1101 B

SCHEDULES C, D, AND E ARE TO BE COMPLETED BY MULTI-STATE BANKS

SCHEDULE C INCOME SUBJECT TO DIRECT ALLOCATION

	Gross Amounts 1	Less: Related Expenses 2	Net Amounts Allocated Direct. to SC and Other States 3	Net Amounts Allocated Directly to SC 4
1. Interest not connected with business				
2. Dividends received				
3. Rents				
4. Gains/losses on real property				
5. Gains/losses on intangible personal property				
6. Investment income directly allocated				
7. TOTAL INCOME DIRECTLY ALLOCATED				
8. INCOME DIRECTLY ALLOCATED TO SC				

SCHEDULE D COMPUTATION OF TAXABLE INCOME FOR BANKS CLAIMING MULTI-STATE OPERATIONS

1. Total net income as reconciled. Enter amount from line 3, Page 1	1.
2. Less: Income subject to direct allocation to SC and other states from Schedule C, line 7	2.
3. Total net income subject to apportionment (line 1 less line 2)	3.
4. Multiply amount on line 3 by the ratio from Schedule E and enter result here	4.
5. Add: Income subject to direct allocation to SC from Schedule C, line 8	5.
6. Total SC Net Income (sum of lines 4 and 5 above) also enter on line 4, Page 1	6.

SCHEDULE E COMPUTATION OF GROSS RECEIPTS RATIO

	1. In SC	2. Total Everywhere	3. Ratio
1. Total Gross Receipts			
2. Less: Exclusion	< >	< >	
3. Gross Receipts (for ratio)			
4. Ratio of Gross Receipts (line 3, Col. 1 ÷ line 3, Col. 2)			%

30893028

SC 1424

Instructions for SC1101 B

GENERAL INFORMATION - Banks cannot elect S Corporation status for SC bank tax purposes. For federal S corporations, prepare and attach a pro forma federal Form 1120 and enter the taxable income on line 1. Provide both FEIN and SC File Number.

Banks cannot be included in consolidated returns.

For the purpose of allocation and apportionment, all of the provisions of Chapter 6, Title 12 that may be appropriate or applicable have been adopted for banks.

Audit Location **(address where the Corporate books are)** includes a block for Audit Contact Information.

When to File: The return must be filed by the fifteenth day of the third month after the tax year end.

Request for Extension to File:

- If any bank tax is due, the taxpayer must make payment with SC1120-T by original due date.
- If no bank tax is due and the taxpayer has requested a federal extension, then the federal extension will be accepted as a SC extension if the bank return is received within the time as extended by the Internal Revenue Service.
- A savings bank is a savings and loan, not a bank.
- There is no extension for payment of bank tax. Any bank tax due must be paid by the prescribed due date to avoid the assessment of late penalties and interest.

Who must File: Any person engaged in a banking business in SC, except cash depositories.

Where to File: South Carolina Department of Revenue, Corporation Return, Columbia, SC 29214-0100.

Declaration of Estimated Tax: A bank must file a Declaration of Estimated Tax with the SC Department of Revenue on or before the fifteenth day of the fourth month of the taxable year, **if the amount of estimated tax is one hundred dollars or more.** The Declaration of Estimated Tax must be calculated on SC1120-CDP. One hundred percent of the tax liability shown to be due on the SC1120-CDP must be paid when filing the declaration or in four equal installments on the fifteenth day of the fourth, sixth, ninth and twelfth month of the taxable year. A bank may avoid the penalty for Underpayment of Declaration by making each payment on time and if the total tax paid is at least the same as the total tax due, pursuant to the requirements for federal estimated income tax in Internal Revenue Code Section 6655. See SC2220 for computation of the penalty.

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

For more information visit our website **www.dor.sc.gov.**

Line by Line Instructions

Line 1 Enter the taxable income as shown on the federal tax return. **The federal return and all supporting schedules must be attached.**

Line 2 Net Adjustment - see Schedules A and B.

Additions to federal taxable income include all income items which are recorded on the books but are not included in federal taxable income. Examples:

(1) Interest on state and local obligations.
(2) Accretion of bond discount.

Additions to federal taxable income also include all expenses deducted on the federal return which are not charged against book income. Examples:

(1) Federal bad debt deduction.
(2) Federal depreciation in excess of book.
(3) Federal net operating loss deduction. (Banks are not allowed a net operating loss deduction.)

Deductions from federal taxable income include all income items subject to tax on the federal return that have not been included in book income. Examples:

(1) Tax over book sale income.
(2) Tax over book securities income.

Deductions from federal taxable income also include all expenses that have been recorded on the books but which have not been deducted on the federal return. Examples:

(1) Nondeductible travel and entertainment expense.
(2) Nondeductible amortization.

Line 4 - ALLOCATION AND APPORTIONMENT Generally the taxable income related to the business of a multistate bank is apportioned to SC using the gross receipts method of Code Section 12-6-2290. Gains and losses from real property less related expenses are allocated to the state where the real property is located. Dividends received from corporate stocks not connected with the taxpayer's business less all related expenses, are allocated to the state of a bank's principal place of business.

Line 6 - Attach SC1120-TC and applicable tax credit schedules. The credits claimed cannot exceed your tax liability.

Line 10 - UNDERPAYMENT OF ESTIMATED TAX If the bank underpaid it's estimated tax, complete SC2220 and attach it to the return. If the bank owes a penalty, show the amount in the space provided. If the bank is due a refund, subtract the penalty amount from the overpayment shown on line 12. SC2220 is available upon request or visit our website: **www.dor.sc.gov.**

Exhibit K

Bank Tax - TRAC Testimony Give by Lloyd Hendricks, President and CEO of South Carolina Bankers Association

Thank you for the opportunity to appear before the commission today and we thank you for your service to assess the effectiveness of the state's current tax structure.

I am Lloyd Hendricks, President and CEO of the South Carolina Bankers Association.

Also with me today is Neil Rashley, Senior Vice President & Counsel, Amber Setzler, Director of Government Relations and Chris Lindsey, our contract lobbyist.

Introduction

- The South Carolina Bankers Association represents banks and thrifts of all sizes and charters and is the voice in the South Carolina Legislature for our 107 banks and savings and loans doing business in South Carolina's communities.
- Their deposits total more than $70 billion.
- 46 institutions have a federal charter- Regulators are OCC, OTS, Federal Reserve and the FDIC
- 61 institutions have a state charter- Regulators are State Board of Financial Institutions, Federal Reserve, State Banking Examiners and the FDIC
- 1,463 branches and offices
- 56 holding companies in SC
- 21 of the 107 finance institutions are savings and loans.
- We merged the CFISC into our association 13 years ago.

SC 1657

- Our banks in SC employ 12,000 people according to the FDIC in September 2009.

Bank and Thrift Tax

- In FY 2009 banks and savings and loans paid a combined total of $12 million in state income taxes to the State of South Carolina. However, this figure is down due to the overall slowdown in the economy.

- In 2008, the combined income tax revenue for banks and savings and loans was over $22 million and in 2007 the total topped $28 million. Income taxes in 2006 and 2005 exceeded $30 million in each of these years. Total for the past 5 years it exceeded $125 million.

- Banks paid more than $56 million in federal taxes in 2008.

- In South Carolina, banks pay an income tax that is not calculated in the same manner as for a C corporation. The bank tax is a franchise tax. Banks are taxed pursuant to Chapter 11 of Title 12.

- S.C. Code § 12-11-20 provides that the entire net income of a bank in South Carolina is to be taxed at 4 ½% rate annually.

- This income is "book income" not "taxable income" which is what C Corps are taxed on. As a result all income and expenses are included in the tax calculation for a bank. And the entire net income is calculated without regard to the majority of the book/tax differences considered for federal income tax purposes, including the NOL carry forward.

- Like banks, savings and loans (thrifts) are taxed pursuant to a separate statute - Chapter 13 of Title 12.

- Thrifts' tax is 6% of net income but, unlike banks, their tax is an income tax.

- §12-13-20 - Net income does not include "income from municipal, state, or federal bonds or securities exempted by law from the tax, including interest earned on deposits at the Federal Home Loan Bank

of Atlanta, or its successors, for those savings and loan associations which meet the qualified thrift lender test set forth in the Financial Institutions Reform, Recovery and Enforcement Act of 1989." (FIRREA) – This act was intended to shore up deposit insurance funds and improve the safety and soundness of financial institutions. (Established FDIC- SAIF)

History of Bank Tax Statutes

- These statutes were added by the General Assembly in 1937 in order to insure a level of stability for banks and have only been amended once to modernize the term "deed recording fee."
- I would like to refer to the proceedings of the 1937 SCBA Annual Convention. It is interesting to note that the principle speaker at the 1937 SCBA Annual Convention was none other than the Honorable Burnet R. Maybank.

- Before 1937, there was an *ad valorem* tax on bank shares. This type of taxation placed a great strain on banks so the South Carolina Tax Commission recommended to the General Assembly that banks be taxed on their income (profitability). This was a conscious decision made by the Ways and Means Committee, the General Assembly and the State Tax Commission to balance taxation of national and state banks in an effort to keep our banks well capitalized.

- The General Assembly and the Tax Commission also recommended that this new income tax be in lieu of all other taxes except real property taxes. Other state had also changed to this type of bank taxation and found it to be successful.

- Capital is king in our business and liquidity is queen, and this was recognized in 1937 following the depression as well as it is today. It is a huge factor following this recession. $1 in capital supports up to $10 of new loans (statement made by Dr. Jim Chessen Chief Economist for ABA, before the committee on finance US Senate on May 4, 2010). The bank tax has direct and severe consequences for large institutions, and it has a broader impact on the smaller banks as well.

- Public policy makers must strike a careful balance between keeping lenders well- capitalized and the desire for revenue.

Other Taxes

- Banks and thrifts pay real property taxes, use taxes and deed recording fees.

- However, S.C. Code § 12-11-30 states that banks pay the income tax in § 12-11-20 in lieu of all other taxes except for real property taxes, use tax and deed recording fees.

- Thrifts have an identical provision in § 12-13-40.

- There is one sales tax exemption involving banking and it is found in S.C. Code § 12-36-2120(11)(d). The exemption is for transactions involving automated teller machines and was added in 1986 as ATMs became prevalent as means for electronic banking transactions – especially for consumers.

Banks Pay Their Fair Share and Community Contributions

- Banks do pay their fair share because some of it is because of who we are. For example, CRA and FDIC premiums. Other businesses have nothing like this. And the increased assessment of FDIC premiums on some of our community banks this past year have resulted in increased expenses exceeding 500%.

- South Carolina's banks contribute to the community in many other ways. In particular, banks are subject to the federal government's Community Reinvestment Act that requires financial institutions to meet the credit needs of their communities, including the low and moderate income sections of the local community. We have to make reports concerning our investment in the areas where we do business, and this is made public as to whether we receive a satisfactory rating.

- Total CRA dollars in 2008 (latest figures from FFIEC) - $3.6 billion

- Despite financial and regulatory pressures, SC banks have continued their tradition of providing financial and human resources for economic and community development organizations. A 2010 community investment survey that the SC bankers recently conducted showed that SC banks made more than $200 million in Community Development Loans in 2009.

- The total amount of bonds purchased was $62 million.

- Banks also had a charitable impact with more than $9 million in giving and 190,000 hours of volunteer work – benefiting more than 2000 charities.

- Our young bankers division has received the national award from ABA 8 out of the past 10 years for its efforts in financial education and financial literacy in our schools, reaching 60,000+ students each year.

- Traditional SC bankers continue their work leading charitable fundraisers, coordinating economic development initiatives, lending to local businesses, facilitating the dream of home ownership, purchasing local government bonds, and leading financial literacy efforts at local schools. This work happens not because of any state or federal mandate, but because a bank's success is tied directly to the creation of a healthy thriving community.

Points Concerning Banks Not Paying Personal Property Tax

- Although it is true that banks and thrifts do not pay personal property taxes, they do pay significant real property taxes, and state and federal income taxes. SC has always been a branching state, and due to significant branching over the years, bank's exposure to real property taxes is considerable.

- Public policy makers understand that different industries need to be taxed differently based on their services and goods. This is extremely true for the lending industry.

- Banks and other lenders are the lifeblood of the consumer and business sector. Banks are good for the local communities throughout SC with over 1400 locations to serve the public and taxation of the banks must be taken seriously. Over-taxation will result in a lack of capitalization for banks and would affect lending.

- Banks are the most heavily taxed and regulated of all lenders. For certain public policy reasons, credit unions and farm credit do not pay taxes. Taxes paid from 2003-2007 for SC Banks was $1,209,503,000 and for SC Credit Unions it was $0 (from approximately 82 state-chartered credit unions). Includes federal, state, and local taxes reported on the banks' call report to FDIC.

- Just as there are legitimate reasons to exempt other lenders from overall taxation, the personal property exemption for banks has a legitimate purpose. Banks have been technology heavy over the years with major investments in computers and programs. This is for the benefit of our customers and users in SC and is found in all 1400 branches and in our operation centers. You would have to look at furniture, fixtures, vaults ATMs and ATM equipment, teller lines (booths) and special computer equipment, all of which is unique to our business, if you were to impose another tax on us.

- The exemption was put in statute in order to balance the tax burden on banks and to provide for adequate capitalization and thus lending. This exemption was debated and recommended by the Tax Commission and the General Assembly in 1937 as part of the overall changes to bank taxation. It was not "slipped in" and has remained the same for more than 70 years.

- **Conclusion:** The banking industry has been severely affected by the challenging economic environment and recently passed congressional regulatory reform that eliminates $129 billion in capital from the Trust Preferred Securities in the US Banking system.

- Additionally, bank regulators have already reacted in significant and severe ways to rein in certain practices and increase disclosures. In the last year and a half, the Federal Reserve alone has issued 31 new or revised regulations. Each carries with it a significant allocation of

bank time and money and builds upon volumes of existing regulation. This is putting a strain on community banks and is becoming a nearly insurmountable burden.

- We also have pressure on us to lend and this reduces our capital. The last thing we need in this environment is another regulation or tax put on our industry.

- Public policy leaders across the nation and in the states have long recognized that taxation of lending institutions is different. And, this is for obvious reasons – lenders are the lifeblood of the business community and vital to the local economy. For all these reasons Mr. Chairman and members of the commission, we ask that you recommend no changes to our present statutes and that you not burden the very institutions who have been responsibly serving their communities.

- Thank you again for the invitation to be with you today and for your service on this commission.

SC 1663

STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

Synovus Bank, Petitioner, v. South Carolina Department of Revenue, Respondent.	)	Docket No. 17-ALJ-17-0418-CC

SYNOVUS BANK'S RESPONSE TO RESPONDENT'S MOTION FOR SUMMARY JUDGMENT

COMES NOW Petitioner Synovus Bank ("Synovus"), by and through its undersigned counsel, and hereby responds to the Motion for Summary Judgment filed by Respondent South Carolina Department of Revenue ("DOR" or "Department"). Due to the filing of cross motions for summary judgement by the parties, Synovus incorporates all arguments made in its Motion for Summary Judgement ("Synovus MSJ") filed with this Court on July 25, 2018 and also replies as follows:

I. The Department Asserts the Wrong Standard

As stated by Synovus in the Synovus MSJ, equity lies at the heart of a tax carryover concept. As such, the question of the allowance of a net operating loss (NOL) carryforward should be construed in favor of the taxpayer, not the Department. *See* Synovus MSJ, p.15.

II. The Department Asserts Misleading Facts Not in the Record

The Department has also asserted misleading facts that are not in the record. First, the Department's assertion that there is "over 80 years of well-settled law and administrative guidance that do not permit NOL deductions for banks"[1] is simply wrong. There is *no authoritative guidance* from the Department *applicable to NOLs* that precludes a bank from

[1] *See* Department MSJ, p.1.

applying an NOL carryforward. There is also no authoritative guidance instructing a bank to use "book income" as defined by generally accepted accounting standards in the United States ("GAAP), as promulgated by the Financial Accounting Standards Board ("FASB"). If there was such guidance, it would be an exhibit to the Department's Motion. At most, there is guidance that indicates the bank tax has historically been considered to be a "franchise tax" without further instruction as to what, exactly, it means to be a franchise tax in South Carolina.

Further, the Department implies that Synovus "suddenly reversed course" from its prior practice for tax filings in South Carolina.[2] Synovus had never been faced with NOLs subject to carryforward in the state of South Carolina prior to the tax filings at issue. Simply put, these losses were an unprecedented product of the significant economic downturn suffered by Synovus during the relevant periods. As such, Synovus filed all taxes and amendments claiming the NOL carryforwards at issue in a timely manner and raised the issue of NOL carryforwards for the first time.

III. The General Assembly Conformed the Bank Tax to the Internal Revenue Code ("IRC") in 2005. As Such, S.C. Code §12-6-1130 and the IRC Allows a Bank to Take an NOL Deduction

The Department attempts to convince the Court that the 1985 conformity amendment did not apply to banks. The 1985 Conformity statute is not, however, controlling. The Department wholesale ignores the fact that the conformity statutes were substantially amended in 2005. It is the 2005 amendment that makes clear conformity does apply to banks. The intent of the General Assembly was not vague. Nor is the statute ambiguous. In 2005, the General Assembly took affirmative action to change the language used in the conformity statutes and intentionally broadened the application of conformity from "this chapter" (Chapter 6) to "title [Title 12] and all other titles which provide for taxes administered by the Department." *See* S.C. Code Ann. §

[2] *See* Department MSJ, p.3

12-6-50; *see also* Synovus MSJ p.17. In terms of how statutes are written and constructed, there is no ambiguity in the use of the term **"Title."** "Title" only has one meaning in this context. That meaning is, without question, Title 12 – the entire tax chapter of the South Carolina Code. The bank tax is, of course, contained therein. There is also no ambiguity in the word "all." The General Assembly chose to apply conformity to "**all** other titles which provide for taxes administered by the Department." For the Department to somehow argue that the bank tax is not included in the definition of "all other . . . taxes administered by the Department" simply does not make sense.

The Department further ignores its own (and only) written policy on NOL deductions post 2005. As discussed in the Synovus MSJ, in SC Revenue Ruling #16-7, dated July 2016, the Department confirmed that the Use of Net Operating Losses Following a Change in Ownership is allowed for *taxpayers*. with no limitation as to the type of taxpayer. The lack of limitation as to types of taxpayers is consistent with the 2005 conformity amendment.

All parties agree based on their separate briefings that NOL carryforwards are allowed for corporations by the S.C. Code under the income tax chapter and the IRC (despite the fact that there is no explicit statute authorizing corporations to take NOLs in the South Carolina Code). If, in fact, the 2005 conformity amendment does apply to the bank tax, there is no need for a specific statute "authoriz[ing] banks to claim a deduction for NOLs when calculating bank tax liability" as suggested by the Department. *See* Department MSJ, p.7. The statute that "authorizes" the NOL carryforward deduction is found in the IRC and applicable to corporations and banks equally based on conformity. As such, if the Court agrees the 2005 conformity amendment does apply to the bank tax, there is no remaining argument that a bank should not be allowed to take an NOL carryforward deduction.

IV. Even if the Bank Tax Was Historically (pre-2005) a "Franchise Tax," NOL Carryforward Deductions Should Still be Allowed

The Department spends an inordinate amount of time attempting to convince this Court that historically the bank tax has been treated as a franchise tax and has not been considered an income tax. Synovus does not disagree, generally, that the bank tax has historically (pre-2005) been called a franchise tax. Synovus does disagree with the Department's frequent assertions that the prior treatment of the bank tax as a franchise tax based upon book income as defined by GAAP is constitutional or a valid interpretation of the statute. *See* Synovus MSJ, pp. 23-31. In addition, Synovus has provided numerous Department positions in which the bank tax and the application of what it means to be a franchise tax under the bank tax has been treated inconsistently. *See* Synovus MSJ, pp. 13-15. In fact, Synovus has provided specific examples of how the IRC has been previously applied to banks, similar to the request of Synovus to file NOL carryforward deductions. *See* Synovus MSJ, pp. 13-15; 21-23. Ultimately, however, the historical treatment of the bank tax prior to 2005 is irrelevant. All parties agree that conformity wholesale changed the tax code in South Carolina. If the 2005 conformity amendment applies to banks, as argued by Synovus, the pre-2005 treatment of the bank tax has no relevance to the post-2005 treatment.

V. The Department Makes Assumptions Regarding Book Income and GAAP Not Based in Statute, Regulation or Department Policy.

The Department argues that because the bank tax is considered to be a franchise tax it must use book income. Even if one does consider the bank tax to be a franchise tax, the Department still asks this Court to make three baseless assumptions: 1) assume a definition of "entire net income"; 2) assume that a franchise tax necessarily equates to the use of book income or income as determined under GAAP; and 3) assume that book income requires a franchise tax

taxpayer in South Carolina to use GAAP. The Department cites no statutory or regulatory authority in support of its argument – none.

A. The Department has Failed to Identify a Single Statute, Regulation or Department Policy That States a Franchise Tax, Including the Bank Tax, Must use "Book Income"

The first issue that the Department must overcome is that the bank tax states, "[a] tax is imposed upon every bank engaged in business in the State which shall be levied, collected and paid annually with respect to the entire net income of the taxpayer." *See* S.C. Code §12-11-20. The General Assembly, failed, however, to define "entire net income." In its MSJ, the Department points to occasions where "entire net income" has been described and defined in numerous ways. The Department has failed, however, to identify a single statute, regulation or Department policy that states "entire net income" is defined as "book income" or that a franchise tax must use "book income."[3]

B. The Department Lacks a Valid Basis for its Assumption that a Franchise Tax Must use "Book Income" and Apply the FASB's GAAP Principles

As discussed in Synovus' MSJ (pp. 23-26), the Department is misguided in its assumption that a franchise tax necessarily equates to the use of book income. For example, there are other states that do have a bank tax that is also considered to be a "franchise tax." None of those states use "book income" or GAAP income alone to compute the franchise tax. A diligent

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[3] The only source cited by the Department that uses the term "book income" is the report of the 2010 S.C. Taxation Realignment Commission (Department MSJ Exhibit H) and corresponding testimony of Lloyd Hendricks (Department MSJ Exhibit K). South Carolina Courts have repeatedly held that legislators and other related parties cannot testify as to legislative intent. "It is a settled principle in the interpretation of statutes that even where there is some ambiguity or some uncertainty in the language used, resort cannot be had to the opinions of legislators or of others concerned in the enactment of the law, for the purpose of ascertaining the intent of the legislature." *Kennedy v. S.C. Ret. Sys.*, 549 S.E.2d 243 (S.C. 2001) (citing *Greenville Baseball, Inc. v. Bearden*, 20 S.E.2d 813, 817 (S.C. 1942)). In this case, the TRAC was a duly appointed body created by Act of the General Assembly (2009 Act 81) tasked with delivering a report to the Senate Finance Committee. The Act mandated that the report not only analyze the competitiveness of South Carolina given its taxing regime, but also "include the text of an amendment that effectuates the recommendations." Thus, the Commission was engaged in the quintessential legislative process that the privilege above was meant to protect. For this reason, the TRAC report and associated testimony of Mr. Hendricks is inadmissible and should not be relied upon or considered by this Court.

search has concluded that there is no state that calculates its bank tax in the manner in which the Department has determined South Carolina's bank tax must be calculated. The reasons are clear: 1) the manner in which the Department would like the bank tax to be calculated is unconstitutional and 2) the method of calculation is based on antiquated reasoning. *See* Synovus MSJ, pp. 23-26. Further, the Department has not pointed to a single statute, regulation or Department policy that uses the term "book income" as defined by GAAP. In short, the Department determined that book income must be used to calculate its franchise tax without instruction from the General Assembly, without regard to the constitutionality of the decision and without any clear basis whatsoever.

In fact, the Department's brief is the first known publication by the agency in which it has ever used or mentioned the terms FASB or GAAP. This is because nothing exists that points a South Carolina taxpayer to GAAP or to a definition of "book income" - anywhere. This is problematic for a number of reasons. First, there are multiple types of book income and multiple forms of GAAP accounting. There is no way for a South Carolina taxpayer to know if it is allowed to use U.S. GAAP, U.K. GAAP, or IFRS (the International Financial Reporting Standards). In short, saying use "book income" could result in different accounting methods being applied depending on who compiles the records. Because of the inherent differences, the Department risks different tax results from different taxpayers, which is surely not the intended result.

C. The Department Lacks a Valid Basis for its Assumption that U.S. GAAP Does Not Allow an NOL Deduction

If one assumes for the sake of argument that the General Assembly did intend to require banks in South Carolina use "book income," and if one also assumes the General Assembly did

intend banks in South Carolina follow U.S. GAAP[4] standards, the Department has still made a critical error in its argument that GAAP does not allow an NOL deduction. Significantly, the Department has not cited a single GAAP section which states NOLs are not allowed. In fact, to the contrary, in its authoritative standards, the FASB does explain how to recognize NOL carryforwards under U.S. GAAP.

As stated in Synovus' MSJ, the FASB is the source of authoritative GAAP, other than guidance issued by the U.S. Securities and Exchange Commission for public companies. *See* Synovus MSJ, p. 23. As such, the FASB drafts and approves GAAP principles. The FASB no longer publishes its authoritative standards on paper. Effective for interim and annual periods ending after September 15, 2009, the FASB Accounting Standards Codification ("ASC") is the source of authoritative U.S. GAAP. The ASC is published online by the FASB through its website.[5] One can only access the FASB on-line and there are sections for which one must be a member to access. Most large accounting firms do, however, issue publically available interpretive guidance on GAAP. ASC Topic 740, Income Taxes, provides authoritative guidance regarding reporting the effects of income taxes that result from a company's activities during the current and preceding years. Its primary objective is to recognize the amount of taxes payable or refundable for the current year and the deferred tax assets and liabilities relating to the future tax consequences of events that have been recognized in a company's financial statements or tax returns. Exhibit A-1, FASB Topic 740 Excerpts. As shown by the guidance issued by the top accounting firms in the United States, ASC 740 does not state that NOL carryforwards are disallowed, as the Department would have this Court believe. The top accounting firms cite to ASC 740 and explain how an entity should report a deferred tax asset, such as an NOL

[4] Synovus asserts that the reliance on the FASB and GAAP is an unconstitutional transfer of the taxing power from the S.C. General assembly to a 3rd party. *See* Synovus MSJ, p.23-26.
[5] www.FASB.org

carryforward or an unused credit carryover, on its financial statements in compliance with the U.S. GAAP. *See* Exhibit B, ERNST & YOUNG, FINANCIAL REPORTING DEVELOPMENTS, A COMPREHENSIVE GUIDE – INCOME TAXES (2017) § 6.3, Exhibit C, DELIOTTE, A ROADMAP TO ACCOUNTING FOR INCOME TAXES (2017) § 25-16, and Exhibit D, PRICEWATERHOUSECOOPERS LLP, FINANCIAL STATEMENT PRESENTATION 2014 (2d ed. 2015) § 16.4.4, 16.7.1 for examples.

For example, Ernst & Young provides a substantial discussion of how to allocate NOL carryforwards that do not expire or have a long expiration date such as the twenty (20) year period allowed for the deduction of NOLs carried forward. *See* Exhibit B § 63. Accountants must understand how and when to take such deductions on their book income to comply with U.S. GAAP, keeping in mind the principals of consistency and transparency of the corporation's financial position and results of operations. To ignore such information would fail to provide a transparent, or accurate, picture of the financial condition of the company to investors.

The Department has a fundamental misunderstanding of what the FASB expects when calculating "book income" in a consistent and transparent manner. The Department has ignored that the FASB has provided a definition for carryforwards (Exhibit A-2), provided initial measurements for carryforwards (Exhibit A-3, ASC 740-10-30), provided instructions for the recognition of deferred tax assets including carryforwards (Exhibit A-4, ASC 740-10-55), and has provided instruction for recognition for a temporary differences (Exhibit A-5, ASC 740-10-25-29). Through ASC 740-10-30-5 (Exhibit A-3), the FASB has also provided guidance on how NOL carryforward losses should be calculated. The FASB also sets forth the requirements for disclosing income taxes specifically addressing NOLs in ASC 740-10-50-3 (Exhibit A-6) and ASC 740-10-50-9 (Exhibit A-7). Further, the Department's approach of recognizing gains

without giving credit for losses only looks at one side of the accounting equation, which is inconsistent with double entry accounting under U.S. GAAP.

VI. Conclusion

The 2005 conformity amendment is unambiguous. Conformity applies to all Chapters within Title 12 of the South Carolina Code. This includes the bank tax. As such, NOL carryforward deductions are allowed under the IRC for banks. Further, regardless of whether the bank tax was historically called a franchise tax, the Department can point to no statute, regulation or written Department policy that precludes a bank from taking an NOL carryforward deduction. As such, Synovus Bank asks this Court to make a determination that banks in South Carolina may make an NOL carryforward deduction on South Carolina taxes.

Dated this 8th day of August, 2018.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on the 8th day of August, 2018, the foregoing SYNOVUS BANK'S RESPONSE TO RESPONDENT'S MOTION FOR SUMMARY JUDGMENT has been served upon the following persons by U.S. First Class Mail, and with the correct amount of postage affixed thereto:

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South Carolina Department of Revenue
PO Box 12265
Columbia, SC 29211-9979



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Exhibit A
FASB Topic 740 Excerpts

Exhibit A-1

Topic 740, Income Taxes, of the Accounting Standards Codification ("ASC"), as published online by the Financial Accounting Standards Board ("FASB") provides authoritative guidance for the accounting for income taxes under U.S. Generally Accepted Accounting Principles (US GAAP).

Glossary
ASC 740-10-20 provides a glossary of income tax terminology used in Topic 740, and specifically defines Carryforwards as deductions or credits that cannot be utilized on the tax return during a year that may be carried forward to reduce taxable income or taxes payable in a future year. An operating loss carryforward is an excess of tax deductions over gross income in a year. The terms carryforward, operating loss carryforward, and tax credit carryforward refer to the amounts of those items, if any, reported in the tax return for the current year.

Recognition
ASC 740-10-25-29 provides that Except for the temporary differences addressed in paragraph 740-10-25-3, which shall be accounted for as provided in that paragraph, an entity shall recognize a deferred tax liability, or asset, for all temporary differences and operating loss and tax credit carryforwards in accordance with the measurement provisions of paragraph 740-10-30-5.

Initial Measurement
ASC 740-10-30-5 specifically provides that Deferred taxes shall be determined for each tax-paying component (an individual entity or group of entities that is consolidated for tax purposes) in each tax jurisdiction. That determination includes the following procedures:

a) Identify the types and amounts of existing temporary differences and the nature and amount of each type of operating loss and tax credit carryforward and the remaining length of the carryforward period.
c) Measure the total deferred tax asset for deductible temporary differences and operating loss carryforwards using the applicable tax rate.

Disclosure
ASC 740-10-50 sets forth disclosure requirements for incomes taxes and specifically addresses operating loss carryforwards as follows:

Statement of Financial Position Related Disclosures
ASC 740-10-50-3 An entity shall disclose both of the following:
a) The amounts and expiration dates of operating loss and tax credit carryforwards for tax purposes

Income Statement Related Disclosures
ASC 740-10-50-9 The significant components of income tax expense attributable to continuing operations for each year presented shall be disclosed in the financial statements or notes thereto. Those components would include, for example:
e) The benefits of operating loss carryforwards

Implementation Guidance and Illustrations
ASC 740-10-55-7 provides that Subject to certain specific exceptions identified in paragraph 740-10-25-3, a deferred tax liability is recognized for all taxable temporary differences, and a deferred tax asset is recognized for all deductible temporary differences and operating loss and tax credit carryforwards.

Exhibit A-2

Business Combination

A transaction or other event in which an acquirer obtains control of one or more businesses. Transactions sometimes referred to as true mergers or mergers of equals also are business combinations. See also Acquisition by a Not-for-Profit Entity.

Carrybacks

Deductions or credits that cannot be utilized on the tax return during a year that may be carried back to reduce taxable income or taxes payable in a prior year. An operating loss carryback is an excess of tax deductions over gross income in a year; a tax credit carryback is the amount by which tax credits available for utilization exceed statutory limitations. Different tax jurisdictions have different rules about whether excess deductions or credits may be carried back and the length of the carryback period.

Carryforwards

Deductions or credits that cannot be utilized on the tax return during a year that may be carried forward to reduce taxable income or taxes payable in a future year. An operating loss carryforward is an excess of tax deductions over gross income in a year; a tax credit carryforward is the amount by which tax credits available for utilization exceed statutory limitations. Different tax jurisdictions have different rules about whether excess deductions or credits may be carried forward and the length of the carryforward period. The terms carryforward, operating loss carryforward, and tax credit carryforward refer to the amounts of those items, if any, reported in the tax return for the current year.

Commencement Date of the Lease (Commencement Date)

Note: The following definition is Pending Content; see Transition Guidance in 842-10-65-1.

The date on which a lessor makes an underlying asset available for use by a lessee. See paragraphs 842-10-55-19 through 55-21 for implementation guidance on the commencement date.

Conduit Debt Securities

Certain limited-obligation revenue bonds, certificates of participation, or similar debt instruments issued by a state or local governmental entity for the express purpose of providing financing for a specific third party (the conduit bond obligor) that is not a part of the state or local government's financial reporting entity. Although conduit debt securities bear the name of the governmental entity that issues them, the governmental entity often has no obligation for such debt beyond the resources provided by a lease or loan agreement with the third party on whose behalf the securities are issued. Further, the conduit bond obligor is responsible for any future financial reporting requirements.

Contract

Note: The following definition is Pending Content; see Transition Guidance in 606-10-65-1.

An agreement between two or more parties that creates enforceable rights and obligations.

Contract Asset

Note: The following definition is Pending Content; see Transition Guidance in 606-10-65-1.

An entity's right to consideration in exchange for goods or services that the entity has transferred to a customer when that right is conditioned on something other than the passage of time (for example, the entity's future performance).

Exhibit A-3

August 07, 2018

740 Income Taxes
10 Overall
30 Initial Measurement

General Note: The Initial Measurement Section provides guidance on the criteria and amounts used to measure a particular item at the date of initial recognition.

General

740-10-30-1 This Section provides guidance on the measurement of total income tax expense. While most of this guidance focuses on the initial measurement of deferred tax assets and liabilities, including determining the appropriate tax rate to be used, the requirements for measuring current taxes payable or refundable are also established. This guidance also addresses the consideration and establishment of a **valuation allowance** for deferred tax assets. Requirements for entities that issue separate financial statements and are part of a group that files a consolidated tax return are also established in this Section.

> Basic Requirements

740-10-30-2 The following basic requirements are applied to the measurement of current and deferred **income taxes** at the date of the financial statements:

a. The measurement of current and deferred tax liabilities and assets is based on provisions of the enacted tax law; the effects of future changes in tax laws or rates are not anticipated.

b. The measurement of deferred tax assets is reduced, if necessary, by the amount of any tax benefits that, based on available evidence, are not expected to be realized.

740-10-30-3 Total income tax expense (or benefit) for the year is the sum of **deferred tax expense (or benefit)** and **income taxes currently payable or refundable**.

> > Deferred Tax Expense (or Benefit)

740-10-30-4 Deferred tax expense (or benefit) is the change during the year in an entity's deferred tax liabilities and assets. For deferred tax liabilities and assets recognized in a business combination or in an **acquisition by a not-for-profit entity** during the year, it is the change since the **acquisition date**. Paragraph 830-740-45-1 addresses the manner of reporting the transaction gain or loss that is included in the net change in a deferred foreign tax liability or asset when the reporting currency is the functional currency.

740-10-30-5 Deferred taxes shall be determined separately for each tax-paying component (an individual entity or group of entities that is consolidated for tax purposes) in each tax jurisdiction. That determination includes the following procedures:

a. Identify the types and amounts of existing temporary differences and the nature and amount of each type of operating loss and tax credit carryforward and the remaining length of the carryforward period.

b. Measure the total **deferred tax liability** for taxable temporary differences using the applicable tax rate (see paragraph 740-10-30-8).

c. Measure the total **deferred tax asset** for deductible temporary differences and operating loss **carryforwards** using the applicable tax rate.

d. Measure deferred tax assets for each type of tax credit carryforward.

e. Reduce deferred tax assets by a valuation allowance if, based on the weight of available evidence, it is more likely than not (a likelihood of more than 50 percent) that some portion or all of the deferred tax assets will not be realized. The valuation allowance shall be sufficient to reduce the deferred tax asset to the amount that is more likely than not to be realized.

> > Income Taxes Payable or Refundable (Current Tax Expense [or Benefit])

740-10-30-6 Income taxes payable or refundable (current tax expense [or benefit]) are determined under the recognition and measurement requirements for tax positions established in paragraph 740-10-25-2 for recognition and in this Section for measurement.

740-10-30-7 A **tax position** that meets the more-likely-than-not recognition threshold shall initially and subsequently be measured as the largest amount of tax benefit that is greater than 50 percent likely of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. Measurement of a tax position that meets the more-likely-than-not recognition threshold shall consider the amounts and probabilities of the outcomes that could be realized upon settlement using the facts, circumstances, and information available at the reporting date. As used in this Subtopic, the term *reporting date* refers to the date of the entity's most recent statement of financial position. For further explanation and illustration, see Examples 5 through 10 (paragraphs 740-10-55-99 through 55-116).

> Applicable Tax Rate Used to Measure Deferred Taxes

740-10-30-8 Paragraph 740-10-10-3 establishes that the objective is to measure a deferred tax liability or asset using the enacted tax rate(s) expected to apply to **taxable income** in the periods in which the deferred tax liability or asset is expected to be settled or realized. Deferred taxes shall not be accounted for on a discounted basis.

740-10-30-9 Under tax law with a graduated tax rate structure, if taxable income exceeds a specified amount, all taxable income is taxed, in substance, at a single flat tax rate. That tax rate shall be used for measurement of a deferred tax liability or asset by entities for which graduated tax rates are not a significant factor. Entities for which graduated tax rates are a significant factor shall measure a deferred tax liability or asset using the average graduated tax rate applicable to the amount of estimated annual taxable income in the periods in which the deferred tax liability or asset is estimated to be settled or realized. See Example 16 (paragraph 740-10-55-136) for an illustration of the determination of the average graduated tax rate. Other provisions of enacted tax laws shall be considered when determining the tax rate to apply to certain types of temporary differences and carryforwards (for example, the tax law may provide for different tax rates on ordinary income and capital gains). If there is a phased-in change in tax rates, determination of the applicable tax rate requires knowledge about when deferred tax liabilities and assets will be settled and realized.

740-10-30-10 In the U.S. federal tax jurisdiction, the applicable tax rate is the regular tax rate, and a deferred tax asset is recognized for **alternative minimum tax** credit carryforwards in accordance with the provisions of paragraph 740-10-30-5(d) through (e).

740-10-30-11 The objective established in paragraph 740-10-10-3 relating to enacted tax rate(s) expected to apply is not achieved through measurement of deferred taxes using the lower alternative minimum tax rate if an entity currently is an alternative minimum tax taxpayer and expects to always be an alternative minimum tax taxpayer. No one can predict whether an entity will always be an alternative minimum tax taxpayer. Furthermore, it would be counterintuitive if the addition of alternative minimum tax provisions to the tax law were to have the effect of reducing the amount of an entity's income tax expense for financial reporting, given that the provisions of alternative minimum tax may be either neutral or adverse but never beneficial to an entity. It also would be counterintuitive to assume that an entity would permit its alternative minimum tax credit carryforward to expire unused at the end of the life of the entity, which would have to occur if that entity was always an alternative minimum tax taxpayer. Use of the lower alternative minimum tax rate to measure an entity's deferred tax liability

Exhibit A-4

a. Application of accounting requirements for income taxes to specific situations

b. [Subparagraph superseded by Accounting Standards Update No. 2015-17]

c. Income tax related disclosures.

> > Application of Accounting Requirements for Income Taxes to Specific Situations

> > > Recognition and Measurement of Tax Positions—a Two-Step Process

740-10-55-3 The application of the requirements of this Subtopic related to tax positions requires a two-step process that separates recognition from measurement. The first step is determining whether a **tax position** has met the recognition threshold; the second step is measuring a tax position that meets the recognition threshold. The recognition threshold is met when the taxpayer (the reporting entity) concludes that, consistent with paragraphs 740-10-25-6 through 25-7 and 740-10-25-13, it is more likely than not that the taxpayer will sustain the benefit taken or expected to be taken in the tax return in a dispute with taxing authorities if the taxpayer takes the dispute to the court of last resort.

740-10-55-4 Relatively few disputes are resolved through litigation, and very few are taken to the court of last resort. Generally, the taxpayer and the taxing authority negotiate a settlement to avoid the costs and hazards of litigation. As a result, the measurement of the tax position is based on management's best judgment of the amount the taxpayer would ultimately accept in a settlement with taxing authorities.

740-10-55-5 The recognition and measurement requirements of this Subtopic related to tax positions require that the entity recognize the largest amount of benefit that is greater than 50 percent likely of being realized upon settlement.

740-10-55-6 See Examples 1 through 12 (paragraphs 740-10-55-81 through 55-123) for illustrations of this guidance.

> > > Recognition of Deferred Tax Assets and Deferred Tax Liabilities

740-10-55-7 Subject to certain specific exceptions identified in paragraph 740-10-25-3, a **deferred tax liability** is recognized for all taxable temporary differences, and a **deferred tax asset** is recognized for all deductible temporary differences and operating loss and tax credit **carryforwards**. A **valuation allowance** is recognized if it is more likely than not that some portion or all of the deferred tax asset will not be realized. See Example 12 (paragraph 740-10-55-120) for an illustration of this guidance.

740-10-55-8 To the extent that evidence about one or more sources of **taxable income** is sufficient to eliminate any need for a valuation allowance, other sources need not be considered. Detailed forecasts, projections, or other types of analyses are unnecessary if expected future taxable income is more than sufficient to realize a tax benefit.

740-10-55-9 The terms *forecast* and *projection* refer to any process by which available evidence is accumulated and evaluated for purposes of estimating whether future taxable income will be sufficient to realize a deferred tax asset. Judgment is necessary to determine how detailed or formalized that evaluation process should be. Furthermore, information about expected future taxable income is necessary only to the extent positive evidence available from other sources (see paragraph 740-10-30-18) is not sufficient to support a conclusion that a valuation allowance is not needed. The requirements of this Subtopic do not require either a financial forecast or a financial projection within the meaning of those terms in the Statements on Standards for Attestation Engagements and Related Attest Engagements Interpretations [AT], AT section 301, *Financial Forecasts and Projections* issued by the American Institute of Certified Public Accountants.

740-10-55-10 See Example 12 (paragraph 740-10-55-120) for an illustration of a situation where detailed analyses are not necessary.

740-10-55-11 See Example 13 (paragraph 740-10-55-124) for an illustration of determining a valuation allowance for deferred tax assets.

Exhibit A-5

Pending Content:

Transition Date: *(P) December 16, 2017; (N) December 16, 2018* | **Transition Guidance:** 606-10-65-1

That occurs, for example, when **revenue** on a long-term **contract** with a **customer** is recognized over time using a measure of progress to depict performance over time in accordance with the guidance in Subtopic 606-10, for financial reporting that is different from the recognition pattern used for tax purposes (for example, when the contract is completed). The temporary difference (income on the contract) is deferred income for tax purposes that becomes taxable when the contract is completed. Another example is organizational costs that are recognized as expenses when incurred for financial reporting and are deferred and deducted in a later year for tax purposes.

740-10-25-26 In both instances, there is no related, identifiable asset or liability for financial reporting, but there is a temporary difference that results from an **event** that has been recognized in the financial statements and, based on provisions in the tax law, the temporary difference will result in taxable or deductible amounts in future years.

740-10-25-27 An entity might be able to delay the future reversal of taxable temporary differences by delaying the events that give rise to those reversals, for example, by delaying the recovery of related assets or the settlement of related liabilities.

740-10-25-28 A contention that those temporary differences will never result in taxable amounts, however, would contradict the accounting assumption inherent in the statement of financial position that the reported amounts of assets and liabilities will be recovered and settled, respectively; thereby making that statement internally inconsistent. Because of that inherent accounting assumption, the only question is when, not whether, temporary differences will result in taxable amounts in future years.

740-10-25-29 Except for the temporary differences addressed in paragraph 740-10-25-3, which shall be accounted for as provided in that paragraph, an entity shall recognize a deferred tax liability or asset for all temporary differences and operating loss and tax credit carryforwards in accordance with the measurement provisions of paragraph 740-10-30-5.

> Basis Differences that Are Not Temporary Differences

740-10-25-30 Certain basis differences may not result in taxable or deductible amounts in future years when the related asset or liability for financial reporting is recovered or settled and, therefore, may not be temporary differences for which a deferred tax liability or asset is recognized. One example, depending on the provisions of the tax law, could be the excess of cash surrender value of life insurance over premiums paid. That excess is a temporary difference if the cash surrender value is expected to be recovered by surrendering the policy, but is not a temporary difference if the asset is expected to be recovered without tax consequence upon the death of the insured (if under provisions of the tax law there will be no taxable amount if the insurance policy is held until the death of the insured).

740-10-25-31 Tax-to-tax differences are not temporary differences. Recognition of a deferred tax asset for tax-to-tax differences is prohibited as tax-to-tax differences are not one of the exceptions identified in paragraph 740-10-25-3. An example of a tax-to-tax difference is an excess of the parent entity's tax basis of the stock of an acquired entity over the tax basis of the net assets of the acquired entity.

> Change in Tax Status

740-10-25-32 An entity's tax status may change from nontaxable to taxable or from taxable to nontaxable. An example is a change from a partnership to a corporation and vice versa. A deferred tax liability or asset shall be recognized for temporary differences in accordance with the requirements of this Subtopic at the date that a nontaxable entity becomes a taxable entity. A decision to classify an entity as tax exempt is a tax position.

740-10-25-33 The effect of an election for a voluntary change in tax status is recognized on the approval date or on the filing date if approval is not necessary and a change in tax status that results from a change in tax law is recognized on the enactment date.

Exhibit A-6

August 07, 2018

740 Income Taxes
10 Overall
50 Disclosure

General Note: The Disclosure Section provides guidance regarding the disclosure in the notes to financial statements. In some cases, disclosure may relate to disclosure on the face of the financial statements.

General

740-10-50-1 This Section provides guidance on the financial statement disclosure requirements relating to **income taxes** applicable to all entities.

> **Statement of Financial Position Related Disclosures**

740-10-50-2 The components of the net **deferred tax liability** or **asset** recognized in an entity's statement of financial position shall be disclosed as follows:

a. The total of all deferred tax liabilities measured in paragraph 740-10-30-5(b)

b. The total of all deferred tax assets measured in paragraph 740-10-30-5(c) through (d)

c. The total **valuation allowance** recognized for deferred tax assets determined in paragraph 740-10-30-5(e).

The net change during the year in the total valuation allowance also shall be disclosed.

740-10-50-3 An entity shall disclose both of the following:

a. The amounts and expiration dates of operating loss and tax credit **carryforwards** for tax purposes

b. Any portion of the valuation allowance for deferred tax assets for which subsequently recognized tax benefits will be credited directly to contributed capital (see paragraph 740-20-45-11).

740-10-50-4 In the **event** that a change in an entity's tax status becomes effective after year-end in Year 2 but before the financial statements for Year 1 are issued or are available to be issued (as discussed in Section 855-10-25), the entity's financial statements for Year 1 shall disclose the change in the entity's tax status for Year 2 and the effects of that change, if material.

740-10-50-5 An entity's **temporary difference** and carryforward information requires additional disclosure. The additional disclosure differs for public and nonpublic entities.

>> **Public Entities**

740-10-50-6 A **public entity** shall disclose the approximate tax effect of each type of temporary difference and carryforward that gives rise to a significant portion of deferred tax liabilities and deferred tax assets (before allocation of valuation allowances).

Exhibit A-7

740-10-50-7 See paragraph 740-10-50-16 for disclosure requirements applicable to a public entity that is not subject to income taxes.

> > Nonpublic Entities

740-10-50-8 A **nonpublic entity** shall disclose the types of significant temporary differences and carryforwards but may omit disclosure of the tax effects of each type.

> Income Statement Related Disclosures

740-10-50-9 The significant components of income tax expense attributable to continuing operations for each year presented shall be disclosed in the financial statements or notes thereto. Those components would include, for example:

a. **Current tax expense (or benefit)**

b. **Deferred tax expense (or benefit)** (exclusive of the effects of other components listed below)

c. Investment tax credits

d. Government grants (to the extent recognized as a reduction of income tax expense)

e. The benefits of operating loss carryforwards

f. Tax expense that results from allocating certain tax benefits directly to contributed capital

g. Adjustments of a deferred tax liability or asset for enacted changes in tax laws or rates or a change in the tax status of the entity

h. Adjustments of the beginning-of-the-year balance of a valuation allowance because of a change in circumstances that causes a change in judgment about the realizability of the related **deferred tax asset** in future years. For example, any acquisition-date income tax benefits or expenses recognized from changes in the acquirer's valuation allowance for its previously existing deferred tax assets as a result of a business combination (see paragraph 805-740-30-3).

740-10-50-10 The amount of **income tax expense (or benefit)** allocated to continuing operations and the amounts separately allocated to other items (in accordance with the intraperiod tax allocation provisions of paragraphs 740-20-45-2 through 45-14 and 852-740-45-3) shall be disclosed for each year for which those items are presented.

> Income Tax Expense Compared to Statutory Expectations

740-10-50-11 The reported amount of income tax expense may differ from an expected amount based on statutory rates. The following guidance establishes the disclosure requirements for such situations and differs for public and nonpublic entities.

> > Public Entities

740-10-50-12 A public entity shall disclose a reconciliation using percentages or dollar amounts of the reported amount of income tax expense attributable to continuing operations for the year to the amount of income tax expense that would result from applying domestic federal statutory tax rates to pretax income from continuing operations. The statutory tax rates shall be the regular tax rates if there are alternative tax systems. The estimated amount and the nature of each significant reconciling item shall be disclosed.

> > Nonpublic Entities

740-10-50-13 A nonpublic entity shall disclose the nature of significant reconciling items but may omit a

Exhibit B
Ernst & Young

Financial reporting developments

A comprehensive guide

Income taxes

Revised October 2017



6.3.1 Limitations on taxable temporary differences related to indefinite-lived assets as a source of future taxable income (updated October 2011 and September 2014)

In order to be a source of future taxable income to support realizability of a deferred tax asset, a taxable temporary difference must reverse in a period such that it would result in the realization of the deferred tax asset (e.g., within the 20-year loss carryforward period). Taxable temporary differences related to indefinite-lived assets, such as intangibles, land and tax-deductible goodwill (related to goodwill that is not amortized for book purposes, discussed further below) are problematic in this regard as, by their nature, they are not predicted to reverse (commonly referred to as naked credits). While such temporary differences would reverse on impairment or sale of the related assets, those events are not anticipated under ASC 740 for purposes of predicting the reversal of the related taxable temporary difference. That is, predicting reversal of a temporary difference related to an indefinite-lived intangible asset and tax-deductible goodwill for tax accounting purposes is inconsistent with the financial reporting assertion that the asset is indefinite-lived. As a result, the reversal of taxable temporary differences with respect to indefinite-lived assets and goodwill should not be considered a source of future taxable income in accordance with ASC 740. There are, however, possible exceptions:

- Held for sale – When an indefinite-lived assets, such as an intangible asset or goodwill is included within an asset group that is classified as held for sale (in accordance with ASC 360), we believe the reversal of any related temporary difference may be scheduled to coincide with the expected disposal date and looked to as a source of future taxable income in that period, as appropriate. We believe this exception to the limitation noted above is appropriate in that while the assets still qualify as indefinite-lived (intangibles and goodwill), the inclusion in a held-for-sale asset group means the group as a whole has satisfied all of the held-for-sale criteria, including the requirement that the sale of the asset (disposal group) is probable, and transfer of the asset (disposal group) is expected to qualify as a completed sale, within one year. If at any point the asset (disposal group) no longer qualifies as held for sale, the reversal of the associated temporary difference should no longer be relied on as a source of taxable income.

- Acquired in-process research and development (IPR&D) – ASC 350 specifies that intangible assets acquired in a business combination for use in a particular R&D project are considered indefinite-lived intangible assets until the completion or abandonment of the associated R&D efforts. Once the R&D efforts are completed or abandoned, the IPR&D will either be impaired or amortized over the asset life as a finite-lived intangible. Because the IPR&D (prior to the completion or abandonment of the R&D) is considered indefinite-lived for accounting purposes, we believe the most appropriate conclusion in those periods is that the reversal of a related deferred tax liability should not be used as a source of future taxable income under ASC 740. That being said, we do not object to a view (if consistently applied) that if the deferred tax liability associated with IPR&D is expected to reverse prior to the expiration of the carryforward period for a deferred tax asset, it may be utilized as a source of future taxable income to realize the deferred tax asset. That is, to the extent acquired IPR&D is expected, within the carryforward period of a deferred tax asset, to either be impaired or completion of R&D efforts will result in a finite-lived intangible asset (i.e., commercialization of a drug) that will be amortized during the carryforward period, the deferred tax liability associated with the IPR&D may be used as a source of taxable income to realize the deferred tax asset. This alternate view requires careful consideration of impairment/commercialization timing and likelihood.

- Book amortization of tax-deductible goodwill – Under ASU 2014-02, *Accounting for Goodwill*, a company that is not a PBE (as defined in ASU 2013-12, *Definition of Public Business Entity*) may elect to amortize goodwill. Because goodwill is being amortized for financial reporting purposes when a company elects to apply ASU 2014-02, any taxable temporary difference associated with the first component of goodwill would be expected to reverse. As a result, a company that applies ASU 2014-02

should consider the taxable temporary differences associated with the first component of goodwill as a source of taxable income when evaluating whether its deferred tax assets are more likely than not to be realized. Further, in the period a company adopts ASU 2014-02, a company may reverse all, or a portion, of its valuation allowance. There are no transitional provisions in ASU 2014-02. As a result, a company should recognize the change in the valuation allowance due to the adoption of ASU 2014-02 as an income tax benefit included in continuing operations in the period of adoption.

- Tax loss carryforwards that do not expire – In some jurisdictions, tax loss carryforwards do not expire. However, a deferred tax asset is not realizable (in accordance with ASC 740) simply because it can be carried forward indefinitely. Instead, the deferred tax asset is realizable only to the extent it can be sustained through the existence of sufficient taxable income of the appropriate character within the carryback or carryforward period available under the tax law (i.e., the four sources of taxable income). Questions often arise as to whether a deferred tax liability related to an indefinite-lived intangible asset (including tax-deductible goodwill) may be used as a source of income to realize a deferred tax asset relating to a loss carryforward that does not expire. Because the deferred tax asset that can be carried forward indefinitely under the tax code is being assessed for realizability, we believe it is most appropriate to *not* consider future taxable income associated with an indefinite-lived intangible asset (including goodwill) as the timing of recognition of the necessary taxable income cannot be predicted. That is, despite both the loss carryforward and the taxable temporary difference seeming to have "infinite" or "indefinite" lives, we believe taxable income associated with the reversal of the temporary difference would not be predicted to support the realization of the deferred tax asset. However, we are aware that in practice an alternative view exists (i.e., a deferred tax asset that does not expire may be assessed as realizable when it is fully offset by a deferred tax liability that relates to an indefinite-lived intangible asset in the same jurisdiction and of the same character), and we have not objected to such a view so long as it is applied on a consistent basis.

6.3.2 Operating loss and tax credit carrybacks (updated September 2013 and September 2015)

A company in a net operating loss position that has deductible temporary differences should consider whether such amounts could be carried back to offset taxable income in prior years in determining the need for a valuation allowance.

Illustration 6-3

In 20X1, an entity generates deductible temporary differences of $300. The deductible temporary differences are expected to reverse in 20X3 (i.e., become currently deductible in 20X3). That is, assuming taxable income exclusive of reversing temporary differences is break even in 20X3, the deductible temporary differences will result in net operating losses in 20X3. No taxable temporary differences exist.

After considering all four sources of taxable income, the entity does not believe the deductible temporary differences are realizable, and a valuation allowance is properly recognized as of 31 December 20X1.

At the end of 20X2, the deductible temporary differences remain unchanged, and the entity generates taxable income of $500 during the year. Further, at 31 December 20X2, the entity has no existing taxable temporary differences, does not expect taxable income exclusive of reversing temporary differences in future years[a] and has no tax planning strategies. The carryback period under the tax law is one year. At 31 December 20X2, the entity reassesses the previously recorded valuation allowance related to the deductible temporary difference that will reverse in 20X3. The $300 of losses that will be generated in 20X3 by the reversal of existing deductible temporary differences are available to be carried back to taxable income in 20X2.

After considering that the deductible temporary differences will reverse in 20X3 and taxable income exists in a carryback period under the tax law, the entity determines that taxable income of $500 in 20X2 allows for realization of the deductible temporary differences that will reverse in 20X3. The benefit of the deductible temporary difference (i.e., a reversal of the valuation allowance) of $300 is recognized in 20X2. In making this assessment, the reversal pattern of temporary differences must be considered together with the statutory tax rules regarding loss carrybacks. In more complicated scenarios, this analysis would require extensive scheduling, including consideration of related carryforward and carryback periods.

[a] While the entity may currently expect that they will generate losses in future years exclusive of the reversal of existing temporary differences, considering those losses is prohibited (ASC 740-10-25-38).

Illustration 6-4

Assume a company in a loss position has a deductible temporary difference of $500 at 31 December 20X3. Further, assume that the taxable loss for 20X3 was carried back and a receivable recognized (i.e., current recoverable taxes), leaving the following amounts of taxable income in carryback years available (a two-year carryback period (current year and prior year) is allowed under the tax law):

20X0	$ 400
20X1	800
20X2	200

Assuming additional taxable income is not expected in 20X4 and that the entire $500 deductible temporary difference is expected to reverse in 20X4, only $200 of the carryback potential can be considered as a source of taxable income for purposes of determining the need for a valuation allowance (i.e., when it reverses in 20X4, the deductible temporary difference could be carried back no further than 20X2). In the absence of appropriate other positive evidence, a valuation allowance would be established at 31 December 20X3 for $300 of the temporary difference ($120 using a 40% tax rate).

This determination also should be made on an individual basis for each significant taxing jurisdiction because the loss carryback rules vary among tax jurisdictions. For example, many states in the US do not allow the carryback of operating losses and allow such losses only to be carried forward. In addition, the character of the loss (i.e., capital loss or ordinary loss) must be considered in determining the carryback benefit.

If a company plans to realize a deferred tax asset (i.e., NOL or tax credit) through carryback, it would be measured using the tax law and rates for the year in which the benefit is expected to be carried back, presuming the refund would be based on the prior-year tax rate.

6.3.2.1 Availability of tax credits

The future reversal of deductible temporary differences that can be carried back to prior years may result in the re-creation of previously utilized tax credits. For example, if previously used tax credits become available as a result of a loss carryback and those tax credits would expire unused after application of the loss carryback, a valuation allowance may be necessary for the deferred tax assets relating to the deductible temporary differences equal to the amount of re-created tax credits that will require a valuation allowance. In other words, although the carryback of the current-period deductible temporary difference would result in the realization of those deferred tax assets, the previously realized tax credits would no longer be realizable. This situation results in the same tax position as deeming it to be more likely than not that all or a portion of the current-period deductible temporary differences will not be realized and recognizing a valuation allowance in the current period on those deferred tax assets. See Section 6.3.3, *Tax benefit substitution versus realization*, for a related discussion.

6.3.3 Tax benefit substitution vs. realization

Excerpt from Accounting Standards Codification

Income Taxes – Overall

Implementation Guidance and Illustrations

740-10-55-37

An operating loss or tax credit carryforward from a prior year (for which the deferred tax asset was offset by a valuation allowance) may sometimes reduce taxable income and taxes payable that are attributable to certain revenues or gains that the tax law requires be included in taxable income for the year that cash is received. For financial reporting, however, there may have been no revenue or gain and a liability is recognized for the cash received. Future sacrifices to settle the liability will result in deductible amounts in future years. Under those circumstances, the reduction in taxable income and taxes payable from utilization of the operating loss or tax credit carryforward gives no cause for recognition of a tax benefit because, in effect, the operating loss or tax credit carryforward has been replaced by temporary differences that will result in deductible amounts when a nontax liability is settled in future years. The requirements for recognition of a tax benefit for deductible temporary differences and for operating loss carryforwards are the same, and the manner of reporting the eventual tax benefit recognized (that is, in income or as required by paragraph 740-20-45-3) is not affected by the intervening transaction reported for tax purposes. Example 20 (see paragraph 740-10-55-156) illustrates recognition of the tax benefit of an operating loss in the loss year and in subsequent carryforward years when a valuation allowance is necessary in the loss year.

An operating loss or tax credit carryforward from a prior year (for which the related deferred tax asset was reduced by a valuation allowance) may sometimes reduce taxable income and taxes payable that are attributable to revenues that are taxable in the year received but deferred for financial reporting purposes (e.g., the gain from a sale-leaseback transaction recognized currently for income tax purposes while deferred and amortized for financial reporting purposes under the guidance in ASC 840). In this case, the deferred gain for financial reporting purposes would result in a deductible difference (i.e., rent expense that will be incurred in the future). The reduction in taxable income and taxes payable from utilization of the operating loss or tax credit carryforward would not result in the recognition of a tax benefit because, in essence, the operating loss or tax credit carryforward has been replaced by a deductible temporary difference. This is commonly referred to as substitution, because the recognition requirements are the same for both deductible temporary differences and operating loss carryforwards. In other words, simply converting net operating loss carryforwards into a deferred tax asset is not the realization of that asset. In the example of a tax-planning strategy to sell and lease back an asset to accelerate taxable temporary difference reversals to offset an operating loss carryforward that would otherwise expire, it is important to remember that such a strategy does not result in the recognition of a tax benefit because the operating loss carryforward is essentially replaced by a deductible temporary difference (related to the deferred gain on the sale-leaseback transaction that is accounted for under ASC 840) that also would have to be assessed for realizability. ASC 740-10-55-37 states the manner of reporting the eventual tax benefit recognized is not affected by intervening transactions reported for tax purposes.

The above discussion of the interaction of operating losses and deductible temporary differences also should be considered when evaluating the effectiveness of tax-planning strategies (e.g., a sale-leaseback transaction that is accounted for under ASC 840). As illustrated by the example that follows, a sale-leaseback transaction that is accounted for under ASC 840 could be used to "freshen" an operating loss that would otherwise have expired unused by converting the operating loss to future deductible temporary differences. Recognition of the deferred tax asset related to the deductible temporary difference (i.e., the deferred gain from the sale-leaseback transaction that is accounted for under 840)

would be evaluated like any other deductible temporary difference. In this regard, the freshening of the net operating loss carryforward coupled with other tax-planning strategies or prospects as to future taxable income may, in certain cases, permit the reduction of the deferred tax asset valuation allowance.

The following example, from ASC 740-10-55-156 through ASC 740-10-55-158, illustrates the interaction of operating loss carryforwards and deductible temporary differences that will result in net deductible amounts in future years.

Illustration 6-5

Note: This example is updated for the amendments from ASU 2016-02.

Assume the financial loss and the loss reported on the tax return are the same in years 1 and 2 except that a gain of $2,500 from a transaction that is a sale for tax purposes but does not meet the sale recognition criteria for financial reporting purposes is the only difference between pretax financial income and taxable income in year 2.

		Financial income	Taxable income
Year 1:	Income (loss) from operations	$(4,000)	$(4,000)
Year 2:	Income (loss) from operations	$ –	$ –
	Taxable gain on sale		2,500
	Taxable income before loss carryforward		2,500
	Partial utilization of loss carryforward from year 1		(2,500)
	Taxable income		$ –

The $4,000 operating loss carryforward at the end of year 1 is reduced to $1,500 at the end of year 2 because $2,500 of it is used to reduce taxable income. The $2,500 reduction in the loss carryforward becomes $2,500 of deductible temporary differences that will reverse and result in future tax deductions when the sale occurs (i.e., control of the asset transfers to the buyer-lessor). The entity has no deferred tax liability to be offset by those future tax deductions, the future tax deductions cannot be realized by loss carryback because no taxes have been paid, and the entity has had pretax losses for financial reporting since inception. Unless positive evidence exists that is sufficient to overcome the negative evidence associated with those losses, a valuation allowance is recognized at the end of year 2 for the full amount of the deferred tax asset related to the $2,500 of deductible temporary differences and the remaining $1,500 of operating loss carryforward.

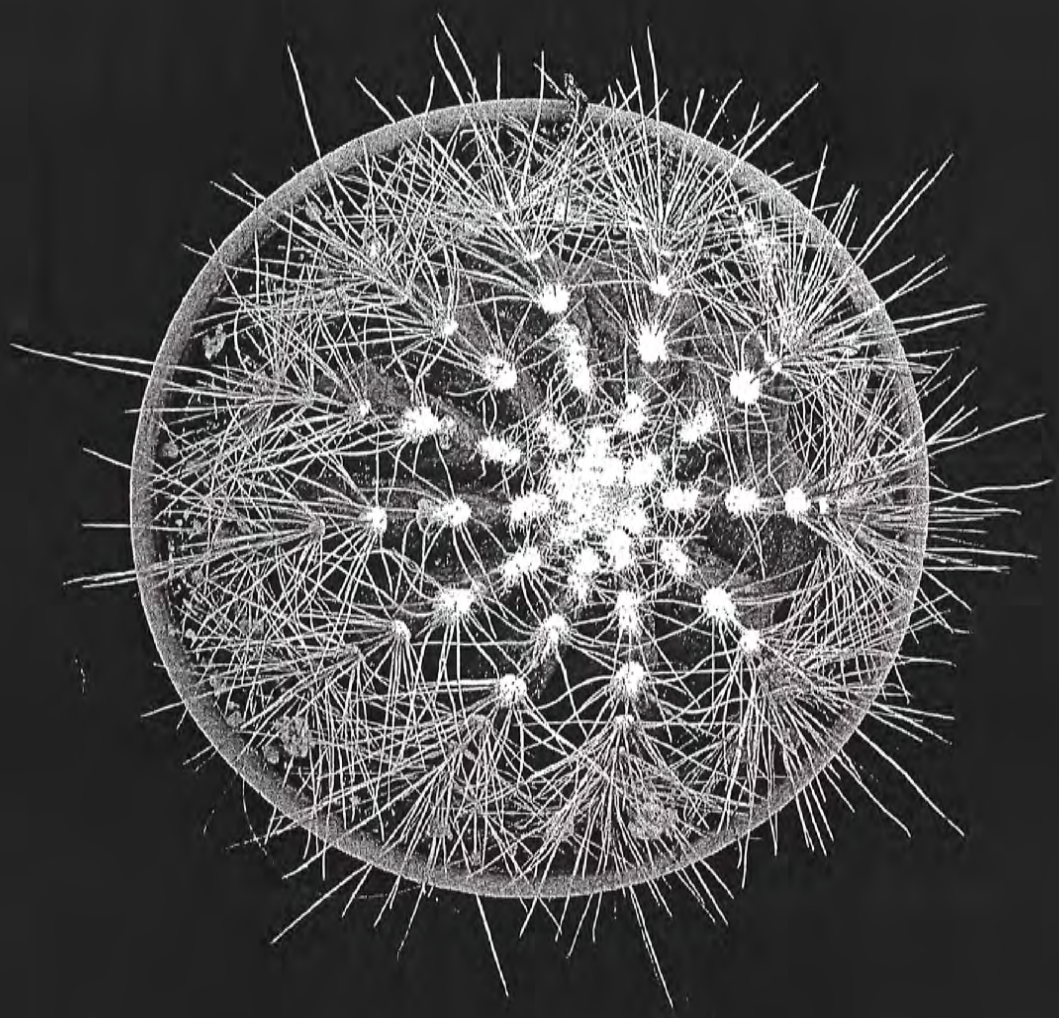
6.4 Tax-planning strategies

ASC 740-10-30-17 requires consideration of all possible sources of taxable income and other available evidence when assessing the need for and amount of a valuation allowance. A tax-planning strategy represents a possible source of positive evidence that must be considered when assessing the need for a valuation allowance. Various actions, elections and strategies are implicit in estimates of expected future taxable income. In that regard, not all tax-planning efforts that a company may ordinarily take would necessarily constitute tax-planning strategies under ASC 740-10-30-19. However, a qualified tax-planning strategy is an action (including an election for tax purposes) that:

1. **Is prudent and feasible.** Implementation of the strategy must be primarily within the control of management. Management must have the ability to implement the strategy and expect to do so unless the need is eliminated in future years. If an action is not considered prudent, management probably would not undertake it, and if the action is considered not feasible, management would not have the ability to do it.

Exhibit C
Deloitte

Deloitte.



A Roadmap to Accounting for Income Taxes

2017

ASC 740-10 (continued)

25-10 As required by paragraph 740-10-25-8(b) an entity shall recognize the benefit of a tax position when it is effectively settled. An entity shall evaluate all of the following conditions when determining effective settlement:

a. The taxing authority has completed its examination procedures including all appeals and administrative reviews that the taxing authority is required and expected to perform for the tax position.

b. The entity does not intend to appeal or litigate any aspect of the tax position included in the completed examination.

c. It is remote that the taxing authority would examine or reexamine any aspect of the tax position. In making this assessment management shall consider the taxing authority's policy on reopening closed examinations and the specific facts and circumstances of the tax position. Management shall presume the relevant taxing authority has full knowledge of all relevant information in making the assessment on whether the taxing authority would reopen a previously closed examination.

25-11 In the tax years under examination, a tax position does not need to be specifically reviewed or examined by the taxing authority to be considered effectively settled through examination. Effective settlement of a position subject to an examination does not result in effective settlement of similar or identical tax positions in periods that have not been examined. [FIN 48, paragraph 10A]

25-12 An entity may obtain information during the examination process that enables that entity to change its assessment of the technical merits of a tax position or of similar tax positions taken in other periods. However, the effectively settled conditions in paragraph 740-10-25-10 do not provide any basis for the entity to change its assessment of the technical merits of any tax position in other periods. [FIN 48, paragraph 10C]

25-13 The appropriate unit of account for determining what constitutes an individual tax position, and whether the more-likely-than-not recognition threshold is met for a tax position, is a matter of judgment based on the individual facts and circumstances of that position evaluated in light of all available evidence. The determination of the unit of account to be used shall consider the manner in which the entity prepares and supports its income tax return and the approach the entity anticipates the taxing authority will take during an examination. [FIN 48, paragraph 5] Because the individual facts and circumstances of a tax position and of an entity taking that position will determine the appropriate unit of account, a single defined unit of account would not be applicable to all situations. [FIN 48, paragraph B13]

25-14 Subsequent recognition shall be based on management's best judgment given the facts, circumstances, and information available at the reporting date. A tax position need not be legally extinguished and its resolution need not be certain to subsequently recognize the position. Subsequent changes in judgment that lead to changes in recognition shall result from the evaluation of new information and not from a new evaluation or new interpretation by management of information that was available in a previous financial reporting period. [FIN 48, paragraph 12] See Sections 740-10-35 and 740-10-40 for guidance on changes in judgment leading to derecognition of and measurement changes for a tax position.

25-15 A change in judgment that results in subsequent recognition, derecognition, or change in measurement of a tax position taken in a prior annual period (including any related interest and penalties) shall be recognized as a discrete item in the period in which the change occurs. [FIN 48, paragraph 13] Paragraph 740-270-35-6 addresses the different accounting required for such changes in a prior interim period within the same fiscal year.

25-16 The amount of benefit recognized in the statement of financial position may differ from the amount taken or expected to be taken in a tax return for the current year. These differences represent unrecognized tax benefits. A liability is created (or the amount of a net operating loss carryforward or amount refundable is reduced) for an unrecognized tax benefit because it represents an entity's potential future obligation to the taxing authority for a tax position that was not recognized under the requirements of this Subtopic. [FIN 48, paragraph 17]

25-17 A tax position recognized in the financial statements may also affect the tax bases of assets or liabilities and thereby change or create temporary differences. A taxable and deductible temporary difference is a difference between the reported amount of an item in the financial statements and the tax basis of an item as determined by applying this Subtopic's recognition threshold and measurement provisions for tax positions. [FIN 48, paragraph 18] See paragraph 740-10-30-7 for measurement requirements.

ASC 740-10 (continued)

Deferred Tax Accounts Not Related to an Asset or Liability

45-9 A deferred tax liability or asset that is not related to an asset or liability for financial reporting (see paragraphs 740-10-25-24 through 25-26), including deferred tax assets related to carryforwards, shall be classified according to the expected reversal date of the temporary difference. [FAS 109, paragraph 41]

Pending Content (Transition Guidance: ASC 740-10-65-4)

45-9 Editor's Note: *Paragraph 740-10-45-9 will be superseded upon transition, together with its heading:*

Deferred Tax Accounts Not Related to an Asset or Liability

Paragraph superseded by Accounting Standards Update No. 2015-17.

45-10 A deferred tax liability or asset for a temporary difference may not be related to an asset or liability because there is no associated asset or liability or reduction of an associated asset or liability will not cause the temporary difference to reverse. The classification required by the preceding paragraph disregards any additional temporary differences that may arise and is based on the criteria used for classifying other assets and liabilities. [FAS 37, paragraph 4]

Pending Content (Transition Guidance: ASC 740-10-65-4)

45-10 Paragraph superseded by Accounting Standards Update No. 2015-17.

Tax Accounts, Other Than Deferred

Unrecognized Tax Benefits

45-10A Except as indicated in paragraphs 740-10-45-10B and 740-10-45-12, an unrecognized tax benefit, or a portion of an unrecognized tax benefit, shall be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. [ASU 2013-11, paragraph 2]

45-10B To the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit shall be presented in the financial statements as a liability and shall not be combined with deferred tax assets. The assessment of whether a deferred tax asset is available is based on the unrecognized tax benefit and deferred tax asset that exist at the reporting date and shall be made presuming disallowance of the tax position at the reporting date. [ASU 2013-11, paragraph 2]

45-11 An entity that presents a classified statement of financial position shall classify an unrecognized tax benefit that is presented as a liability in accordance with paragraphs 740-10-45-10A through 45-10B as a current liability to the extent the entity anticipates payment (or receipt) of cash within one year or the operating cycle, if longer. [ASU 2013-11, paragraph 2]

45-12 An unrecognized tax benefit presented as a liability shall not be classified as a deferred tax liability unless it arises from a taxable temporary difference. [FIN 48, paragraph 18] Paragraph 740-10-25-17 explains how the recognition and measurement of a tax position may affect the calculation of a temporary difference.

Offsetting

45-13 The offset of cash or other assets against the tax liability or other amounts owing to governmental bodies is not acceptable except as noted in paragraphs 210-20-45-6 and 740-10-45-10A through 45-10B. [APB 10, paragraph 7]

Exhibit D
PricewaterhouseCooper

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Financial statement presentation

2014

Second edition, June 2015

pwc

Chapter 16: Income taxes

of significant temporary difference and tax carryforward that comprises deferred tax assets and liabilities (before allocation of valuation allowances). ASC 740 does not impose a "bright line" for determining which types of temporary differences are significant and, therefore, this assessment requires judgment. As a practical benchmark, we believe that a particular type of temporary difference should be considered significant if its deferred tax effects equal five percent or more of either total deferred tax assets (before valuation allowance) or total deferred tax liabilities, whichever is greater.

A private company is not required to provide numeric information regarding the types of temporary differences and carryforwards that give rise to significant deferred tax assets and liabilities. However, a private company must disclose the nature of significant items.

16.4.4 *The amounts and expiration dates of loss and tax credit carryforwards*

Reporting entities should disclose the nature and potential effects of any tax law provision that might limit the availability or utilization of loss or tax credit carryforward amounts (e.g., limitations caused by changes in ownership).

In the United States, for both regular tax and AMT, there is an annual limitation under IRC Section 382 on the use of loss and other carryforwards, and of certain built-in losses. The annual limitation exists if there has been a cumulative change in ownership of more than 50 percent within a three-year period.

Triggering the annual limitation could result in a permanent loss of potential tax benefits (e.g., when an entire carryforward cannot be utilized prior to its expiration because of the annual limitation). In this situation, the reporting entity should reduce the recorded deferred tax asset and the amount of carryforward disclosed. It may also be appropriate for reporting entities to disclose the fact that an annual limitation exists so that financial statement users understand the timeframe over which carryforwards can be used and the effect the limitation has on cash taxes each year.

The rules for computing a change in ownership are complex. It is possible for the limitation to apply to an entity that is not an acquired entity in a business combination. The limitation could be triggered, for example, by exercises of stock options, conversions of convertible debt or preferred stock, new common stock offerings, or treasury share purchases.

Unless the prospect of such a change in ownership is remote, we recommend disclosing the potential limitation in all circumstances by means of a brief statement such as: "If certain substantial changes in the entity's ownership occur, there would be an annual limitation on the amount of the carryforward(s) that can be utilized."

If there are circumstances that make the change in ownership reasonably possible in the foreseeable future, a general description of those circumstances

EXAMPLE 16-5

Disclosure of tax holidays

Germany grants FSP Corp a ten-year tax holiday beginning in 20X4. During the holiday, FSP Corp will be 100% exempt from taxation for the first five years, followed by five years at a reduced tax rate of 12.5%. The current statutory rate in Germany is 25%.

What should FSP Corp disclose in its 20X4 financial statements?

Analysis

FSP Corp should provide disclosure that is similar to the following to comply with the SEC disclosure requirements:

"In 20X4, we were granted an income tax holiday for our manufacturing facility in Germany. The tax holiday allows for tax-free operations through December 31, 20X9, followed by operations at a reduced income tax rate of 12.5% on the profits generated through December 31, 20Y4, with a return to the full statutory rate of 25% for periods thereafter. As a result of the tax holiday in Germany, our net income was higher by $2.0 million ($0.02 per share) for the year ended December 31, 20X4."

This type of disclosure should cover all income statement periods presented. However, for purposes of this illustration, the example footnote only covers one year.

16.7 *Presentation and disclosure for uncertain tax positions*

Uncertain tax positions represent tax positions taken that are subject to significant and varied interpretations of applicable tax law. ASC 740 is applicable to all income tax positions that were included on previously filed tax returns, as well as those that are expected to be included on returns that have not yet been filed (e.g., amended returns or refund claims that have not yet been filed). The timing of the filing of a tax return is irrelevant, as long as a tax position taken or expected to be taken is filed or will be filed on an original or amended return.

16.7.1 Presentation of unrecognized tax benefits

In July 2013, the FASB issued ASU 2013-11, *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*, to provide guidance on the presentation of unrecognized tax benefits on the balance sheet. The accounting standard — codified as ASC 740-10-45-10A and 45-10B — clarifies the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists.

The guidance requires reporting entities to present an unrecognized tax benefit (or a portion thereof) in the balance sheet as a reduction to a deferred tax asset for a net operating loss carryforward or a tax credit carryforward. This requirement does not apply when the carryforward attribute is not available (under the jurisdictional tax law) to settle the additional income taxes that would result from the disallowance of a tax position. In such a case, the unrecognized tax benefit should be presented as a liability. This liability should not be classified as a deferred tax liability unless it arises from a taxable temporary difference.

Reporting entities that present classified balance sheets should present a liability-classified unrecognized tax benefit as a current liability if they anticipate payment of cash within one year. Otherwise, such amounts should be presented as noncurrent liabilities.

16.7.2 *Disclosure requirements for uncertain tax positions*

Uncertain tax position assessments often require judgment. Management can, at times, be concerned with including information in the financial statements that could be helpful to the taxing authority examining its tax positions. ASC 740 addresses this tension in part by requiring a qualitative discussion of only those positions where a change is reasonably possible within the next 12 months. Further, for public entities as defined in ASC 740, the quantitative rollforward of unrecognized tax benefits is prepared on a worldwide aggregated basis. The specific disclosure requirements are discussed in the following sections.

Refer also to ASC 740-10-55-217 for an illustrative disclosure about uncertainty in income taxes.

Question 16-4

For what periods should unrecognized tax benefit disclosures be provided for purposes of the annual financial statements?

PwC response

Reporting entities should provide disclosures as of the end of each annual reporting period presented in the financial statements.

To meet this requirement, we believe disclosures related to historical information reflected in the financial statements (e.g., the tabular reconciliation of unrecognized tax benefits discussed in FSP 16.7.4) should cover the years for which income statements are presented.

For disclosures that are primarily forward-looking in nature (e.g., the total amount of unrecognized tax benefit that, if recognized, would affect the effective tax rate discussed in FSP 16.7.5), we believe it is appropriate to present this information as of the most recent balance sheet date only. However, in practice, some reporting entities have taken an alternative point of view that the requirements related to unrecognized tax benefits should be presented for all

STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

Synovus Bank, Petitioner, vs. South Carolina Department of Revenue, Respondent.	)	DOCKET NO. 17-ALJ-17-0418-CC **RESPONDENT'S RESPONSE TO PETITIONER'S MOTION FOR SUMMARY JUDGMENT**

The Respondent, South Carolina Department of Revenue (the "Department" or "DOR") by and through the undersigned counsel, respectfully responds to Petitioner's Motion for Summary Judgment filed July 25, 2018 by Synovus Bank ("Synovus" or "Taxpayer") regarding the above-captioned matter ("Synovus' motion"). For the reasons set forth below, the South Carolina Administrative Law Court (the "ALC" or "Court") should grant the Department's Motion for Summary Judgment ("Department's motion") because the material facts not in dispute demonstrate that Synovus is not entitled to deduct net operating loss carryforwards when computing its bank tax liability.

MATERIAL FACTS NOT IN DISPUTE

For the purposes of this Response, the parties have filed a joint Stipulation of Facts that are not in dispute. The Department incorporates by reference those Stipulation of Facts as well as the Department's Facts stated in the Department's motion as if set forth fully herein.

ARGUMENTS

I. SYNOVUS IS NOT ENTITLED TO DEDUCT NET OPERATING LOSS CARRYFORWARDS IN COMPUTING ITS BANK TAX LIABILITY IN SOUTH CAROLINA.

A. Whether Synovus can deduct NOL carryforwards is not a question of equity.

Despite Synovus' statement to the contrary, a determination of whether or not NOL carryforwards can be taken by a bank in South Carolina is not a question of equity that should be construed in favor of Synovus. As argued in the Department's motion, South Carolina law is well-settled that tax deductions are a matter of legislative grace and that a taxpayer may not claim a tax deduction unless the governing law specifically allows it. *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). "In order for a taxpayer to avail himself of a deduction in the calculation of a tax, the taxpayer must bring himself squarely within the terms of that statute authorizing such deduction." *AVCO Corp. v. Wasson*, 267 S.C. 581, 588, 230 S.E.2d 614, 617 (1976).

Moreover, under standard rules of statutory construction, a tax exemption statute must be given its plain, ordinary meaning. *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 Supreme Court has repeatedly noted that where a statute allowing a deduction is ambiguous, the statute is 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. Because NOL deductions exist only as creatures of statute, any statute or statutory scheme purporting to grant NOL deductions must be construed strictly against Synovus.

B. The 2005 amendments to the conformity provisions did not grant banks the authority to utilize a net operating loss carryforward deduction.

As discussed in the Department's motion, the 1985 IRC conformity provisions do not apply to the bank tax. Nevertheless, Synovus contends that the amendment to section 12-6-50 in 2005 extended the applicability of the 1985 IRC conformity provisions to the bank tax. However, the 2005 amendment neither extended the applicability of the IRC conformity provisions in general, nor subsection 12-6-50(6) specifically, to the bank tax.

Synovus erroneously argues that amending the introduction of section 12-6-50 from "[f]or purposes of this chapter" to "[f]or purposes of this title" extends the applicability of section 12-6-50, including the NOL carryback provision of subsection 12-6-50(6), to the bank tax. Essentially, Synovus argues that the 2005 amendment expanded the scope of the IRC conformity provisions in section 12-6-50 from only Chapter 6 regarding income taxes to other chapters in Title 12 including Chapter 11 regarding the bank tax.

However, Synovus' argument assumes that the General Assembly adopted the IRC for bank tax purposes, which it did not. For its argument to prevail, Synovus must prove that the General Assembly adopted the IRC for bank tax purposes. Only if the IRC conformity provisions apply to the bank tax would the non-adoption statute of section 12-6-50, and specifically subsection 12-6-50(6) that mentions NOLs, be applicable to banks. Although the bank tax is included in Title 12, the South Carolina statutory framework does not adopt the IRC for purposes of the bank tax.

As explained in the Department's motion, the General Assembly adopted the IRC only for the corporate income tax, S.C. Code Ann. § 12-6-580 (2014), and for certain other taxes, S.C. Code Ann. §§ 12-6-560, 12-6-590, 12-6-600, 12-6-610, 12-6-630 (2014). Importantly, banks are specifically excluded from sections 12-6-580 and 12-6-630 and do not fit into the other categories of taxpayers for which the IRC was adopted. *See* S.C. Code Ann. § 12-6-550(1) (2014). In fact, the plain language of amended section 12-6-50 acknowledges that it does not apply to all taxes administered by the Department because it included the limiting language stating "except as otherwise specifically provided." Here, the General Assembly specifically provided that banks were excluded from the income taxes to which it applied the IRC.[1] Because the General Assembly did not adopt the IRC for banks and it had a reason to change the language in section 12-6-50 that did not affect the bank tax, the 2005 amendment to section 12-6-50 did not extend section 12-6-50(6) to the bank tax.

Banks do not fall into any of the categories of taxpayers for which the General Assembly adopted the IRC. The IRC conformity provisions of Chapter 6 are not applicable to banks, and hence, banks do not use the IRC to determine their South Carolina tax base. Accordingly, this court should reject Synovus' argument that the IRC conformity provisions in Chapter 6 (including §12-6-50(6)) allow it to deduct NOLs.

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[1] Further, the General Assembly had a reason to change the provision's language to "[f]or purposes of this title." In many chapters other than Chapter 6 in Title 12, it had used the term "Internal Revenue Code" referring to other taxes administered by the Department. *See e.g.*, S.C. Code Ann. § 12-13-20 (2014) (using the term "Internal Revenue Code" when addressing the South Carolina income tax on building and loan associations).

C. Synovus' use of NOL deductions on its previous tax filings does not render such deductions permissible under South Carolina law.

Synovus next asserts that even if "the application of book income to banks is found to be constitutional, the [Department] still has no reason to deny NOL carryforward deductions." As support for this assertion, Synovus points to the affidavit of Mark Robinson to establish that it "is possible to take an NOL deduction under the book income form of accounting." (Synovus' motion, p. 27; Ex. 2 of motion.) However, Synovus' use of NOL deductions on its tax filings does not indicate that such deductions are allowed under South Carolina law. As discussed at length in this response and the Department's motion, since the General Assembly adopted the bank tax in 1937, banks have had no statutory authority to deduct NOLs on their South Carolina bank tax returns. This has not changed over the decades. The provisions of Chapter 11 of Title 12 regarding the bank tax have not changed in any meaningful way since 1937 that would allow a bank to deduct NOLs, and the IRC conformity provisions adopted into Chapter 6 of Title 12 do not apply to banks.

D. The General Assembly Did Not Adopt All of Subchapter H of the Internal Revenue Code. Rather, it adopted only IRC § 584, which does not permit banks to deduct NOLs.

In 1985, the General Assembly established a partially adopted IRC as the starting point for calculating the South Carolina corporate income tax and certain other taxes, but it chose not to establish the IRC as the starting point for calculating the bank tax. Synovus incorrectly asserts that as part of the 1985 IRC conformity provisions the General Assembly adopted the entirety of Subchapter H of the IRC, which is titled "Banking Institution," and that IRC § 584, which was adopted in South Carolina, permits banks to deduct NOLs.

Subchapter H of the IRC includes IRC sections 581-582, 584-585, 591, 593-594, and 597, but, in the 1985 conformity provisions, the General Assembly did not adopt IRC sections 581, 582,

and 585 through 597.[2] Act No. 101, 106th Session § 12(h) (1985); *see also* S.C. Code Ann. § 12-6-50(9) (2014). Therefore, when reading sections 12-6-40 and 12-6-50 together, the General Assembly adopted only IRC § 584 for IRC conformity purposes, not the entirety of Subchapter H.

The only provision from Subchapter H of the IRC that the General Assembly adopted was section 584 regarding common trust funds. The IRC defines a "common trust fund" as follows:

> [A] fund maintained by a bank
> (1) exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank in its capacity:
> (A) as a trustee, executor, administrator, or guardian, or
> (B) as a custodian of accounts
>
> ***
>
> and
> (2) in conformity with the rules and regulations, prevailing from time to time, of the Board of Governors of the Federal Reserve System or the Comptroller of the Currency pertaining to the collective investment of trust funds by national banks.

I.R.C. § 584(a) (West 2017).

A common trust fund is not a bank. The IRC defines a common trust fund differently than it defines a bank. *Compare* IRC § 584(a) (West 2017) (defining a common trust fund) *and* IRC § 581 (West 2017) (defining a bank). A common trust fund is a "fund maintained by a bank. It is not a bank itself. *See* IRC § 584(a) (West 2017). A common trust fund is a collective investment vehicle in which a bank acts as a trustee, custodian, or similar position for the benefit of the collective investment vehicle. *See* IRC § 584(a)(1) (West 2017). A common trust fund is not considered a corporation. IRC § 584(b) (West 2017). Common trust funds are not subject to

[2]Today, South Carolina law has also adopted I.R.C. § 597; however, it is not relevant to this matter. *See* S.C. Code Ann. § 12-6-50(9) (2014).

federal and state income tax; like a partnership, each participant in the common trust fund includes its own share of the tax attributes of the common trust fund on its own tax return. *See* IRC §§ 584(c), (d), (g) (West 2017). Finally, a common trust fund is a separate entity from the bank, which acts as the fund's trustee or in a similar position, and common trust funds issue their own audited financial statements that are separate and apart from the respective bank's financial statements.[3]

Despite the fact that banks are *entirely* different from common trust funds and the General Assembly included only the IRC statute concerning common trust funds in the South Carolina partially adopted IRC, Synovus erroneously asserts that IRC § 584(g) allows NOL deductions for banks while denying them for common trust funds. That subsection is wholly irrelevant to banks. *See* IRC § 584(g) (West 2017). In fact, the subsection allows NOL deductions by the participants in the common trust fund, as permitted under Treasury regulations. *Id.* Therefore, IRC § 584(g) does not permit Synovus – a bank – to deduct NOL carryforwards.

Synovus' argument fails for two primary reasons. First, the General Assembly did not adopt the entirety of Subchapter H of the IRC. When reading sections 12-6-40 and 12-6-50 together, the partially adopted IRC included only IRC § 584. Thus, Synovus' assertion that, by adopting the entirety of Subchapter H regarding banking institutions, the General Assembly implied that the IRC conformity provisions apply to the bank tax in Chapter 11 of Title 12 – is simply incorrect. Synovus' position is in error because the General Assembly did not adopt the entirety of Subchapter H but adopted only IRC § 584 regarding common trust funds. Second, IRC

[3] *See* Audited Financial Statements of Wells Fargo Bank Common Trust Funds for Personal Trusts at Dec. 31, 2015, https:// www.08.wellsfargomedia.com/assets/pdf/personal/the-private-bank/ucm_prd_216897.pdf (last visited June 27, 2017).

§ 584 applies to common trust funds, not to banks. The adoption of IRC § 584 has no impact on whether banks may deduct NOL carryforwards on their South Carolina bank tax returns.

Simply put, the General Assembly did not impose the IRC conformity provisions on banks. Thus, all of Synovus' arguments that primarily rely on IRC conformity provisions to justify an NOL deduction for banks must fail.

II. THERE IS A PLETHORA OF SUPPORTING AUTHORITY—INCLUDING TESTIMONY FROM THE BANKING INDUSTRY ITSELF—FOR THE DEPARTMENT'S POSITION THAT THE BANK TAX IN SOUTH CAROLINA IS A FRANCHISE TAX, NOT AN INCOME TAX. THUS, THE "ENTIRE NET INCOME" OF A BANK IS BASED UPON ITS BOOK INCOME.

A. Since 1937, the bank tax has remained a franchise tax that is imposed on the entire net income, or book income, of the bank.

In Synovus' motion, it asserts there is no support for the Department's position "that a franchise tax necessarily equals the use of book income accounting." (Synovus' motion, p. 23.) However, as discussed in the Department's motion, South Carolina authorities have long recognized the bank tax is distinct from the income tax because it is a franchise tax that uses book income accounting.

Entire net income is sometimes referred to as "book income." *See e.g.*, Final Report of S.C. Taxation Realignment Commission, pp. 75-76, 140-41 (Dec. 2010) (stating that the entire net income of a bank is based on its ***book*** income). Entire net income, or book income, means that a bank may deduct all of its expenses from all of its revenues to calculate entire net income. *See* S.C. Code Ann. Regs. 117-1500.1, 117-1500.3 (West 2017); *see also* I-D-189 (Jan. 24, 1975) (stating that the bank tax has a special tax base that is economic income rather than taxable income). A bank may use either the cash or accrual method of accounting. S.C. Code Ann. Regs. 117-1500.2 (West 2017). The Department's longstanding administrative policy is that the bank tax

is based on financial accounting rather than federal income tax accounting. *Id.* Thus, the bank tax is based on financial reporting income and should generally be computed using Generally Accepted Accounting Principles (GAAP). Under GAAP, entire net income, or book income, does not include a net operating loss deduction.

The Department's longstanding interpretation of the bank tax as a franchise tax based on book income is consistent with a 1948 Attorney General Opinion, a 1975 Tax Commission decision, bank tax regulations, and the findings of the Taxation Realignment Commission (TRAC).

First, as early as 1948 the South Carolina Attorney General opined that the bank tax is a franchise tax based on all income less all expenses (book income). 1947-48 Op. S.C. Att'y Gen. 294 (March 12, 1948). This is a key difference between the bank tax and the corporate income tax because a state may not impose a direct income tax (e.g., the corporate income tax) on interest income earned from government obligations. *See, e.g.*, Richard D. Pomp, *State and Local Taxation*, 10-12 (8th ed. 2015) (noting that interest on federal securities can be included in the income of a corporation and taxed under a franchise tax, but that such interest cannot be taxed under an income tax "unless Congress so provides—which it has not yet done").

Second, subsequent regulations approved by the General Assembly likewise recognize the bank tax as a franchise tax—not an income tax—that is based on the net income of banks. *See, e.g.*, S.C. Reg. BA-R-1 (December 6, 1967) (defining "entire net income" to include "income derived from any source whatsoever including interest on obligations of the United States, the United States Government or its possessions or of any state and any political subdivision thereof."); *see also* S.C. Code Ann. Regs. 117-1500.1 (same); S.C. Code Ann. Regs. 117-1500 ("Chapter 11 of Title 12 imposes a franchise tax on banks.").

Third, the former South Carolina Tax Commission noted that there are "special rules" when it comes to taxing banks in South Carolina because the bank tax is a franchise tax measured by the bank's entire net income (i.e. economic income rather than taxable income). *See Re: Bank Tax*, 1975 WL 23740, at *1 (S.C. Tax. Comm. January 24, 1975).

Fourth, the statutorily-created South Carolina Taxation Realignment Commission (TRAC) recognized the longstanding distinction that banks in South Carolina are exempt from income taxes because they 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, pp. 74–75, 140–41 (Dec. 2010) (emphasis added).

Finally, the Department itself has long-differentiated the bank tax from the corporate income tax. *See* S.C. Revenue Ruling # 92-9 ("Code Section 12-11-20 provides for a franchise tax based on net income on banks . . ."). As discussed in the Department's motion, the South Carolina bank tax is calculated based on a bank's entire net income, which includes all income from whatever source derived, even income from non-taxable securities, less all expenses incurred. *See Re: Bank Tax*, 1975 WL 23740, at *1 (S.C. Tax. Comm. January 24, 2975); S.C. Code Ann. § 12-11-20 (2014). By contrast, since 1985 the South Carolina corporate income tax has been calculated based on a corporation's *taxable income*. Taxable income as defined by the IRC excludes certain income from taxation (e.g., interest income on government obligations) and disallows a deduction for certain expenses (e.g., federal income taxes).

Thus, the Department's position that a franchise tax necessarily equals the use of book income accounting is consistent with its longstanding interpretation of the bank tax, and is overwhelmingly supported by a variety of South Carolina authorities.

B. **Imposing the bank tax on the entire net income – or book income – is not an unconstitutional delegation of legislative power and does not violate former federal banking laws.**

In its motion, Synovus asserts that taxing a bank on "book income" is "an unconstitutional delegation of powers from the General Assembly to an external entity" and violates former federal banking law. (Synovus motion, p. 23.) This assertion and argument is a nonstarter that merely confuses and distracts from the material issues in this case.

First, the use of book income in calculating the bank tax is not an unconstitutional delegation of powers. Synovus cites to *Eastern Federal Corp. v. Wasson*, 281 S.C. 450, 316 S.E.2d 373 (1984) to support its assertion that any delegation of taxing power to the Financial Accounting Standards Board [FASB] would be unconstitutional. However, this case is distinguishable from the facts before the Court in this matter. In *Eastern Federal Corp.*, the statute in question did not specify any guidelines for the rating of films; rather, the statute left that determination "solely to the discretion of the [Motion Picture Association of America] MPAA." *Eastern Federal Corp.*, 281 S.C. at 452, 316 S.E.2d at 374. Thus, based on the MPAA's determination of the film rating, it necessarily determined which films would be taxed at a higher rate. This was a clear unconstitutional delegation of legislative power. *Id.*

Here, the relevant statutes of Chapter 11 do not delegate any determination to FASB regarding which taxpayers in South Carolina are subject to the bank tax. S.C. Code Ann. § 12-11-10 provides for the definition of "banks" and "taxpayers" for purposes of Chapter 11. Further, S.C. Code Ann. § 12-11-20 provides that the bank tax is based upon the "entire net income." *See also* S.C. Code Ann. Regs. 117-1500.1.

There is nothing contained in either Chapter 11 or the relevant regulations that delegate any taxing power to the FASB. Instead, the definition of "entire net income" is based on a well-recognized definition from established accounting principles (GAAP). The General Assembly and South Carolina courts routinely use definitions from dictionaries to assist in defining terms or phrases that are not specifically defined within a statute. *See Comm'rs of Public Works of the City of Laurens v. City of Fountain Inn*, --- S.C. ---, 815 S.E.2d 21, 26 (Ct. App. 2018) ("Whe[n] a word is not defined in a statute, our appellate courts have looked to the usual dictionary meaning to supply its meaning."); *S.C. Pub. Interest Found. v. Courson*, 420 S.C. 120, 124, 801 S.E.2d 185, 187 (Ct. App. 2017), *cert. denied*, S.C. Sup. Ct. Order dated Feb. 1, 2018 (finding when a word is not defined by statute, "the court must look to the usual and customary meaning . . . to ascertain the legislature's intent.").

Second, imposing a franchise tax on a bank's book income does not violate former federal banking laws. In 1926, Congress amended the National Banking Act to provide that states could tax national banks in four ways, including imposing "a franchise tax on national banks measured by their net income." Hellerstein, State Taxation Vols. I & II (3d ed.), ¶ 6.30; *see also* Synovus' mo., p. 25. Eleven years later, the General Assembly enacted the bank tax in 1937. As permitted to do under the National Banking Act, the General Assembly imposed a bank (franchise) tax on "the entire net income of the taxpayer doing a banking business within this State." 1937 S.C. Acts page no. 565. Nevertheless, even if Synovus' is correct that using book income to calculate a bank's tax liability somehow violates federal banking laws, Synovus is asking this court to declare the Department *previously* violated a **former** federal banking law that is no longer in existence and has no application to the present matter. This court should not engage in speculation upon

matters that are not before the court. *See Wallace v. City of York*, 276 S.C. 693, 281 S.E.2d 487 (1981) (holding courts will "not give opinion on merely abstract or theoretical matters but only [] decide actual controversies injuriously affecting the rights of some party to the litigation. Accordingly, cases or issues which have become moot or academic in nature are not a proper subject of review.").

III. THE DEPARTMENT'S POLICY DOCUMENTS SUPPORT THE DEPARTMENT'S POSITION THAT SYNOVUS IS NOT ENTITLED TO DEDUCT NOL CARRYFORWARDS IN ITS 2011 THROUGH 2014 BANK RETURNS.

In its motion, Synovus points to specific Department policy documents to support its assertion that NOL carryforward deductions are applicable to banks. It is one thing to rely on portions of the IRC as guidance for applying the bank tax in the absence of specific guidance in the bank tax (Chapter 11); it is a much different matter to import certain statutorily created rights (NOL carryforward deductions) into a statutory scheme where the General Assembly specifically declined to do so.

A. S.C. Private Letter Ruling 95-10, Tax Commission Information Letter # 94-35, and Income Tax Decision (I-D-200) (1975).

Synovus points to three particular policy documents to support its argument that the Department has always treated the bank tax as an income tax, and that the Department "instructed banks to report income each year *based upon its taxable income* not book income." (Synovus' motion, p. 29.) However, Synovus takes phrases within the policy out of context and reads such provisions in isolation and without reference to the administrative purpose of such policy documents. *See* S.C. Private Letter Ruling 95-10 (private letter issued "[f]or purposes of the reorganization transaction" involved a bank); Tax Commission Information Letter # 94-35 (information letter regarding banks conducting a banking business in multiple states); and Income

Tax Decision (I-D-200))1975) (decision regarding the merger of two South Carolina banks). As discussed below, these policy documents reference certain provisions of the IRC and Chapter 6 (or predecessor statutes) that are necessary only for enforcement and administrative purposes.

Since the inception of the bank tax in 1937, the General Assembly has ensured that a statute existed in the bank tax chapter allowing for the adoption of certain income tax provisions (currently from Chapter 6 of Title 12) as appropriate for the administration and enforcement of the bank tax. However, this statute is a limited adoption of some provisions of the South Carolina Income Tax Act ***for administrative and enforcement purposes only***; it does not adopt the IRC conformity provisions or permit banks to deduct NOL carryforwards.

The bank-tax statute that was applicable during the years at issue in this case was as follows:

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

S.C. Code Ann. § 12-11-40 (2014). As this statute says, the income tax statutes adopted from Chapter 6 are for only "enforcement and administration" purposes. *Id.* 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.

Section 12-11-40 does not adopt the provisions of Chapter 6 that calculate gross income or taxable income or that impose the tax or the tax rate upon a taxpayer. It addresses only some provisions of Chapter 6 "that may be appropriate or applicable . . . for the enforcement and administration" of the bank tax. *Id.* Administration activities would include such activities as

payment of the bank tax, *see* S.C. Code Ann. § 12-11-50 (2014), and the deadlines for filing a bank tax return. Enforcement activities would include activities such as making and publishing rules and regulations. S.C. Code Ann. § 12-6-20 (2014). The other Chapter 6 activities adopted by this bank-tax statute include collection, liens, penalties, and other similar provisions. For bank tax purposes, the General Assembly did not adopt provisions of Chapter 6 used to define or calculate the tax base. Finally, in 1996 the General Assembly amended section 12-11-40 to adopt the "allocation and apportionment" provisions of Chapter 6 for purposes of the bank tax. Act No. 248, 111th Session § 1 (1996).

Although this adoption does affect the calculation of South Carolina net income to which the bank tax rate of 4.5% is applied, it does not adopt the IRC conformity provisions, which would be necessary for the Taxpayer to prevail in this matter. It merely imposes the allocation and apportionment provisions of Chapter 6 on whatever multistate tax base that a bank must apportion to South Carolina. It was reasonable for the General Assembly to ensure in 1996 that banks operating in South Carolina could use the allocation and apportionment provisions because that is the period in which banks were being de-regulated and commencing multi-state banking operations. Additionally, if section 12-11-40 or its predecessor statutes were a broad adoption of the Chapter 6 income-tax provisions for bank tax purposes, there would have been no need to adopt in 1996 the allocation or apportionment provisions of Article 17 of Chapter 6 for bank tax purposes.

Section 12-11-40 and its predecessor statutes are an adoption of certain provisions of Chapter 6 that are necessary only for enforcement and administrative purposes. Section 12-11-40 is not an adoption of the IRC conformity provisions or of section 12-6-50(6) that mentions NOLs;

hence, the General Assembly through section 12-11-40 did not adopt the IRC conformity provisions of Chapter 6, including the NOL provision of section 12-6-50(6), for bank tax purposes.

B. S.C. Rev. Ruling # 16-7.

Next, Synovus asserts that the Department issued a policy document "regarding NOL carryforwards applicable to all taxpayers, without exclusion for banks." (Synovus motion, p. 29.) Thus, Synovus argues that S.C. Revenue Ruling # 16-7 supports its position that the General Assembly extended the income tax rules to the bank tax. However, this revenue ruling clearly applies to corporate income tax and not to the bank tax. As noted in the Department's motion and this response, the South Carolina bank tax is calculated based on a bank's entire net income. S.C. Code Ann. § 12-11-20 (2014). By contrast, since 1985 the South Carolina corporate income tax has been calculated based on a corporation's *taxable income*. Simply put, the bank tax and the corporate income tax are distinctly different taxes with different tax bases that exist for different purposes. Because they are different taxes, the corporate income tax provisions and related policy documents do not apply to taxpayers, like Synovus. Thus, Revenue Ruling # 16-7 does not support Synovus' position. To the contrary, long-standing Department policy and the lengthy history of the bank tax establish that the Department has not allowed an NOL deduction for bank tax purposes.

CONCLUSION

Although the Legislature has enacted specific statutory authority for corporations to deduct NOLs for corporate income tax purposes, it has never adopted a similar provision for the bank tax. Since the inception of the bank tax in 1937, the Department and other South Carolina authorities have interpreted and applied the bank tax to be a franchise tax, not an income tax, whose tax base

is calculated differently than the corporate income tax and for which NOLs are not deductible. This longstanding interpretation is entitled to deference. Further, the IRC conformity statutes adopted by the General Assembly starting in 1985 do not apply to the bank tax. Thus, the IRC conformity provision in § 12-6-50(6) that implicitly permits a deduction for NOL carryforwards do not apply to banks. Because the bank tax of Chapter 11 of Title 12 does not authorize a bank to deduct NOL carryforwards, the Department respectfully requests this Court enter an order finding Synovus may not deduct NOL carryforwards in bank tax years 2011 through 2014.

Respectfully submitted,

SOUTH CAROLINA DEPARTMENT OF REVENUE

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Columbia, South Carolina
August 8, 2018

STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

Synovus Bank, Petitioner, vs. South Carolina Department of Revenue, Respondent.	)	Docket No. 17-ALJ-17-0418-CC **PROOF OF SERVICE**

I, the undersigned employee of the South Carolina Department of Revenue, Office of General Counsel, do hereby certify that I have served the Respondent's Response to Petitioner's Motion for Summary Judgment in connection with the above-captioned matter by causing a copy of the same to be deposited in the United States Mail on the below date, postage prepaid to the following parties at their address of record:

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Columbia, South Carolina
August 8, 2018

STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

Synovus Bank, Petitioner, v. South Carolina Department of Revenue, Respondent.	)	Docket No. 17-ALJ-17-0418-CC

REPLY IN SUPPORT OF THE SYNOVUS BANK MOTION FOR SUMMARY JUDGMENT

Synovus Bank ("Synovus"), by and through its undersigned counsel, herein files this Reply in Support of Synovus Bank's Motion for Summary Judgement. Due to the filing of cross motions by the parties, Synovus herein incorporates and references the Synovus Response to Respondent's Motion for Summary Judgement ("Synovus Response") and further replies as follows:

I. The 2005 Conformity Amendments Make Clear Conformity Applies to "Title" 12 and "All" Taxes Administered By The Department, Including Banks.

Based on the 2005 conformity amendments, Synovus Bank falls "squarely within the terms of [the] statute authorizing [an NOL carryforward] deduction." Department Resp. p. 2. The intent of the General Assembly in 2005 was not vague. Nor is the statute ambiguous. In 2005, the General Assembly took affirmative action to intentionally broaden the application of conformity to include "all other … taxes administered by the Department." *See* S.C. Code Ann. § 12-6-50; *see also* Synovus MSJ p. 17; Synovus Resp. pp. 2-3. There is no question that the bank tax is a tax administered by the Department and is part of Title 12.

The Department seems to argue three (3) main points in opposition to the 2005 Conformity amendment.

First, the Department's contention that banks are not allowed to take NOL carryforward deductions[1] because the General Assembly did not specifically create a statute applying said deductions to banks is inconsistent with both the Department's arguments in this case and the application of conformity generally.[2] The Department overlooks the fact that the General Assembly also failed to a create statute "specifically" allowing NOL deductions for corporations. Is the Department now saying a corporation cannot take an NOL carryforward despite what the IRC allows? Of course not. A specific statute for an NOL deduction is not required for corporations or banks if conformity applies. Instead, both are allowed to rely on S.C. Code Ann. § 12-6-1130(4)(d). Based on the 2005 actions of the General Assembly, there is no argument to be made that the bank tax is not subject to conformity.[3] Accordingly, a bank in South Carolina is entitled to take an NOL carryforward deduction pursuant to S.C. Code Ann. § 12-6-1130(4)(d) and the IRC.

Second, the Department argues that only S.C. Code Ann. § 12-6-50 (the decoupling statue) contains the language that expanded conformity to "all" taxes. Therefore, according to the Department, because S.C. Code Ann. § 12-6-40 (the conformity statute) did not contain the expanded language, there was nothing to "decouple." This argument is a red herring. The intent of the legislature can clearly be gleamed from the actual 2005 Act, which expanded conformity to "all" taxes. The 2005 Act No. 145, § 8 (H.B., 3768) itself states the intent of the General

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[1] The use of the term "deduction" in regards to a net operating loss carryforward is colloquial and not entirely accurate. A net operating loss is an excess of deductions over gross income in a year. A net operating loss carryforward is not a deduction in and of itself, but is the carryforward of "excess deductions" in one year to a future year for potential offset of income in future years.

[2] The Department repeatedly urges this Court to construe the bank tax as a franchise tax based on book income governed by GAAP. The argument is pursued despite the fact that there is no statute that "specifically" creates a franchise tax for banks, or a statute that states book income should be used by banks, or a statute that requires GAAP principals of accounting be followed for South Carolina bank taxes.

[3] Synovus further contends that to the extent any section from the tax code is required for the enforcement, administration, allocation or apportionment of the bank tax pursuant to S.C. Code Ann. § 12-11-40, the 1985 conformity amendments also apply.

Assembly in 2005 was "[t]o amend **Sections 12-6-40 and 12-6-50**, both as amended, relating to definitions and conformity provisions for purposes of the South Carolina Income Tax Act, so as 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* Synovus MSJ p.9, Exhibit 5 (emphasis added). Further, the title of § 12-6-40 (conformity statute) confirms conformity applies to "state tax laws" not just Chapter 6. Likewise, § 12-6-40(2)(a) makes clear the application of conformity is "[f]or purposes of this title." The appicable language leaves no room to doubt that the intent of the legislature was to amend both Sections 12-6-40 and 12-6-50 and to apply conformity to the entirety of Title 12, including "all" taxes administered by the Department.

Third, the Department argues the bank tax is wholly exempt from the income tax based on S.C. Code Ann. § 12-6- 550(1) (corporations exempt from taxes imposed by Sections 12-6-530 and 12-6-540). The Department's argument related to Section 12-6-550(1) is not logical. The statute explicitly states that the exclusion for the bank tax is limited *only* to the "tax imposed by Section 12-6-530 and Section 12-6-540." *See* S.C. Code Ann. § 12-6- 550(1). In turn, Sections 12-6-530 and Section 12-6-540 are limited to the tax rate. The limited exclusion for the bank tax from the income tax for tax rates is consistent with the intent of the General Assembly and has no impact on conformity. Admittedly, the bank tax rate *is* different from the corporate tax rate. But the different tax rate does not equate to an entirely different scheme of taxation as argued by the Department. *See also* Synovus MSJ pp.18-20. Additionally, the reading of S.C. Code Ann. § 12-6- 550(1) as a limited exclusion for the tax rate is consistent with the bank tax itself which refers taxpayers (and the Department) back to the "[a]ppropriate Chapter 6 provisions" for the "enforcement, administration, allocation and apportionment of income tax on

banks." S.C. Code Ann. § 12-11-40. If no portion of the income tax code is applicable to banks as argued by the Department, how does the Department square Section 12-11-40.?. In short, it does not. The bank tax exclusion is limited to the tax rate and other specified exclusions. Nothing about the difference in tax rates impacts the fact that in 2005 the General Assembly expanded conformity to include all of Title 12, including the bank tax. As a result thereof, banks are allowed to take NOL carryforward deductions.

II. There is No Basis for the Department's Assumption that a Franchise Tax Equates To Book Income

The Department continues to assume that a franchise tax must use book income. The reliance of the Department on this unrecognized assertion seems to originate from the 1948 Attorney General opinion that declared the bank tax was a franchise tax.[4] The Attorney General's opinion did not, however, declare that the bank tax, even if a franchise tax, would use book income as its base. As shown in Synovus' prior filings, similar bank taxes that are properly described as franchise taxes in other states do not use book income as the base to apply the bank franchise tax. *See* Synovus MSJ pp. 23-25. Similarly, a franchise tax is not typically defined as using book income as its base. Black's Law Dictionary, for example, defines a franchise tax as: "A tax imposed on the privilege of carrying on a business (esp. as a corporation), usu. Measured by the business income." Black's Law Dictionary (10th ed. 2014).

A stated in Synovus' Response to the Department's MSJ (p. 5), there is no South Carolina statute, regulation or authoritative Department policy that states a bank must use book income as its base if the bank tax is considered to be a franchise tax. Similarly, there is no definition for the term "book income" in any statute, regulation, or authoritative policy *ever* issued by the Department. How then does the Department expect a bank taxpayer to calculate the

[4] Synovus argues the bank tax was never intended by the General Assembly to be a franchise tax and the opinion of the Attorney General has no precedential value. *See* Synovus MSJ pp. 27-29.

tax owed, regardless of whether or not the bank tax is a franchise tax? The answer is clear, following conformity, the bank taxpayer must look to the IRC and the voluminous statutes contained therein.

A. There Is No Basis for the Court to Assume the Term "Entire Net Income" Means "Book Income"

The Department places significant emphasis on the definition of "entire net income" for its position that book income must be used for the bank tax calculation. "[E]ntire net income" is the term used by the General Assembly to determine what type of income should be taxed by a bank in South Carolina. *See* S.C. Code Ann. § 12-11-20. The Department faces an insurmountable task to establish that "entire net income" equates to book income because:

1) the General Assembly failed to define "entire net income" in regard to the bank tax;

2) the General Assembly has used the term "entire net income" to mean *taxable income*, not book income, throughout Title 12 for in excess of fifty years;

3) none of the Department policies identified by the DOR actually use the term "book income" (or GAAP); and

4) in its own briefing, the Department uses multiple terms to define "entire net income" evidencing the confusion created by the Department through its refusal to follow the instructions of the General Assembly and conform "all" taxes to the IRC.

As a result, the Court must evaluate the available, admissible sources[5] to determine the intended meaning of "entire net income" by the General Assembly.

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[5] The only source cited by the Department that uses the term "book income" is the report of the 2010 S.C. Taxation Realignment Commission (Department MSJ Ex, H) and corresponding testimony of Lloyd Hendricks (Department MSJ Ex. K). South Carolina Courts have repeatedly held that legislators and other related parties cannot testify as to legislative intent. "It is a settled principle in the interpretation of statutes that even where there is some ambiguity or some uncertainty in the language used, resort cannot be had to the opinions of legislators or of others concerned in the enactment of the law, for the purpose of ascertaining the intent of the legislature." *Kennedy v. S.C. Ret. Sys.*, 549 S.E.2d 243 (S.C. 2001) (citing *Greenville Baseball, Inc. v. Bearden*, 20 S.E.2d 813, 817 (S.C. 1942)). In this case, the TRAC was a duly appointed body created by Act of the General Assembly (2009 Act 81) tasked with delivering a report to the Senate Finance Committee. The Act mandated that the report not only analyze the competitiveness of South Carolina given its taxing regime, but also "include the text of an amendment that effectuates the recommendations." Thus, the Commission was engaged in the quintessential legislative process that the privilege

1. The Historical Statutory Authorities Support Synovus' Position that "Entire Net Income" was intended by the Legislature to Mean Taxable Income Commensurate with the Corporate Income Tax Code.

The definition of "entire net income" proposed by the Department is wholly inconsistent with the statutory history and use of the term "entire net income" by the General Assembly. The first known use of the term "entire net income" comes from the Income Tax Act of 1926. From 1926 until conformity in 1985, the corporate income tax in South Carolina was based on "entire net income." In 1985, the income tax chapter was revised to define the type of income to be taxed as "gross income" and "taxable income" to conform to the terminology used in the IRC. The term "entire net income" was, at all times between 1926 and 1985, interpreted to mean taxable income for corporate tax purposes. Beginning in 1937 with the first bank tax, the term "entire net income" was used for application to banks. Thus, for almost fifty years the corporate and bank tax sections both used the term "entire net income." The Department has no basis for their creation of an interpretation of "entire net income" that differs between the two tax sections. It is wholly inconsistent to argue "entire net income" had one definition applicable to the corporate tax and another application for the bank tax when the General Assembly gave no such instruction.

2. The Department has Failed to Provide a Statute, Regulation or Authoritative Department Policy to Support Its Position that "Entire Net Income" means "book income" as computed by GAAP.

In its response to the Synovus' MSJ, the Department argues the bank tax regulations allow a cash or accrual method of accounting. The Department then asserts, based on the alleged longstanding policy of the Department, that GAAP should be used. *See* Department Responses pp. 8-9. The Department citations to the bank tax regulations and department policies are not

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above was meant to protect. For this reason, the TRAC report and associated testimony of Mr. Hendricks is inadmissible and should not be relied upon or considered by this Court.

persuasive that "entire net income" means book income as computed in accordance with GAAP. The bank regulations cited by the Department (DOR MSJ, Ex G) define "net income tax" as "income derived from any source whatsoever . . . ." The bank tax regulations then state "net income of the taxpayer... shall be computed on either a cash or an accrual basis." There is no mention of "book income" or GAAP.

The Department's simultaneous reliance on both the regulations and GAAP is improper. As shown in the FASB Accounting Standards Codification on page 11 (Exhibit A), GAAP does not include guidance on other forms of accounting such as "cash basis" accounting. For the Department to argue that the regulations allow the application of both a cash basis and GAAP does not make sense and shows a fundamental misunderstanding of the purpose of GAAP and its limitations. The cash method of accounting is not GAAP, and it is not acceptable for GAAP (GAAP is predicated on the accrual method of accounting). Similarly, the Department has failed to point to any GAAP authority that uses the term "entire net income." The Department cannot do so because the term "entire net income" does not exist within GAAP and has not been defined by the FASB.

Further, even the Department's own exhibits[6] on which they rely do not define "entire net income" to mean book income, nor do *any* of the referenced Department policies/opinions use the terms "book income" or GAAP. To the contrary, the Department highlights the inconsistent use of terminology associated with the bank tax and the type of income to be taxed. This is further evidenced by the Department's own brief in which they describe the accounting method to be used for the bank tax as financial accounting, entire net income, net income, book income, economic income, GAAP income and financial reporting income. These terms are not

[6] Even the Department's exhibits submitted in support of the Department's MSJ fail to use the terms book income or GAAP.

synonymous. In fact, of all the terms used by the Department, only "net income" has been defined by the FASB. (Exhibit B.) The use of alternate terms (with differing potential meanings) show the confusion the Department has created by its refusal to accept the General Assembly's explicit instructions that "all" taxes administered by the Department conform to the IRC.

The Department also ignores its own policies provided by Synovus as evidence that the Department has, in fact, treated the bank tax as an income tax and applied IRC provisions to banks in the past. *See* Synovus MSJ pp. 13-15; Synovus Resp. pp. 4-5. The prior application of IRC provisions to banks is consistent with Synovus' current application of NOL carryforwards and is allowed by both the IRC and GAAP as descried in ASC 740. *See* Synovus Resp. pp. 13-16, Exhibit A.

III. CONCLUSION

Synovus has evidenced that in 2005 the General Assembly expanded the application of conformity to specifically include the entirety of Title 12 and all taxes administered by the Department of Revenue. There is no wholesale exception for the bank tax. The limited exception for the bank tax is due to the different tax rate charged to banks versus corporations in South Carolina. As such, conformity applies to banks in South Carolina. Once it is determined that conformity does apply, then you must look to S.C. Code Ann. § 12-6-1130(4)(d) and the IRC for authoritative guidance. When looking to S.C. Code Ann. § 12-6-1130(4)(d) and the IRC, it is clear that NOL carryforwards are allowed for both corporations and banks.

Synovus has also established that the Department's reliance on its alleged long standing administrative policy that the bank tax is a franchise tax has no bearing on a bank's ability to take a NOL carryforward deduction. Even if the bank tax is a franchise tax, there is no statute,

regulation or authoritative Department policy that then necessitates the application of "book income" or that requires GAAP principles be followed. As shown by Synovus, the requirement to follow GAAP under these circumstances is an improper application of GAAP (because GAAP does not conform to cash accounting standards) and is an unconstitutional allocation of the taxing powers to a third party (the FASB). As admitted in the Department's brief (p. 12), the South Carolina Legislature did not instruct the taxing powers of the State of South Carolina be transferred to the FASB, which drafts and approves GAAP. Likewise, the DOR has no power to do so by applying GAAP principals to the bank tax. Regardless, the Department has provided no evidence that GAAP does not allow NOL carryforwards while Synovus has provided evidence that NOL carryforward principals are contemplated through ASC 740.

Based on the arguments above, Synovus has established that NOL carryforwards are applicable to banks in South Carolina. Accordingly, Synovus Bank asks this Court to make a determination that banks in South Carolina may take an NOL carryforward deduction on South Carolina taxes.

Dated this 15th day of August, 2018.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on the 15th day of August, 2018, the foregoing REPLY IN SUPPORT OF THE SYNOVUS BANK MOTION FOR SUMMARY JUDGMENT has been served upon the following persons by U.S. First Class Mail, and with the correct amount of postage affixed thereto:

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Exhibit A
FASB Accounting Standards Codification, p. 11

FASB ACCOUNTING STANDARDS CODIFICATION®

About the Codification

(v 4.10)

Transition guidance for first-time adopters of US GAAP

The Codification eliminates transition guidance for all guidance that is fully effective as of December 31, 2008. However, entities that need to apply US GAAP for the first time may need to access the original standards to determine the relevant transition guidance. This is especially true for cases when there are long transition periods.

Non-GAAP

The FASB concluded that the Codification represents authoritative US GAAP. Therefore, the Codification does not include guidance for non-GAAP matters such as:

1. Other Comprehensive Basis of Accounting (OCBOA)
2. Cash Basis
3. Income Tax Basis
4. Regulatory Accounting Principles (RAP).

Governmental accounting standards

The Codification does not include governmental accounting standards.

Audit guidance

The Codification eliminated references to audit guidance.

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Exhibit B
FASB Master Glossary

Net Carrying Amount of Debt

See Topic(s) 470

Net carrying amount of debt is the amount due at maturity, adjusted for unamortized premium, discount, and cost of issuance.

Net Cash Settlement

Definition 1 | See Topic(s) 815

The party with a loss delivers to the party with a gain a cash payment equal to the gain, and no shares are exchanged.

Definition 2 | See Topic(s) 480

A form of settling a financial instrument under which the entity with a loss delivers to the entity with a gain cash equal to the gain.

Net Closed Block Liability

See Topic(s) 944

The carrying amount of closed block liabilities in excess of the carrying amount of closed block assets each adjusted to eliminate the effect of related amounts in accumulated other comprehensive income at the actuarial calculation date. Deferred acquisition costs are not assets of the closed block.

Net Income

See Topic(s) 205, 220

A measure of financial performance resulting from the aggregation of revenues, expenses, gains, and losses that are not items of other comprehensive income. A variety of other terms such as net earnings or earnings may be used to describe net income.

Net Income Unitrust

See Topic(s) 958

A trust established in connection with a split-interest agreement, in which the donor or a third-party beneficiary receives distributions during the agreement's term of the lesser of the net income earned by the trust or a fixed percentage of the fair value of the trust's assets, with or without recovery and distribution of the shortfall in a subsequent year. Upon termination of the trust, a not-for-profit entity (NFP) receives the assets remaining in the trust.

Net Incurred Claims Cost (by Age)

See Topic(s) 715

The employer's share of the cost of providing the postretirement health care benefits covered by the plan to a plan participant; incurred claims cost net of retiree contributions. See Incurred Claims Cost (by Age).

Net Investment in an Original Loan

See Topic(s) 310

STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

Synovus Bank, Petitioner, vs. South Carolina Department of Revenue, Respondent.	)	DOCKET NO. 17-ALJ-17-0418-CC **RESPONDENT'S REPLY TO PETITIONER'S RESPONSE TO THE RESPONDENT'S MOTION FOR SUMMARY JUDGMENT**

The Respondent, South Carolina Department of Revenue (the "Department" or "DOR") by and through the undersigned counsel, respectfully replies to Petitioner's Response to the Department's Motion for Summary Judgment filed August 8, 2018 by Synovus Bank ("Synovus" or "Taxpayer") regarding the above-captioned matter ("Synovus' response"). For the reasons set forth below, the South Carolina Administrative Law Court (the "ALC" or "Court") should grant the Department's Motion for Summary Judgment ("Department's motion") because the material facts not in dispute demonstrate that Synovus is not entitled to deduct net operating loss ("NOL") carryforwards when computing its bank tax liability.

MATERIAL FACTS NOT IN DISPUTE

For the purposes of this Reply, the parties have filed a joint Stipulation of Facts that are not in dispute. The Department incorporates by reference those Stipulation of Facts as if set forth fully herein.

ARGUMENTS

I. WHETHER SYNOVUS CAN DEDUCT NOL CARRYFORWARDS IS NOT A QUESTION OF EQUITY.

In its response, Synovus again asserts that the issue in this matter is a question of equity. As the Department previously argued, it is axiomatic under South Carolina law that tax exemption statutes (such as a claimed deduction) are construed strictly against the taxpayer. The taxpayer bears the burden of bringing itself squarely within the terms of the authorizing statute; it is not a question of equity. (Department's motion, pp. 6-7; Department's response, pp. 2-3.)

II. THE DEPARTMENT'S MOTION FOR SUMMARY JUDGMENT IS SUPPORTED BY SOUTH CAROLINA LAW, ADMINISTRATIVE GUIDANCE, AND THE STIPULATIONS IN THE RECORD.

In its response, Synovus asserts the Department's statement that there is "over 80 years of well-settled law and administrative guidance that do not permit NOL deductions for banks" is misleading. (Synovus response, p. 1.) The Department disagrees, and as noted in the Department's motion, since the inception of the bank tax in 1937, South Carolina authorities, and the banking industry itself have all consistently interpreted the bank tax to be an annual privilege tax, which calculates its tax base differently from the corporate income tax and which does not allow deductions for NOLs. (Department's motion, pp. 8-19; 1947-48 OP. S.C. Att'y Gen. 294 (March 12, 1948)); *Re: Bank Tax*, 1975 WL 23740, at *11 (S.C. Tax Comm. Jan. 24, 1975); S.C. Code Ann. Regs. 117-1500 – 117-1500.3 (2012); S.C. Rev. Ruling #92-9; Final Report of S.C. Taxation Realignment Commission, pp. 74-75, 140-141 (Dec. 2010); Department-issued instructions to Form SC 1101B (South Carolina Bank Tax Return).

Further, Synovus challenges the Department's assertion that Synovus "suddenly reversed course from its practice for tax filings in South Carolina." (Synovus response, p. 2.) As stated in

the parties' Stipulation of Facts, for bank tax years 2011, 2012, and 2013, Synovus filed its original South Carolina Bank Tax Returns without claiming any NOL carryforwards from 2009 or 2010. (Stipulation, ¶ 16.) Similarly, neither of Synovus' predecessors (CB&T and NBSC) claimed NOL deductions on their prior bank tax returns either. Subsequently, on December 19, 2014, Synovus filed a *third* amended return for tax year 2011 on which it claimed, for the first time, that it was entitled to deduct the losses from 2009 in the form of NOL carryforwards. (Stipulation, ¶ 18.) Thus, the parties' Stipulations support the Department's assertion that Synovus reversed course from its practice for tax filings in South Carolina, and Synovus' assertion is without merit.

III. THE 2005 AMENDMENTS TO THE CONFORMITY PROVISIONS DID NOT GRANT BANKS THE AUTHORITY TO UTILIZE A NOL CARRYFORWARD DEDUCTION.

In its response, Synovus asserts that the General Assembly conformed the bank tax to the Internal Revenue Code in 2005. The Department addressed this issue in its motion for summary judgment and response to Synovus' motion for summary judgment. Thus, the Department respectfully requests this Court to refer to the Department's motion for summary judgment and response to Synovus' motion for summary judgment. (Department's motion, pp. 16-18; Department's response, pp. 3-4.)

IV. THE BANK TAX IS A FRANCHISE TAX, AND THUS, NOL CARRYFORWARD DEDUCTIONS ARE NOT ALLOWED IN SOUTH CAROLINA.

In its response, Synovus asserts that the Department has been inconsistent in its position and application of a franchise tax under the bank tax. As noted in the Department's response, the specific policy documents cited by Synovus reference certain provisions of the IRC and Chapter 6 that are necessary only *for enforcement and administrative purposes*. (Department's response, pp. 13-16.)

Further, the Department does not agree that conformity "wholesale changed" the bank tax code in South Carolina. (Synovus' response, p. 4.) The 1985 amendments made changes to the entire income tax section of the South Carolina code, including how to compute the taxable income of corporations. However, the legislation made no changes whatsoever to the provisions of the bank tax code, including how the tax base for the bank tax was determined. By leaving the tax base for bank tax purposes as the "entire net income" while changing the tax base for the corporate income tax to the taxable income based on a partially adopted IRC, it is evident that the tax base for the bank tax differs entirely from the tax base for the corporate income tax. *See also* (Department's motion, pp. 11-12; Department's response, pp. 16-18.)

V. SYNOVUS' ARGUMENT REGARDING TAX DEFERRED ASSETS AND LIABILITIES IS IRRELEVANT IN THIS MATTER.

In its response, Synovus asserts that the "Department has still made a critical error in its argument that GAAP does not allow an NOL deduction." (Synovus response, p. 7.) Synovus discusses GAAP principles, the FASB, and the FASB Accounting Standards Codification ("ASC") to support its assertion that NOL carryforwards should be allowed. As further support, Synovus argues that "top accounting firms cite to ASC 740 and explain how an entity should report a deferred tax asset, such as an NOL carryforward or an unused credit carryover, on its financial statements in compliance with the U.S. GAAP." (Synovus response, pp. 7-8.)

A deferred tax asset is a financial accounting concept used by a taxpayer on its balance sheet to recognize that the tax NOL will be a benefit to the taxpayer because it can be used to reduce their tax liabilities on future returns. This "guidance" cited by Synovus merely states that federal tax NOLs are an asset to the taxpayer because it will reduce future tax liabilities of the taxpayer. This tax NOL is part of the calculation for the bank income tax expense for book income

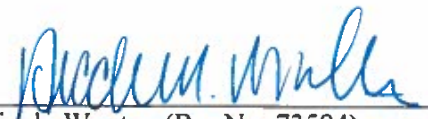
and to that extent, it may reduce a bank's book income. That deduction is already part of the book income reported on the South Carolina Bank Tax Return. Thus, Synovus' argument must fail as it attempts to confuse the issue in this matter.

CONCLUSION

Although the Legislature has enacted specific statutory authority for corporations to deduct NOLs for corporate income tax purposes, it has never adopted a similar provision for the bank tax. Since the inception of the bank tax in 1937, the Department and other South Carolina authorities have interpreted and applied the bank tax to be a franchise tax, not an income tax, whose tax base is calculated differently than the corporate income tax and for which NOLs are not deductible. This longstanding interpretation is entitled to deference. Further, the IRC conformity statutes adopted by the General Assembly starting in 1985 do not apply to the bank tax. Thus, the IRC conformity provision in S.C. Code Ann. § 12-6-50(6) (2014) that implicitly permits a deduction for NOL carryforwards do not apply to banks. Because the bank tax of Chapter 11 of Title 12 does not authorize a bank to deduct NOL carryforwards, the Department respectfully requests this Court enter an order finding Synovus may not deduct NOL carryforwards in bank tax years 2011 through 2014.

Respectfully submitted,

SOUTH CAROLINA DEPARTMENT OF REVENUE



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August 15, 2018

STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

Synovus Bank, Petitioner, vs. South Carolina Department of Revenue, Respondent.	)	DOCKET NO. 17-ALJ-17-0418-CC **PROOF OF SERVICE**

I, the undersigned employee of the South Carolina Department of Revenue, Office of General Counsel, do hereby certify that I have served the South Carolina Department of Revenue's Respondent's Reply to Petitioner's Response to the Respondent's Motion for Summary Judgment in connection with the above-captioned matter by causing a copy of the same to be deposited in the United States Mail on the below date, postage prepaid to the following parties at their address of record:

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Columbia, South Carolina
August 15, 2018

STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

Synovus Bank, Petitioner, v. South Carolina Department of Revenue, Respondent.	)	Docket No. 17-ALJ-17-0418-CC

PETITIONER SYNOVUS BANK'S SUPPLEMENTAL BRIEF

The questions to be addressed in this supplemental briefing illustrates the fallacy in the Department's reliance on today's version of GAAP accounting methods as the source for determining the basis of the bank tax. As Doug Branch[1] testified, GAAP is always changing. Hr'g Tr. 75:12–13. Since the passage of the bank tax in 1937, the South Carolina bank tax code has seen virtually zero change. S.C. Bank Tax Act of 1937, No. 349. Exhibit A. The accounting methods used by banks (and corporations), however, have undergone massive changes as the accounting profession and economy have developed, changed and grown. As a result, GAAP accounting is the method of calculation, not the reasoning behind, the bank tax basis. To determine whether or not NOL carryforwards are allowed to be taken by banks in South Carolina, the intent of the legislature and statutory authority afforded banks to calculate "entire net income" on all profit and all expense in 1937 must be examined and determined. Regardless of how the accounting method is viewed, both under historical legislative interpretation and under accounting methods, it is clear Net Operating Loss carryforwards are now, and always have been, allowed for banks in South Carolina.

[1] Doug Branch is the GAAP expert Synovus presented at trial.

BRIEF HISTORY OF GAAP ACCOUNTING AND TAXES

Records of early forms of accounting exist from centuries ago. In 1494, Luca Pacioli, considered the father of accounting, wrote a famous paper "Everything about Arithmetic, Geometry, and Proportion." Bernhard Grossfeld, COMPARATIVE CORPORATE GOVERNANCE: GENERALLY ACCEPTED ACCOUNTING PRINCIPLES V. INTERNATIONAL ACCOUNTING STANDARDS, 28 N.C. J. Int'l L. & Com. Reg. 847, 859 (2003). In the treatise, Pacioli revealed that several merchants kept books of debits which means "he owes" as well as credits which means "he trusts." Matthew J. Barrett, The Sec and Accounting, in Part Through the Eyes of Pacioli, 80 Notre Dame L. Rev. 837, 844 (2005). With this early double entry accounting system, merchants were able to maintain records so that they could improve the efficiency of their businesses. *Id.* With these records came the primitive income and balance sheet statements we see today. *Id.*

During the Industrial Revolution, accounting continued to advance as industrial companies sought out to gain financing and maintain efficiency through operations. In or around 1887, the first accounting organization was developed in New York. S. Zeff, "*How the U.S. Accounting Profession Got Where It Is Today: Part II*," Accounting Horizons (December 2003). Exhibit B. The title and professional license of the Certified Public Accountant followed shortly in the year 1896. *Id.*

It was not until the 1900s that the concept of income taxes began. Paul, Randolph E., "*History of Taxation in the United States*" at p. 6, 7 (1955). Exhibit C. In a campaign speech, then candidate Taft predicted that the "country would someday resort to the income tax as a revenue measure." *Id.* at 7.

Taft suggested the income tax should come from "whatever source derived." *Id.* In 1909, Taft's prediction came true and Congress passed the first income tax on corporations. *Id.* The

sixteenth amendment was passed soon thereafter. *Id.* The ability to use losses to offset income earned in other years can be traced back to as early as the Revenue Act of 1918, which first allowed for net operating loss carrybacks and carryforwards. § 29:2. Legislative history, 7 Mertens Law of Fed. Income Tax'n § 29:2. *See also Tax Management Portfolio 539, Net Operating Losses – Concepts & Computations*. From its inception, the rationale behind a carryforward has focused on fairness. THE LOSS CARRYOVER DEDUCTION AND CHANGES IN CORPORATE STRUCTURE, 66 Colum. L. Rev. 338, 339, Sec. II A. (1966); S. REP. NO. 705, 665, at 7 (1932). The Senate Report to the 1918 Act (Exhibit D) noted that the NOL provision would address a "grave injustice" that exists when the tax law does not "recognize the exigencies of business." *Id.* The Senate Report to the Revenue Act of 1932 (Exhibit E) continued to describe NOL carryover rules as equitable and fair, providing "essential protection against excessive hardship inherent in a tax based upon arbitrary annual accounting." S. REP. NO. 705, 665, at 11 (1932). It further noted that a taxpayer's ability to pay is diminished if it needs the profits of one year to cover losses from a prior year. *Id.* Likewise, the House Report to the Revenue Bill of 1939 describes the carryover rules in terms of "in the interest of equity ... net operating business loss carry-over will greatly aid business and stimulate new enterprises." House Rep. no. 855, 76th Cong., as reported in *Roberts v. Comm'r*, 258 F.2d 634, 638 (5th Cir. 1958) (quoting H.R.Rep. No. 855, 76th Cong.).

The original income tax for South Carolina passed in 1922 was essentially conformity to the federal tax code. *Crescent Mfg. Co. v. Tax Comm'n*, 129 S.C. 480, 124 S.E. 761, 763 (1924); *Lancaster Cotton Mills v. S.C. Tax Comm'n*, 132 S.C. 466, 129 S.E. 429, 431 (1925). As such, net operating losses were allowed in South Carolina for banks (and all taxpayers) from the inception of income taxes in this state. *See Lancaster Cotton Mills v. S.C. Tax Comm'n*, 132 S.C. 466, 129 S.E. 429, 431 (1925) (holding that because the Federal Income Tax Statute allowed for a net

operating loss, so must South Carolina's Income Tax statute). In 1926, the South Carolina legislature passed its first standalone income tax. *U. S. Rubber Prod. v. S.C. Tax Comm'n*, 189 S.C. 386, 1 S.E.2d 153, 154 (1939); 1926 S.C. Acts. § 15-386. This tax applied to both banks and corporations and used the term "entire net income" for the first time. 1926 S.C. Acts. § 15-386. The South Carolina Bank tax was passed as a separate tax for banks in 1937. S.C. Bank Tax Act of 1937 565 (1). Exhibit A. After the corporate and bank tax were separated into their own sections, both continued to use the term "entire net income" until 1985. *See* Tax Reform Act of 1986 PL 99–514 (HR 3838), PL 99–514, October 22, 1986, 100 Stat 2085. After 1985, only the bank tax continued to use the term "entire net income."

As income tax laws developed, accounting rules also began to develop. U.S. GAAP was in the process of being developed by the American Institute of Certified Public Accountants (AICPA) and the Financial Accounting Standards Board (FASB) in the year 1939. SEC COMPLIANCE: FINANCIAL REPORTING AND FORMS, A brief history of U.S. GAAP., 2016 WL 7113358. Exhibit F. Generally Accepted Accounting Principles were established primarily as a response to the Stock Market Crash of 1929 and the Great Depression, which were believed to be at least partially caused by less than forthright financial reporting practices by some publicly-traded companies. S. Zeff, "How the U.S. Accounting Profession Got Where It Is Today: Part II," Accounting Horizons (December 2003); *see also*, Branch testimony, Hr'g Tr. 72:19-24.

Early Bulletins issued by the American Institute of Public Accountants show the need for such conformity for accounting procedures. Bulletin 8, issued in 1941, details that all entities were not yet using separate balance sheets and income statements. BULLETIN NO. 8, Combined Statement of Income and Earned Surplus (Am. Inst. Of Certified Pub. Accountants 1941). Exhibit G. Bulletin 8 expressed affirmative approval for entities to use combined statements of income

and earned surplus. *Id.* at p. 63. Bulletin 8 was passed to address the "'increased recognition of the significance of the income statement' and the resulting 'tendency to regard the balance sheet as the connecting link between successive income statements and as the vehicle for the distribution of charges and credits between them.'" *Id.*

In 1944, the American Institute of Certified Public Accountants, Committee on Accounting Procedure issued Bulletin, no. 23. BULLETIN NO. 23, Combined Statement of Income and Earned Surplus (Am. Inst. Of Certified Pub. Accountants 1944). Exhibit H. Bulletin 23 is the earliest record identified that addresses the issue of excess expenses and income taxes for accountants. Bulletin No. 23 was passed to address the "[b]asic difficulties [that] arise in connection with income taxes where there are material and extraordinary differences between taxable income upon which they are computed and the income reported in the income statement under generally accepted accounting principles.... As a result of such transactions the income tax legally payable may not bear a normal relationship to the income shown in the income statement." *Id.* at p. 185. Bulletin No. 23 addresses the concept of a carryforward and discusses how a carryforward of excess losses and/or unused excess profits should be shown on the income statement as of 1945.

> (7) Where material amounts of losses or unused excess-profits credits of prior years are carried forward into the current tax return, the operating results for the current year should preferably be shown without inclusion of the tax reduction resulting therefrom, i.e., the current provision for income taxes should be computed and shown in the income statement without the benefit of such "carry-forward," and the amount of the tax reduction should be shown in the income statement as a separate item. *Id.* at 184.

Bulletin No. 23 specifically addressed how to show Carry-forward of Losses and Unused Excess-Profit Credits in a corporations accounting. As stated, at least as of 1945, if a taxpayer had a carryforward loss or unused excess-profit credit, the following procedure was to be used.

> In the preparation of annual income statements, the resulting tax reduction should be reflected in the year to which such losses or unused credits are carried. The committee recommends, however, that the income statement for that period indicate the results of operation without inclusion of such reduction, which should be shown as a final item before the amount of net income of the period; but if there is substantial reason to believe that misleading inferences might be drawn from such inclusion, the tax reduction may be credited to surplus.

Id. at 191-192.

Shortly thereafter, in 1948, the South Carolina Attorney General issued the seminal the opinion on the bank tax. Exhibit I. The 1948 Attorney General opinion confirms that "entire net income" under the bank tax is a calculation of all income and all expenses. *Id.* at SC 1377. It also first stated that the bank tax is a franchise tax. *Id.*

GAAP has continued to gradually evolve, based on established concepts and standards, as well as on best practices that have come to be commonly accepted across different industries.

> The American Institute of Accountants, aware of divergences in accounting procedures and of an increasing interest by the public in financial reporting, has given consideration to problems raised by these divergences. Its studies led it, in 1933, to make certain recommendations to the New York Stock Exchange which were adopted by the Institute in 1934. Further consideration developed into a program of research and the publication of opinions, beginning in 1938, in a series of Accounting Research Bulletins. Forty-two bulletins were issued during the period from 1939 to 1953. Eight of these were reports of the committee on terminology. The other 34 were the result of research by the committee on accounting procedure directed to those segments of accounting practice where problems were most demanding and with which business and the accounting profession were most concerned at the time.

ARB 11.

APB 11, passed in June 1953, replaced ARBs issued from 1939-1953. In 1987, FAS 96 replaced APB 11, with significant changes in the method used to produce the provision for income

tax expense. STATEMENT OF FINANCIAL ACCOUNTING STANDARDS NO. 96, Accounting For Income Taxes (Fin. Accounting Standards Bd. 1987). The terminology of "temporary differences" and "permanent differences" was adopted in FAS 96 (replacing the concept of "timing difference" in APB 11). *Id.* FAS 96 was replaced with FAS 109 in 1992. STATEMENT OF FINANCIAL ACCOUNTING STANDARDS NO. 109, Accounting For Income Taxes (Fin. Accounting Standards Bd. 1992). FAS 109 continued with the balance sheet approach and the concept of "temporary" and "permanent" differences. *Id.* at p. 11. FAS 109 did allow the consideration of expected future income and expenses in determining deferred tax assets and liabilities. *Id.* at p. 18.

Today, what was the original ARB 11 has transformed and is now known as ASC 740. Trial Ex. 38.

Over the past 83 years, the bank tax in South Carolina has remained essentially unchanged. Since its inception, the only change to the Bank Tax compared to the current version consisted of the distribution of the tax revenue: in 1937 the revenue from the Act was paid in specific ratios to the State, County, and Municipalities. In the current version, the revenue from the Act goes exclusively to the general fund of the State. *Compare* S.C. Bank Tax Act of 1937, No. 349, § 6 *with* S.C. Code Ann. § 12-11-60. The corporate income tax, on the other hand, has gone through momentous change and is not recognizable to its 1927 original version or to the 1937 version.

By 1952, the bank tax and the corporate tax in South Carolina were no longer apples to apples. First, based on the 1948 attorney general's opinion, the bank tax was, by this time, being treated as a franchise tax. Op. S.C. Att'y Gen. (March 12, 1948). As a franchise tax, it was to be taxed on "entire net income." The term "entire net income" under the bank tax had been defined to mean all expenses and all income. *Id.*

The corporate tax was not deemed to be a franchise tax like the bank tax and was instead viewed by the legislature as a wholly separate, income tax. By 1952, the income tax section of the Code had been revised to include no fewer than forty (40) separate sections, including specific deductions that could be taken. S.C. Acts. Of 1926 §§15-388-428. Exhibit J. The 1952 corporate income tax went on to define "corporations" under the income tax code and defined how the corporate income tax was to be calculated. S.C. Code Ann. § 65-222. It also specified that an "income year" for the corporate tax code meant calendar year or fiscal year. S.C. Code. Ann. § 65-259(13)(A).

Further, since at least 1952, the code also dealt with such issues as "Nonresidents carrying on business in State" § 65-231; the meaning of "entire net income" in case of apportionment. § 65-238; defined "gross income" §65-251; identified "items exempt from gross income" § 65-253 and defined, specifically, net income for the income tax section of the code.

> Net Income defined.
>
> The word "net income" as used in this chapter mean the gross income of a taxpayer less the deductions *allowed by this chapter.*

§ 65-255 (emphasis added)

No such limitations were placed on banks in 1937, and no such limitations have ever been placed on the bank tax because the bank tax has remained essentially unchanged since the initial version. 1937 S.C. Acts Bank Tax 563. Because the income tax applicable to corporations had a provisions that specified *only deductions allowed by the chapter* could be taken, an NOL deduction could not be taken by a corporation unless specifically included by the legislature in the income tax chapter. In 1955, a specific section of the corporate tax code was added to address an NOL carryforward. *See* Exhibit K, 1955 (49) 437, § 6 (adding S.C. Code § 65-259(13)). The NOL

carryforward specifically described net income under the corporate tax as taxable income, not bank income. *Id.* (B).

The General Assembly's adoption of an explicit net operating loss carryforward for corporations in 1955 also coincided with a fundamental shift in the application of the net operating loss carryforward at the federal level. Prior to 1955, the federal tax code allowed a more limited net operating loss carryforward and attempted to take an economic approach to calculating the net operating loss carryforward. By the end of 1954, however, § 122 of the prior federal tax code was replaced with the more modern-day iteration of the net operating loss deduction, first found in § 172 of the Internal Revenue Code of 1954. This §172 replaced the concept of economic loss for NOLs and replaced it with a concept based on taxable loss.

This new-found focus on "taxable loss" was a fundamental shift in tax policy. *Tax Management Portfolio 539, Net Operating Losses – Concepts and Computations*, describes the impact of this change:

> The net operating loss rules under the 1939 Code employed an "economic loss" concept for purposes of determining whether a taxpayer sustained a net operating loss. Underlying this theory was the idea that a true net operating loss did not arise unless the relevant deductions offset not only a taxpayer's taxable income but also nontaxable items and deduction items that were artificially increased. For example, tax-exempt income had to be taken into account. Similarly, the excess of percentage depletion over cost depletion was added back to taxable income for purposes of determining a net operating loss.
>
> * * * *
>
> The Internal Revenue Code of 1954 made a fundamental change in the computation of net operating losses. The "economic loss" concept employed by the 1939 Code was substantially replaced with a "taxable loss" concept under which net operating losses are determined with reference to a taxpayer's taxable income. The "taxable loss" concept continues to apply under the Internal Revenue Code of 1986. Under the 1986 Code, for example, a modification for tax-exempt income is not required. Similarly, the excess of percentage depletion over cost depletion does not have to be added back to a taxpayer's taxable income in computing a net operating loss.

> However, the abandonment of the economic loss concept was not complete. For example, adjustments are still required for the deduction for personal [and business] exemptions. Like its predecessors, §172 confines the deduction primarily to business losses, allowing deductions that are "not attributable to a taxpayer's trade or business" to figure into a net operating loss only to the extent of the gross income from such business.

Section X, Background of the Deduction (citations omitted).

ARGUMENT

I. The Legislative History Makes Clear an NOL Carryforward Deduction Is Allowed for Banks

From the very first inception of an income tax in South Carolina, banks have been allowed to take an NOL carryforward deduction. In 1922, when the first South Carolina income tax was passed, an NOL carryforward was allowed to be taken pursuant to the federal tax code. As a result, an NOL carryforward was also available to a bank as early as 1922. *Lancaster Cotton Mills v. S.C. Tax Comm'n,* 132 S.C. 466, 129 S.E. 429, 431 (1925) (South Carolina income tax was a percentage of the federal tax due and owing). Subsequently, in 1926 when South Carolina passed its first standalone income tax, the term "entire net income" was used to define the income tax basis. S.C. Acts. Of 1926 § 15-388. As Synovus has argued previously, the legislature does not include words without reason. *Gordon v. Phillips Utils., Inc.*, 362 S.C. 403, 608 S.E.2d 425 (2005) (citing *State ex rel. McLeod v. Montgomery*, 244 S.C. 308, 314, 136 S.E.2d 778, 782 (1964)) ("[T]he legislature intends to accomplish something by its choice of words, and would not do a futile thing.") The term "entire" has no reasonable definition other than "all." The use of the term "entire net income" remained in both the corporate and the bank tax when the bank tax was separated from the corporate income tax in 1937. S.C. Bank Tax Act of 1937, No. 349 § 2. The interpretation that the term "entire net income" means "all" is consistent with the opinion of the 1948 South Carolina Attorney General. In 1948, the Attorney General issued an opinion that specifies that "entire net

income" for banks includes all income and all expenses without a limitation to one year. Op. S.C. Att'y Gen. (March 12, 1948). The 1948 attorney general opinion also made clear that the bank tax is a franchise tax. *Id.* As the DOR has conceded, a franchise tax is taxed in its entirety as a condition of doing business in the state. DOR Mem. In Supp. Of Summ. J p. 12. As a franchise tax, a tax based on entirety includes both income and expenses. Synovus is unaware of any authority that limits the bank tax to a basis or calculation that would only include annual expenses.

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. 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). As such, an NOL carryforward is, and always has been, available to a bank in South Carolina.

II. The 1955 Amendment to the Corporate Income Tax Had No Impact on the Bank Tax, Which Already Allowed an NOL Carryforward

By the 1950s, the corporate tax and the bank tax were no longer apples to apples. The bank tax had remained relatively unchanged since its inception in 1937. *Compare* S.C. Bank Tax Act of 1937, No. 349, *with* S.C. Code Ann. § 12-11-10 through § 12-11-60. The corporate income tax, on the other hand, had seen large scale modification and expansion. *See* Act No. 234, 1955 S.C. Acts 437, § 6, Corporate Tax (amending S.C. Code § 65-259 (1952), now codified at § 12¬6-1130). Exhibits K and L.

For example, by 1952, the corporate tax was clearly not a "book tax" and was not considered to be a franchise tax. Based on the 1948 attorney general's opinion, banks were

considered a franchise tax and had to pay a tax on state and federal bonds. Op. S.C. Att'y Gen. (March 12, 1948). Corporations, on the other hand, had a specific exemption for interest earned on state and federal tax exempt bonds. S.C. Code § 65-253(4) (1952) (exempting from the definition of "gross income" "[i]nterest upon obligations of the United States or its possessions or of this State or any political subdivision thereof"). Likewise, by 1952, the corporate tax defined "entire net income" and its means of calculation through its specific definition of "net income" and "gross income." S.C. Code § 65-251 (1952).

No such definitions were included in the bank tax in 1937, 1952, 1955, or at any other time. S.C. Bank Tax Act of 1937 No. 349.

In 1955, a specific section addressing NOL carryforwards was included in the South Carolina income tax section for corporations. S.C. Act of 1955 No. 234 (adding S.C. Code § 65-259(13)). The corporate income tax code specifically defined "net income." S.C. Code § 65-251 (1952). The definition of net income in the corporate income tax chapter of 1952 served two purposes: First, it defined how to calculate net income through a calculation of gross income. Gross income is all income you receive that is not explicitly exempt from taxation. Gross income is different from taxable income. Taxable income is equivalent to adjusted gross income less any items you are entitled to claim as a deduction. S.C. Code Ann. § 12–6–1110 (defining South Carolina taxable income by reference to federal taxable income). Second, the definition of "net income" in the 1952 corporate income tax chapter specifically limited any deduction to net income to only those deductions "*allowed by this chapter.*" S.C. Code § 65-251 (1952). Without an affirmative addition of a net operating loss carryforward in the corporate section, no such carryforward was allowed under the definition of net income found in the corporate tax section.

This affirmative addition of an NOL carryforward deduction was also consistent with changes in the federal tax code related to NOLs that occurred at the end of 1954.

Unlike the corporate tax section, no limitation on deductions exists, nor has it ever existed, in the bank tax section or in the definition of "entire net income" found therein. As a result, there was no need for the bank tax to include the same type of affirmative language that the corporate tax chapter required in 1955. The term "entire net income" already allowed the deduction for a net operating loss carryforward without need for additional legislative action for banks.[2]

III. GAAP Accounting Also Makes Clear an NOL Carryforward Deduction Is Allowed for Banks in South Carolina.

The accounting standards have also provided specific instructions for how excess expenses should be treated by entities, including banks, since their inception. Because the concept of a net operating loss carryforward has been present since the inception of income taxes, this has always been an issue that accounting procedures have had to address in the "books." The first official pronouncement codifying the issue and addressing how accountants should show excess expense in subsequent years was issued in 1945. Coincidentally, this was just before the Attorney General issued the 1948 opinion that also held all expenses should be calculated. Since the issuance of the

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[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 has stated that:

> Although the bank tax is a franchise tax and not an income tax, because the bank tax chapter is titled "Income Tax on Banks," the Department believes that the legislative intent was to allow income tax credits 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. 198:25–201:22.

1945 accounting bulletin, at all times, the accounting profession has had specific instructions and a method for addressing this issue. BULLETIN NO. 23, Combined Statement of Income and Earned Surplus at p. 185 (Am. Inst. Of Certified Pub. Accountants 1944). Over time, how the NOL carryforward is shown on the books has changed, but at no time has there not been a method to show an NOL carryforward. *Id.* The changes to "book income" in relation to the net operating loss carryforward since 1945 have dealt primarily with timing issues. Generally, the timing rules are dependent on the taxpayer's method of accounting. BLOOMBERG TAX PORTFOLIO, Gross Income: Overview and Conceptual Aspects, No. 501. Exhibit M. As is made clear by SC tax regulation 117-92.2, a bank in South Carolina may use either the cash or accrual form of accounting. As was made clear at trial, because Synovus is a publicly traded bank, it uses the accrual method of accounting (or GAAP). As a result, because GAAP has always provided a method for excess expenses to be carried forward, there is no argument that such was not the case in 1937 when the bank tax was originally passed. Because there has always been a method for net operating loss carryforwards on the books, the intent of the 1937 legislature is clear – a net operating loss carryforward has always been allowed for banks. If the 1937 legislature had intended otherwise, they would not have used the word "entire" and/or would have stated an exclusion for banks operating their books in accordance with the accepted accounting rules of the era.

CONCLUSION

It is clear that the intent of the Legislature in 1937 was to allow a bank to take a Net Operating Loss Carryforward. The accounting principles of the time allowed such a carryforward to be show "on the books" and the legislative history makes clear that, from the original income tax passed in South Carolina, NOL carryforwards were allowed and recognized by the Legislature.

There have never been any additions or deletions from the bank tax to suggest that the Legislature changed its mind in regards to the application of an NOL carryforward for a bank. The term chosen by the Legislature for the basis of the bank tax, "entire net income," was chosen with reason, not happenstance. As has been argued repeatedly by Synovus, "entire net income" means all income and all expenses. To the extent a bank has expenses that cannot be utilized in one calendar year for tax purposes there is no means to utilize such expenses other than through a Net Operating Loss Carryforward. As such, this Court should affirm the use of a Net Operating Loss Carryforward for a bank in South Carolina.

Dated this 20th day of February, 2020.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on the 20th day of February 2020, the foregoing PETITIONER SYNOVUS BANK'S SUPPLEMENTAL BRIEF has been served upon the following persons via U.S. Mail, First Class thereto:

Jason P. Luther, Esq.
Andrew W. Saleeby, Esq.
South Carolina Department of Revenue
PO Box 12265
Columbia, SC 29211-9979

Teri Atkinson

41785337.5

Exhibit A

(619) **No. 349.**

AN ACT to Raise Revenue for the Support of the State Government by the Levy and Collection of a Tax Upon the Income of Banks in Lieu of All Other Taxes Except Taxes on Real Property.

Section 1. "Banks and taxpayers" defined.—Be it enacted by the General Assembly of the State of South Carolina: For the purpose of this Act and unless otherwise required by the context, the words "banks and taxpayers," wherever used in this Act, shall mean any person, firm or corporation, engaged in a banking business whether incorporated under the laws of this State, any other State, or the United States, or whether unincorporated except cash depositories.

§ 2. **Tax on banks.**—A tax is hereby imposed upon every bank engaged in business in the State of South Carolina, which tax shall be levied, collected and paid annually, with respect to the entire net income of the taxpayer doing a banking business within this State, or from the sales or rentals of property within this State, computed at the following rate:

Four and one-half (4½%) per centum of the entire net income of such bank or taxpayer.

§ 3. **In lieu of other taxes except taxes on real property.**—The income taxes herein provided shall be in lieu of all other taxes, except taxes on real property. The real property of any such bank, or banking association, shall be taxed in the place where the same may be located, the same as the real property of individuals.

§ 4. **Enforcement—administration.**—That for the purpose of administration, enforcement, collection, liens, penalties, and other provisions of enforcement, all of the provisions of Sections 2435-2479, inclusive, Code of Laws of South Carolina, 1932, that may be appropriate or applicable are hereby adopted and made a part of this Section for the enforcement and administration of this Act.

§ 5. **Invalidity.**—In case the first provision (contained in the first sentence) of Section 3 hereof should for any reason be declared to be invalid by a Court of competent jurisdiction, then and in that event, the taxes provided in Section 2663-2667, inclusive, Code of Laws of South Carolina, shall be and remain in full force and effect, and the income tax provided herein shall not be effective.

§ 6. **Payment of tax—distribution.**—The taxes herein provided for shall be paid to South Carolina Tax Commission as is provided in Section Four (4) of this Act and the income taxes paid under the provisions of this Act shall be distributed between the general fund of the State, the County and Municipality in which the bank is located as follows:

Ten (10) per cent to the general fund of the State

Sixty (60) per cent to the County

Thirty (30) per cent to the Municipality in which the Bank is located.

The Tax Commission is authorized and directed to draw warrants on the State Treasurer for such distribution on or before May 15 of each year and the State Treasurer is authorized and directed to honor said warrants.

For the purpose of and in the distribution of the taxes paid under this Act by a bank having one or more branches, each branch of the bank shall be deemed to have paid such portion of the entire tax as its deposits on January 1st of each taxable year bear to the total of the deposits of all branches and the tax distributed accordingly.

§ 7. **Repeal.**—All Acts or parts of Acts inconsistent with this Act are hereby repealed except as hereinabove provided.

§ 8. **Time effective.**—This Act shall take effect immediately upon its approval by the Governor and shall be retroactive so as to apply during the year 1937.

Approved the 19th day of May, 1937.

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(623) **No. 350.**

AN ACT Abolishing the Governing Board (Advisory Board) and Devolving All the Powers, Duties, Responsibilities and Functions Thereof on the Supervisor of Union County, Abolishing the Salaries of Members of Governing Board (Advisory Board) of Union County, and Making It Unlawful for the Supervisor to Issue Vouchers in Payment of the Same After July 1st, 1937, and Making It Unlawful for the Treasurer of Union County to Honor and/or Pay the Same After July 1st, 1937, with the Exception of Salaries Aforesaid Members of Governing Board (Advisory Board) Earned Prior to July 1st, 1937.

Exhibit B

Accounting Horizons
Vol. 17, No. 3
September 2003
pp. 189–205

How the U.S. Accounting Profession Got Where It Is Today: Part I

Stephen A. Zeff

Synopsis: Few would deny that the U.S. accounting profession is in a very troubled state. The aim of this two-part article is to explain how and why the profession evolved and changed during the 20th century, with particular emphasis on the last three decades. It is my hope that this article will illuminate the origins and consequences of these changes that collectively brought the profession to its current condition.

This paper reviews, examines, and interprets the events and developments in the evolution of the U.S. accounting profession during the 20th century, so that one can judge "how we got where we are today." While other historical works study the evolution of the U.S. accounting profession,[1] this paper examines two issues: (1) the challenges and crises that faced the accounting profession and the big accounting firms, especially beginning in the mid-1960s, and (2) how the value shifts inside the big firms combined with changes in the earnings pressures on their corporate clients to create a climate in which serious confrontations between auditors and clients were destined to occur. From available evidence, auditors in recent years seem to be more susceptible to accommodation and compromise on questionable accounting practices, when compared with their more stolid posture on such matters in earlier years.

INTRODUCTION

The paucity of available evidence about actual changes occurring within the big firms, especially from the 1970s onward, poses a major difficulty in conducting this kind of research. Without statistical analysis, the court cases, regulatory investigations, and press reports of alleged audit

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The author expresses his appreciation to several accounting academics and to more than a dozen active and retired senior partners of major accounting firms for their comments on earlier drafts. He also appreciates the suggestions of the anonymous reviewers.

Editor's note: Professor Zeff agreed to have this lengthy but very important article published in two parts. Splitting an article of this nature is judgmental and unavoidably somewhat arbitrary. We both believe that your appetite will be whetted for Part II, forthcoming in December 2003, beginning as it does with Professor Zeff's discussion of "A Gradual Degeneration of Professional Values." The complete set of references will appear at the end of Part II.

[1] Interested readers should consult Previts and Merino (1998), which paints on a much broader canvas than this paper. While their book treats a number of the developments in the evolution of the U.S. profession, it does not provide as extensive a discussion of the subject taken up in this paper. An article that traces the evolution of the Big Eight firms, focusing heavily on published data on their internal growth as well as their growth through mergers, is Wootton and Wolk (1992). Miranti (1990) has also written a valuable work on the development of the profession, but it extends only to 1940.

Submitted: January 2003
Accepted: April 2003
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failures can be dismissed by leaders of the profession as isolated instances, not representative of the general way in which the big firms fulfill their professional obligations. Of necessity, I relied on letters from those who do know, on public expressions of concern by leaders of the profession and by regulators, and on the writings by close students of the profession. I formed interpretations and conclusions based on the available evidence, and I welcome comments and reactions from readers.

Three major sections comprise this paper. The first section surveys the evolution of the profession prior to the 1940s, essentially a period of groundbreaking and early development. The second section, covering the 1940s, the 1950s, and the first half of the 1960s, displays the profession at the height of its reputation and influence. The third section, beginning in the mid-1960s, treats the scandals, court cases, the profession's loss of its accounting standard setter and the impact of that loss on the vitality of professional discourse, Congressional criticism, pressures from government to alter the competitive climate of the profession, the burgeoning consulting services, and, in the end, the transformation of the big firms from organizations strongly imbued with professional values to ones that strongly pursue goals associated with commercial and business success. This reshaping of the firms as engines of growth, profitability, and global reach in turn placed added pressure on audit partners, already under pressure to generate fees and to placate clients. Such circumstances exert a severe strain on auditor independence. At the same time, top executives in publicly traded companies found themselves under greatly increased pressure for revenue and earnings performance, which they transmitted first to their accounting staff and eventually to their external auditors. The confluence of these developments inevitably led to the confrontations mentioned above.

PRIOR TO THE 1940s: SETTING THE STAGE

The U.S. accounting profession emerged during the last quarter of the 19th century, the first major accounting body being the American Association of Public Accountants, the lineal predecessor of the American Institute of Certified Public Accountants, established in 1887.[2] New York State passed the first law, in 1896, to recognize the qualification known as Certified Public Accountant, which, as Carey writes, "marked the beginning of an *accredited* profession of accounting in the United States" (Carey 1969, 44).

Scottish and English Chartered Accountants, who settled in the United States during the last quarter of the 19th century to report on British interests, performed much of the early auditing work. These pioneers from Britain included Edwin Guthrie, Arthur Young, James T. Anyon, John B. Niven, Ernest Reckitt, George Wilkinson, Arthur Lowes Dickinson, and George O. May. Americans who formed important accounting firms in the late 1890s and during the first two decades of the next century included Alwin C. Ernst, Charles Waldo Haskins, Elijah Watt Sells, Robert H. Montgomery, and Arthur E. Andersen.

Prior to the 1930s, no laws or regulations obliged corporations to have their financial statements audited. Quite a few companies had done so, however, for more than a decade, including United States Steel Corporation, E. I. duPont de Nemours & Company, General Motors Corporation, Eastman Kodak Company, and International Business Machines Corporation.

Early Professional Services and Ethical Norms

In 1913, following approval of the Sixteenth Amendment to the Constitution, Congress passed the first Revenue Act, which, coupled with "[r]ising tax rates, during and after the war, and the increasing complexities of the tax laws and regulations added enormously to the demand for accountants" (Carey 1969, 146, and 67–71, 213–215; also see Sommerfeld and Easton 1987, 169–170). Previously, many companies had never kept adequate accounting records, and, as a result of the

[2] For an extensive treatment of this period, see Miranti (1990), Previts and Merino (1998, Chapters 5 and 6), and Carey (1969).

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Revenue Acts of 1913 and 1918, many company executives came to appreciate the importance of recording depreciation, because it was deductible for tax purposes. The Bureau of Internal Revenue's famous Bulletin "F," *Depreciation and Obsolescence*, appeared in 1920 (Grant and Norton 1955, 208–211). Accountants responded eagerly to meet the burgeoning demand for their services. In 1924, the newly instituted Board of Tax Appeals authorized both lawyers and CPAs to practice before it, which represented a strong endorsement of the standing of CPAs to conduct tax practice (Carey 1969, 222–224).

From the earliest days of the profession, accounting firms rendered consulting services. By the 1910s, they included the installation of factory cost systems, studies of organizational efficiency, investigations in connection with possible investments in other businesses, and an array of other services to management, which, as Carey writes, "were often rendered in conjunction with audits" (Carey 1969, 146). But accounting, auditing, and taxation constituted the solid core of the firms' services.

In 1922, the American Institute of Accountants, now known as the American Institute of Certified Public Accountants (AICPA), banned certain forms of self-promotion by accounting firms. The following year, A. C. Ernst and two of his partners in Ernst & Ernst, by then a national firm, were accused of violating the Institute's rules against soliciting and advertising, and all three promptly resigned their Institute membership. Even after his firm no longer engaged in those practices, A. C. Ernst never rejoined the Institute (Carey 1969, 233–234).

Federal agencies sought the advice of the organized accounting profession because of its growing reputation. In 1917, at the request of the Federal Trade Commission (FTC) and the Federal Reserve Board, the Institute supplied a technical memorandum for publication by the Board as a bulletin on auditing procedures. The FTC sought to promote uniform accounting, while the Board wanted to apprise commercial bankers of the importance of securing audited financial statements from their borrowers. Despite the title of the bulletin, "Uniform Accounting," it actually dealt with recommended auditing procedures and the format of the balance sheet and profit and loss statement. This represented the first authoritative guidance on auditing procedures published in the U.S. In 1929, at the request of the Federal Reserve Board, the memorandum was revised by the Institute and published anew (Carey 1969, 129–135, 159–160; Previts and Merino 1998, 229–234, 250–251; Zeff 1972, 113–115, 118–119).

Audit work developed apace in the 1920s, as an increasing number of listed companies issued audited financial statements. By 1926, more than 90 percent of industrial companies listed on the New York Exchange were audited (May 1926, 322), even though the Exchange did not require audited statements by newly listed companies until 1933 (Rappaport 1963, 39–40). Yet the Exchange had informally encouraged companies to publish audited financial statements "for some years" before then (Staub 1942, 14–15).[3]

Initial Accounting Principles and Auditing Procedures, and the SEC

In 1930, following on the heels of the 1929 stock market crash, the New York Stock Exchange sought out the Institute for advice on the policies it should adopt with respect to the financial statements of its listed corporations. After three years of deliberations, a blue ribbon committee of the Institute provided the Exchange with a philosophy and a framework for dealing with the accounts of listed companies. The committee proposed a set of "five broad principles" of accounting that it regarded "as so generally accepted that they should be followed by all listed companies" (Carey 1969, 177). These, together with a sixth, were officially approved in 1934 by a vote of the Institute's membership. The committee also recommended a standard form of the auditor's report. The

[3] The great increase in the frequency of appearance of audit reports occurred between 1920 and 1928 (Hawkins 1962, 364).

committee's work quickly established the Institute as a body of stature in the field of corporate financial reporting. The leader of the Institute's committee was George O. May, the senior partner of Price, Waterhouse & Co. (Carey 1969, 174–180).

In June 1932, *Fortune* magazine, the trumpet of American capitalism, acknowledged the growing importance of the accounting profession by devoting a major article to a profile of the largest firms (Certified Public Accountants, 1932).

Early in his first term, President Franklin D. Roosevelt signed into law two major pieces of reform legislation, the Securities Act of 1933 and the Securities Exchange Act of 1934, the second of which created the Securities and Exchange Commission. These Acts, as implemented by the SEC, required all new and continuing registrants to have their financial statements audited by independent CPAs, thus highlighting the importance of the accounting profession and generating an increased demand for its services. A government takeover of the auditing of publicly traded companies was averted, as Col. Arthur H. Carter, the senior partner of Haskins & Sells and the president of the New York State Society of Certified Public Accountants, succeeded in persuading the Senate Committee on Banking and Currency, during the hearings on the proposed Securities Act, not to assign the external audit function to a government agency, but instead to allow it to be done by firms in the private sector (Carey 1969, 186–187; Wiesen 1978).

In 1935, the SEC appointed a chief accountant, Carman G. Blough, who promptly began to work closely with the Institute and the American Accounting Association (the organization of academic accountants), and other accounting experts, to identify the norms of proper accounting and auditing practice. In 1937–38, Blough succeeded in persuading the Institute to empower the Institute's Committee on Accounting Procedure to approve and publish bulletins constituting "substantial authoritative support" for accounting principles, known as Accounting Research Bulletins (Zeff 1972, 132–138; Seligman 1982, 197–201).

In 1939, the Institute established a similar standing committee to promulgate a series of bulletins on auditing procedures, a step precipitated by the gigantic McKesson & Robbins auditing scandal, which led to a widely reported SEC investigation, greatly embarrassing the profession (Carey 1970, 22–38). The editor of the Institute's *Journal of Accountancy* wrote in February 1939, "Like a torrent of cold water the wave of publicity raised by the McKesson & Robbins case has shocked the accountancy profession into breathlessness" (The McKesson & Robbins Case 1939, 65).[4] McKesson & Robbins had grossly inflated its receivables and merchandise inventory, and its auditor, Price, Waterhouse & Co., had neither confirmed the receivables nor verified the existence of the inventory. Neither of these tests was a required auditing practice at the time. In response, a special committee formed by the Institute promptly issued a bulletin requiring that both of these tests become standard auditing procedures.

The organized profession consolidated into one national body in 1936, as the Institute merged with its rival, the American Society of Certified Public Accountants. Thus, for the first time since 1921, when the Society was formed, the organized accounting profession became united (Carey 1969, Chapter 19).

The decade of the 1930s ended with the organized profession, represented by the Institute, poised to be the principal source of authoritative pronouncements on both accounting and auditing that the SEC would require for use by SEC registrants and their auditors. The professional and academic literature thus became the place where improvements in accounting and auditing norms could be discussed and debated.

The end of the 1930s marked the close of a major chapter in the profession's history. In a similar vein, John L. Carey, in his landmark history of the Institute from 1896 to 1969, identified 1936/37 as

[4] For more on the McKesson & Robbins scandal, see McCarten (1939), Shaplen (1955), and Keats (1964).

the turning point between his two volumes, subtitled "From Technician to Professional" (1969) and "To Responsibility and Authority" (1970).

1940s TO THE MID-1960s: THE PROFESSION AT ITS PEAK

From the 1940s to the mid-1960s, accounting, auditing, and the accounting profession in the United States reached the height of their standing and reputation. Throughout this period, the SEC relied on committees of the Institute for "generally accepted accounting principles" (GAAP) and the auditing procedures that accounting firms were to adopt in their engagements. Nowhere else in the world did the organized accounting profession possess such a large degree of influence in setting the norms of professional practice.

Moreover, in 1947, the Institute's Committee on Auditing Procedure recommended a set of "generally accepted auditing standards," which the Institute's membership approved at an annual meeting in September 1948. These standards, as distinct from procedures, dealt with the auditor's professional qualities and the exercise of judgment in the conduct of the audit engagement (Carey 1970, 147–150). Once again, the organized profession set the terms governing the performance of its flagship service, the external audit.

At the top of its form, the Institute held well-attended annual meetings, which addressed both policy and technical issues in plenary sessions and roundtables, and distributed the papers widely in volumes of proceedings.

By 1950, all of the states and territories had enacted CPA laws, with all jurisdictions but one adopting the Institute's Uniform CPA Examination. Accounting courses were offered in nearly all major universities, and a large American literature on accounting and auditing had come into existence (Accounting at the Half-Century Mark 1951).

In 1940, the American Accounting Association published *An Introduction to Corporate Accounting Standards*, by Professors W. A. Paton and A. C. Littleton, which both the Association and the Institute distributed as a dividend to its members (Zeff 1966, 57). This monograph, which provided an elegant rationale for the conventional accounting model, profoundly influenced accounting thought, education, and practice for decades thereafter. (See Sterling 1967, 340–343; Ijiri 1980, 620–622.)

In 1943, George O. May, the doyen of the accounting profession, wrote an important treatise, *Financial Accounting: A Distillation of Experience*, and from 1947 to 1952 he directed a major study sponsored by the Institute and the Rockefeller Foundation on the appropriateness of different concepts of business income during periods of substantial change in price levels, a subject of great importance during the postwar inflation (Study Group on Business Income 1952).

CPAs Emerge as Prominent Public Figures

From the late 1930s through the 1960s, CPAs served in important government positions, gave testimony before Congressional committees, and served as expert witnesses in court cases, in rate regulation hearings, and before federal wage tribunals. From 1938 to 1941, Eric L. Kohler was comptroller of the Tennessee Valley Authority; from 1948 to 1951, he served as controller of the post-World War II Economic Cooperation Administration, known as the Marshall Plan. In 1942, Norris Poulson became the first CPA elected to Congress; his election in 1953 as mayor of Los Angeles made him the first CPA to head a major city.[5] In 1948 and again in 1954, former President Herbert C. Hoover tapped Paul Grady, a Price Waterhouse audit partner, to chair a task force to study government lending agencies under the auspices of the first and second Commissions on Reorganization of the Executive Branch of Government, known as the Hoover Commissions. In

[5] Abraham Beame became comptroller of New York City in 1969 and mayor in 1973.

1949, Donald C. Cook, also a lawyer, became the first CPA to be named to the SEC; he served as chairman of the Commission in 1952–53. Three days after Cook joined the Commission, Edward T. McCormick, another CPA, became a Commissioner.[6] McCormick left the SEC in 1951 to become chairman of the New York Curb Exchange, renamed the American Stock Exchange two years later. In 1953, T. Coleman Andrews became the first CPA to serve as Commissioner of Internal Revenue, and in 1954 Joseph Campbell became Comptroller General of the U.S., the first CPA to head the General Accounting Office.

In 1959, when Christopher Del Sesto won election as governor of Rhode Island, he became the first CPA to serve as governor of a state. Two leading accounting practitioners, Percival F. Brundage and Maurice H. Stans, became successive directors of the Bureau of the Budget, appointed by President Dwight D. Eisenhower, and in 1969 President Richard M. Nixon named Stans as his Secretary of Commerce. Members of the accounting profession were coming to the fore in public affairs because of the increasing respect accorded to the profession (see Carey 1970, 382–384).

Movement into Information-Based Services

Following the Second World War, the major accounting firms began to develop capabilities in new information-based services, gradually expanding beyond their traditional services of accounting, auditing, taxation, and systems design and installation. They chose to describe this new line as "management services," "management advisory services," or "administrative services." It began with punched card and punched tape systems, followed by the introduction in the mid-1950s of electronic computers for business applications, which in turn led to the development of computerized information systems and computer modeling. Operations research and electronic data processing were among the early pillars of this broadened scope of activity. Some firms, such as Arthur Andersen & Co., Peat, Marwick, Mitchell & Co. and Touche, Niven, Bailey & Smart, invested heavily in these new services (Glickauf 1971; Wise 1982, 48–49; Swanson 1972, 39–40).

In the mid-1950s, Arthur Andersen & Co. designed and installed the first business application of a computer, a payroll system at General Electric Company's Appliance Park facility in Kentucky. As the firm wrote, "This was a milestone event in the development of computers for business use as well as in the development of our administrative services practice, and it marked the beginning of a dramatic firm-wide growth in our practice" (*The First Sixty Years 1913–1973* 1974, 67). (Also see *A Vision of Grandeur* 1988, 95–98.) From the inception of Andersen's administrative services division in 1942, its staff grew to 400 in 1965, and nearly tripled to 1,150 by January 1970 (Glickauf 1971, 113, 175). By 1969, the division's gross fees accounted for "roughly one-fourth of the firm's business" (Williams 1971, vi).

In 1965, after 30 years of controversy and a protracted battle with the legal profession, CPAs secured Congressional recognition of their status to represent tax clients before the Treasury Department (Carey 1970, Chapter 9). The position of CPAs in tax practice was now secure.

Accounting Principles Become Controversial

Also in the mid-1950s, Leonard Spacek, the outspoken managing partner of Arthur Andersen & Co., began publicly criticizing the probity of the Institute's committee that issued pronouncements on GAAP. The Institute sensibly channeled Spacek's criticisms toward constructive change by appointing him to a blue ribbon committee to recommend a better approach (see Zeff 2001). The committee proposed a new body, the Accounting Principles Board, and charged it to undertake basic and applied research as well as issue pronouncements on GAAP. The Institute promptly accepted and implemented the committee's recommendation in 1959, and during the 1960s, especially in

[6] Both Cook and McCormick had been SEC staff members before being named to the Commission. In 1969, James J. Needham became the first CPA firm partner to be appointed to the Commission.

1966–67, the APB earned some credit for narrowing the areas of difference in a number of controversial areas of GAAP.

During the 1960s, as the APB became active in addressing controversial areas, leading partners of the Big Eight firms—each of whom had a vote on the APB—began to speak at public forums and write articles and even books on the major accounting principles issues of the day. From the 1930s to the 1970s, *The Journal of Accountancy* regularly contained articles dealing with accounting and auditing issues of interest to the profession, as did *The Accounting Review* from the 1930s to the 1960s. Journals published by a number of state CPA societies also carried the dialogue, and several universities, including Ohio State, Tulsa, and the City University of New York, held annual conferences or sponsored lecture series to air controversial professional issues.

Beginning in the mid-1950s, Arthur Andersen & Co. prepared reprints of partners' speeches and booklets expressing the firm's views on accounting principles, and distributed them to a wide audience of academics, practitioners, and companies. From 1962 to 1967, the investment banking house of Hayden Stone sponsored an annual Accounting Forum, featuring major accounting practitioners speaking on accounting principles at well-attended one-day programs held at New York University. And starting in 1968, the Institute co-sponsored a series of Seaview Symposia, at which representatives of the preparers, auditors, and users of financial statements debated major issues of the day. The decade of the 1960s was marked by a vibrant dialogue on accounting principles, with active participation both by partners in the big firms and by accounting academics (see Zeff 1986).

This was a time when audit partners were, except in rare instances of substandard performance, assured of tenure until they retired, and they expected their firm to back them with its full resources when they stood up to their clients over questionable accounting practices. Partnership in one of the big accounting firms was seen as the pinnacle of one's career, it being almost unknown for partners to leave their firms to take positions in industry. The idea of a "marketing" campaign for new clients did not exist. If a partner secured a new client, he was praised, but the rewards doled out to partners recognized the quality of audit service to one's clients.

The corporate merger movement of the 1960s that led to the formation of conglomerates and multinationals focused attention on a sensitive accounting issue, segment reporting, and called forth a demand for the international comparability of financial statements. Numerous high-profile mergers heightened the pressure on top corporate executives to deliver improved earnings performance—either to defend against takeovers or to engineer takeovers—thus prompting the corporate sector to begin opposing constraints on their freedom of choice of accounting methods, especially any limits on the use of "pooling of interests" accounting for business combinations.

Early in the 1960s, the business press took notice of the much higher profile of the accounting profession. While comparatively little had been written in the press about accounting and the profession in previous decades, this coverage mushroomed in the 1960s, especially when the APB moved into controversial territory—accounting for the investment tax credit, leases, pensions, income tax allocation, convertible debt, extraordinary items, and business combinations and goodwill. The decade began with a major, two-part article in the November and December 1960 issues of *Fortune*, "The Auditors Have Arrived." Written by T. A. Wise, the article began as follows:

> It is a curious and noteworthy fact that the tremendous growth of the U.S. accounting profession in the postwar years has taken place almost unnoticed by most Americans.

This was the article that coined, or at least popularized, the term, "the Big Eight," referring to the eight largest public accounting firms. Special interest magazines such as *Business Week*[7] and *Forbes*, and even the more general *Time* and *Newsweek*, as well as *The Wall Street Journal*, *The New York Times*, and newspapers across the country, began covering accounting principles issues, as they

[7] A good example is "A Matter of Principle Splits CPAs" (1963).

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became news of interest to more than accountants. During the 1968–70 debate over "pooling of interests" and goodwill, the Financial Executives Institute flooded the nation's press with criticisms of the APB's draft pronouncements. Articles on accounting principles also began appearing in the likes of the *Harvard Business Review* and *California Management Review*.

In 1963, after issuing its second Opinion, the APB suffered a stunning reversal. In its Opinion, the board narrowly voted to require that the investment tax credit be deferred for accounting purposes rather than be taken immediately into income. Immediately afterward, pressure from several major accounting firms, whose partners voted against the Opinion, and from an important segment of industry, as well as from the Department of the Treasury (behind the scenes), led the SEC to reject the APB's single permissible treatment. Instead, the SEC allowed registrants either to defer the credit or to take it immediately into income. This rebuff by the SEC forced the APB to concede the acceptability of both treatments in Opinion No. 4, issued two years later. In 1967, the board once more tried to gain acceptance for its preferred treatment of the credit, but it was again defeated by the Treasury, this time in the open. Political lobbying by powerful interest groups against objectionable draft standards began afflicting the APB in the early and mid-1960s. (See Zeff 1972, 178–180, 201–202; Moonitz 1966; Zeff 1978.)

MID-1960s TO THE PRESENT—THE PROFESSION BEGINS A DESCENT UNDER STRESS

All was not rosy as the three decades from the 1940s through the 1960s came to a close. Threatening clouds began to form over the accounting profession in the middle and latter 1960s. Financial scandals burst on the scene, raising questions about the performance of auditors. Trailing in the wake of the scandals, auditors found themselves as defendants in a number of highly publicized lawsuits. And the accounting profession lost its prized authority to pronounce on "generally accepted accounting principles" (GAAP) to an independent body, with unfortunate ramifications for the vitality of professional discourse.

Scandals, Lawsuits, and Criticism of the Profession

The collapse of Westec (1965) and National Student Marketing (1969), which were notorious practitioners of what Abraham J. Briloff, an acerbic critic of unprincipled accounting, called "dirty pooling" (Briloff 1967, 1970), as well as the bankruptcies of Penn Central and Four Seasons Nursing Centers (both in 1970), visited huge losses on investors and raised questions about the performance of their auditors. The Westec case eventually animated a serious concern that its auditor's independence was compromised by rendering certain consulting services to the audit client.[8]

During the second half of the 1960s, criticism of the accounting profession was on the rise. John L. Carey, the Institute's administrative vice president, said in 1967 that "the accounting profession is going through a most unusual and difficult period. On some days it seems as though we were being attacked from all sides." He was concerned over "a feeling that CPAs are not quite the stalwart protectors of investors and creditors that the public had assumed they were" (Carey 1967, 15). It was, he said, a time of rising expectations of auditors (Carey 1967, 18). Carey's colleague at the Institute, Leonard M. Savoie, a former research and education partner in Price Waterhouse (PW) and, since 1967, the Institute's executive vice-president, bluntly criticized the "opinion shopping" that was beginning to pit firm against firm:

> competition to obtain a client for the lowest fee or to obtain or retain a client at the expense of technical standards is debilitating. It will weaken and, if unchecked, destroy the profession. Competition for a client based on accounting principles must be stopped. (Savoie 1968, 112)

[8] This charge was made both by Briloff (1972, 292–293) and by the Commission on Auditors' Responsibilities (1978, 102).

The second half of the 1960s witnessed a series of important federal court decisions: *Fischer v. Kletz* (1967), also known as the Yale Express case; *Escott v. BarChris* (1968); and *United States v. Simon* (1969), also known as the Continental Vending case (see Isbell 1970), triggered a "litigation explosion" against auditors in the 1970s (Jaenicke 1977, 1). After decades of comparative calm, the profession was coming under attack by the plaintiff's bar. "By the mid-1970s," Jaenicke (1977, 1) wrote, "hundreds of suits were filed against auditors."

In a speech given in 1970, John C. (Sandy) Burton, an accounting and finance professor at Columbia Business School, took a dim view of developments in the profession:

> In recent years, there is little evidence that the "public" in public accounting has been emphasized. In its zeal to protect itself from liability, the profession has given every impression of attempting to avoid responsibility. In the professional literature pains have been taken to assert what the auditor does *not* do, and to indicate that auditors attest only to the general acceptability, rather than the desirability, of management's choice of accounting principles.
>
> It is not at all surprising that articles critical of the accounting profession are beginning to appear more and more frequently in the business press. (Burton 1971, 49)

Tribulations of the Accounting Principles Board

In the mid-1960s, under pressure from the SEC and from the Big Eight firms and at a time when the accelerated pace of corporate merger activity focused increased attention on the earnings measure, the APB began to issue longer and more prescriptive Opinions. Several of these pronouncements attracted significant numbers of dissenting votes from board members. In two instances (on interperiod tax allocation in 1967 and on business combinations/goodwill in 1970), a board member from a Big Eight firm infuriated his colleagues in the majority by rescinding his vote on a contentious Opinion after the board had, in a final vote, approved a position that had secured a bare two-thirds majority. In 1967, the reversal occurred after the Opinion in 1967 was printed and ready for distribution. In both instances, the board met in emergency session to rescue the pronouncement. Thus was the intensity of pressure on board members, probably brought, directly or indirectly, by a firm's important clients.

Burton alluded to complicity by audit firms in helping their clients escape the adverse effects of the APB's pronouncements: "By writing precise rules, ... [the APB] has made it possible for people to observe the letter and avoid the spirit, with the blessing (and often the assistance) of their auditors" (Burton 1971, 50), a state of affairs that continues today.

Although the APB received praise from some quarters for "narrowing the areas of difference" on such contested subjects as pensions and interperiod tax allocation, other Opinions, especially Opinion No. 15 issued in 1969 on earnings per share, were criticized by leading accounting professionals for being laden with detailed rules. Ernest L. Hicks (1969, 60), a technical partner in Arthur Young & Company, complained that "much of the difficulty the Board has experienced resulted when it yielded to pressure to move too fast, with less than an adequate exposure of the issues." No less an exalted figure than Professor *Emeritus* William A. Paton, who served for 11 years on the old Committee on Accounting Procedure, reviled Opinion No. 15 as an illustration of "obscurity and unnecessary detail." He also criticized the board for its "dictatorial tendencies" in recent Opinions (Paton 1971, 42), a view echoed by retired PW senior technical partner Paul Grady, who had served as the Institute's director of accounting research in 1963–64 (Grady 1971, 24). PW executive office partner A. Carl Tietjen derided the APB for issuing "cookbooks" (Tietjen 1970, 10), as Hicks (1969, 60) did earlier. George R. Catlett, senior technical partner of Arthur Andersen & Co. and a longtime APB member, contended that the APB, like its predecessor, "has been so busy 'putting out fires' and dealing with a large and ever-increasing backlog of current problems that it has never established an adequate basis upon which to build" (Catlett 1969, 62).

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Also, the ferocity with which Corporate America lobbied against APB proposals that limited companies' flexibility in matters of accounting choice, most notably between 1968 and 1970 on business combinations and goodwill as the conglomerate merger craze was losing steam, led to a widespread loss of confidence in the board's effectiveness after the board issued a highly compromised Opinion No. 16, with six dissenting votes. The press followed every step in the board's tortured deliberations with relish (Zeff 1972, 212–216; Olson 1982, 3).[9] Critics from both inside and outside the profession inveighed against the organized profession's body charged with establishing the norms of proper accounting practice.

In August 1970, the APB finally issued its two hotly contested Opinions, Nos. 16 and 17, on accounting for business combinations and goodwill; the two Opinions were regarded more as the result of intense lobbying by industry than the product of sound thinking and analysis. The Big Eight accounting firms themselves differed profoundly and even emotionally over the best solution, partly fueled by their clients' preponderant views. So strong were the firms' reactions to the pressurized process in which these two Opinions were developed that three of the Big Eight notified the Institute in November 1970 that they had lost confidence in the APB.[10] The three firms recoiled at the powerful intrusion of self-interested lobbying and lamented the board's lack of agreement on the objectives of financial statements.

In August 1970, the American Accounting Association (AAA) became involved by appointing a special committee to inquire into the formulation of accounting principles. Acting swiftly, the committee urged the Institute and other interested bodies to cooperate with the AAA to convene a Commission of Inquiry to develop a better alternative to the APB. The Association's Executive Committee promptly endorsed its report (Report of the Committee on Establishment of an Accounting Commission 1971).

The Profession Loses Its Accounting Standard Setter

Declining to share the standard-setting stage with the AAA, the Institute itself appointed a Study Group to recommend a better way of establishing accounting principles. This Study Group, chaired by Francis M. Wheat, a former SEC Commissioner, recommended the establishment of the Financial Accounting Standards Board (FASB), which was to be an independent body, not a committee of the Institute. The Institute's Council promptly endorsed the Wheat recommendation in its entirety, thereby, for the first time, ceding the authority for setting accounting standards to a body outside the province of the organized accounting profession. Members of the FASB would hold full-time appointments, be supported by a large research staff, and could count on financial support to be provided by a newly established, broad-based Financial Accounting Foundation (FAF) (Report of the Study on Establishment of Accounting Principles 1972). This sea change disenfranchised the Big Eight firms from representation on the standard-setting body. As will be seen, this repositioning of the big firms from the center to the margin of standard setting soon served to dampen their interest in actively participating in the public dialogue on accounting principles, which should be a *sine qua non* of professional discourse.

But the Institute did not surrender all of its influence over the new standard setter. The FAF's bylaws provided that four of the seven board members must be CPAs with experience in public practice and that the Institute's board of directors would be the sole elector of the FAF's trustees. Yet, in 1977, the FAF's trustees repealed both of these provisions (*Status Report No. 50* 1977, 1).

[9] For further discussion, see Chatov (1975, Chapters 13 and 14), Brooks (1973, Chapter 7), Seligman (1982, 417–430) and *Conglomerate Mergers and Acquisitions: Opinion & Analysis* (1970).

[10] The firms were Arthur Andersen & Co., Touche Ross & Co., and Arthur Young & Company (Zeff 1972, 224–225). Also see the letters from Harvey E. Kapnick, Robert M. Trueblood, and Ralph E. Kent in the attachments to AICPA President Marshall S. Armstrong's letter dated December 21, 1970 to Those Invited to Conference on Establishment of Accounting Principles.

In 1974, less than a year after the APB passed the standard-setting baton to the FASB, Leonard M. Savoie (1974, 64), the Institute's principal spokesman on APB matters from 1967 to 1972, expressed his disappointment with the handover and the recent behavior of the big firms:

> In abandoning its rule-making function the AICPA has lost its most conspicuous source of prestige and good public relations potential. At the same time, it has extricated itself from the center of dissent and turmoil caused by recalcitrant accounting firms that were more interested in pushing their own views than in working within the institutional structure and reaching a consensus.

Even while the Wheat Study Group deliberated, the APB suffered another setback, again on the investment tax credit. In November 1971, when the Congress was about to enact a new form of the investment tax credit, the board, in its third such try, approved an exposure draft that required the deferral method, but the Treasury opposed it, as did the same large segment of industry as before. The opponents succeeded in persuading Congress to insert a provision in the eventual legislation that taxpayer corporations could use any method of accounting for the credit in their financial statements filed with the SEC. This denouement confirmed the inability of the Institute's standard-setting body to counter the self-serving forces arrayed against some of its more controversial Opinions (see Zeff 1972, 219–221). Three other setbacks occurred during 1971, when powerful industry pressures thwarted the APB from acting on accounting for marketable securities, leases, and oil and gas exploration (Zeff 1978, 14).

The FASB's relations with the SEC during its first five years were anything but smooth. From 1972 to 1976, during Sandy Burton's term as SEC Chief Accountant, the Commission issued 70 Accounting Series Releases (more than a third of which dealt with financial reporting), compared with 126 from 1937 to 1972.[11] Arthur Andersen unsuccessfully challenged the propriety of one of the SEC's Releases in court (Our Firm Files Petition with SEC 1976; Arthur Andersen is Set Back in Bid to Bar SEC Rulings 1976). An activist Chief Accountant, Burton surprised the FASB by declaring that, while the FASB was to take the lead on matters of accounting measurement, financial disclosures properly fell within the province of the SEC (Burton 1974). Additionally, Burton criticized the FASB's 1974 exposure draft recommending general price-level accounting, and two years later he pressed ahead with his own solution, a requirement that some 1,300 large registrants report replacement cost data in a supplementary disclosure. Burton's initiative forced the FASB to issue its own standard, Statement No. 33, on the disclosure of current cost and constant dollar information.

In 1978, the SEC again rebuffed the FASB, this time on accounting for oil and gas exploration. Under intense political pressure from small oil and gas exploration companies, with assistance from members of Congress, the SEC rejected FASB Statement No. 19's required use of "successful efforts" costing and instead proposed a kind of current value accounting for oil and gas reserves. The SEC's decision took the FASB aback, yet the SEC made it clear that the oil and gas issue was a unique case and did not "represent any change in the Commission's basic policy of looking to the FASB for the initiative in establishing and improving accounting standards" (*Securities and Exchange Commission Report to Congress on the Accounting Profession and the Commission's Oversight Role* 1979, 50). (Also see Gorton 1991; Miller et al. 1998, 125–127.)[12]

[11] John R. Evans, an SEC Commissioner from 1973 to 1983, argues that "the Commission was virtually forced to become more active [in the early 1970s] because of investor losses in companies, which had been able to exaggerate reported earnings and conceal financial problems, and because of permissive accounting standards and lax auditing procedures." He then cited several major corporate failures, including Penn Central and Equity Funding, and added: "Questions were raised as to why accountants charged with performing an independent audit of these companies had failed to detect or report on the developing problems. Some questioned whether accountants had participated actively with management in a fraud" (Evans 1984, 159). Also see Orben (1984, 142–143).

[12] For a fuller discussion of these standard-setting issues, see Miller et al. (1998, Chapter 5).

An Important Implication of the Loss of the Profession's Standard Setter

It was not long into the FASB's tenure that the Big Eight firms began withdrawing from an active dialogue over accounting principles and standards, perhaps in the belief that their task had become one of persuading the FASB of their views and no longer persuading either academics or their brethren in the profession. Indeed, this was also a time when many accounting academics seemed to abandon interest in accounting policy issues as well. Another reason for audit partners' withdrawing from this public dialogue was the increasing proliferation, complexity, and technical detail in the FASB's pronouncements.

By the mid-1980s, speeches by Big Eight audit firm partners taking positions on controversial accounting issues had almost disappeared from the scene, and only a few audit partners in, at most, three of the Big Eight firms[13] continued to write articles intermittently on such topics. Moreover, in 1982 the *Journal of Accountancy*, the Institute's journal, announced that it was encouraging the submission of "practical" articles, code language for the avoidance of controversy (see Zeff 1986). As the audit market became more competitive, one inferred that the firms did not wish to give prominence to their views on controversial issues, lest it might offend important clients, who might seek an audit firm with more accommodating views. Opinion shopping, which began to occur in the 1960s, continued into the 1970s and 1980s, as companies actively sought out more client-friendly audit firms.

More Scandals, and Attacks from Congress

In 1973, the sudden collapse of Equity Funding, coming on the heels of the Stirling Homex bankruptcy a year earlier,[14] jarred the accounting profession. (See Report of the Special Committee on Equity Funding 1975; Seidler et al. 1977.) As the Institute's executive director later wrote, "The huge losses by investors in [Equity Funding's] securities, closely following a series of other business failures, dealt a shattering blow to the credibility of independent auditors" (Olson 1982, 87–88). Propelled by these embarrassments, the Institute in 1974 appointed a Commission on Auditors' Responsibilities, headed by former SEC Chairman Manuel F. Cohen. These celebrated collapses, coupled with the discovery of illegal and improper payments by major corporations that were not disclosed in their financial statements, prompted two Congressional committees to level criticism at the accounting profession and at the private-sector setting of accounting standards.[15] The profession thus came under its first broad attack in the Congress.

Rep. John E. Moss, Democrat from California, chaired his subcommittee's investigation of federal regulatory agencies. The subcommittee's report recommended that the SEC play a direct role in setting accounting and auditing standards (*Federal Regulation and Regulatory Reform* 1976, 51–53) and thus remove this authority from the private sector. On the Senate side, a subcommittee headed by Sen. Lee Metcalf, Democrat from Montana, launched a major investigation of the accounting profession. His subcommittee's 1,760-page staff study, *The Accounting Establishment* (1976), consisted of an extensive factual examination of the Big Eight firms, the Institute, and the FASB, accompanied by a number of highly controversial conclusions and recommendations. Wallace E. Olson, the Institute's full-time chief executive, characterized the staff study as "almost as damaging to the profession as the Japanese attack on Pearl Harbor was to the U.S. Navy in 1941" (Olson 1982, 43).

[13] This included several partners from Arthur Andersen's Accounting Principles Group; Dennis R. Beresford of Ernst & Whinney until 1987, when he became FASB chairman; and Dale L. Gerboth of Arthur Young/Ernst & Young until 1990, when he retired.

[14] For the SEC's report on its investigation into the matters of Penn Central, National Student Marketing Corporation, and Stirling Homex, all of which were clients of the same audit firm, see its Accounting Series Release No. 173 (July 2, 1975).

[15] See an extract from a 1977 speech by Rep. Moss in Olson (1982, 39) and the comments by Senators Metcalf and Charles H. Percy, Republican from Illinois, and Rep. Moss in *Accounting and Auditing Practices and Procedures* (1977, 3, 10, 14). Also see Nelligan (1980, 111).

Two of the staff study's conclusions were that the Big Eight firms lacked independence from their clients and that they dominated both the Institute and the process of setting of accounting standards. The study also asserted that the Big Eight firms, through their influence on the FASB, did the bidding of their corporate clients (*The Accounting Establishment* 1976, 1–24). Almost mirroring the course taken by the Moss subcommittee, the Metcalf subcommittee's staff study recommended that the federal government set accounting and auditing standards for publicly traded corporations (*The Accounting Establishment* 1976, 20–24). Although both subcommittees held hearings and issued reports, they produced no legislation.[16] Nonetheless, the two subcommittees' lengthy and well-publicized investigations, which finally concluded in 1979, put the accounting profession on the defensive.

In April 1977, both the Institute and the FASB responded at length to the Metcalf staff study's findings and recommendations. The Institute issued a 40-page booklet, *The Institute Responds ...*, in which it countered the arguments in the Metcalf staff study. To the charge that the Big Eight firms compromised their independence when they advocated positions that were favorable to their clients, the Institute asserted that, by doing so, "they are not tools of their clients" (*The Institute Responds ...* 1977, 32). Yet, a scant six years later, Touche Ross & Co. issued a booklet, *Employers' Accounting for Pensions* (1983, 3), in which it offered to help clients prepare "an effective and persuasive response" to the FASB by which the firm would "assist your company in evaluating the effects, developing empirical supporting evidence, and identifying the economic consequences of the positions your company supports and rejects." Thus, as the competition for the favor of clients intensified in the 1980s, at least one of the Big Eight firms—Touche Ross—was willing to become a blind advocate for its clients. In its 44-page reply, the FASB defended the integrity, independence, and objectivity of its process (FASB 1977).

Under the Gun, the Institute Reforms

The unwanted public attention led the Institute to adopt a hurried reform in September 1977: creation of a Division for CPA Firms, composed of an SEC Practice Section and a Private Companies Practice Section. Wm. R. Gregory, the Institute's board chairman in 1979–80, explained the move as follows:

> Council created the division for CPA firms without seeking a vote of the membership because it believed that Congress would enact new legislation to regulate the profession if immediate steps were not then taken to bolster the profession's system of self-regulation. That perception was borne out by the introduction by Congressman Moss on June 16, 1978 of H.R. 13175, which provided for a new federal statutory regulatory organization under the oversight of the SEC, to be known as the National Organization of Securities and Exchange Commission Accountancy. (Gregory 1980, 3)

The body proposed in Rep. Moss's bill, which died in committee at the end of 1978, foreshadowed in a striking number of respects the Public Company Accounting Oversight Board, established by the Sarbanes-Oxley Act of 2002.

The Institute also installed a Public Oversight Board (POB), composed of distinguished public servants, to oversee the activities of the SEC Practice Section, including the setting and enforcing of quality control standards and a newly established peer review process. The SEC, which had ordered several major firms to undergo peer reviews because of alleged audit deficiencies in early and middle 1970s, welcomed the Institute's new section and the POB (*Securities and Exchange*

[16] Rep. Moss retired from the House on December 31, 1978. Sen. Metcalf died suddenly in January 1978, and the work of his subcommittee was carried on by Sen. Thomas F. Eagleton, Democrat from Missouri, in his own subcommittee until 1979, when interest in the subject lapsed. See Olson (1982, Chapter 3).

Commission Report to Congress on the Accounting Profession and the Commission's Oversight Role 1978, 15–27). But pressure from Congress had clearly precipitated the Institute's restructuring.

Intrusions of Federal Antitrust Bodies That Fundamentally Altered the Professional Climate

During the 1970s and 1980s, the Institute also felt unrelenting pressure from the Department of Justice and the Federal Trade Commission (FTC) over portions of its Code of Professional Ethics alleged to be in restraint of trade. In 1972, the Institute gave in to Justice by removing the ban on competitive bidding from its code of ethics. By 1979, Justice and the FTC compelled the Institute to drop its rules prohibiting direct, uninvited solicitation and advertising that is purely informational (see Bialkin 1987, 105–106). Many Institute members strongly opposed these forced concessions. During the 1980s, the FTC also pressed the Institute to remove its ban on contingent fees and commissions. In the end, the two bodies reached a compromise: to allow the receipt of commissions only from nonattest clients (Chenok 2000, 106). These amendments to the Institute's code of ethics, particularly on competitive bidding and direct, uninvited solicitation, profoundly changed the climate in which audit firms conducted their affairs. Competition among firms came to be signified more in the idiom of commerce—the aggressive pursuit of profit—thus, placing strains on professional values.

Whether because of the changes in the code of ethics or because of changing conditions in the practice of public accounting, allegations began to surface that competition among firms for clients was becoming more intense and vicious. In an article in *Barron's*, an editor who had long been a close observer of the accounting profession wrote as follows:

> What's happened, essentially, is that the nation's top accounting firms—some big, some smaller—are locked in a fierce battle marked by vigorous price cutting. Some blame a growth-at-any-cost syndrome they say has afflicted some of the profession's top firms. Others contend that it's an inevitable consequence of a slowing in chargeable hours as the pickings for new clients get slimmer. (Anreder 1979, 9)

The Institute's Commission on Auditors' Responsibilities also pointedly remarked, "The practice of accepting an audit engagement with the expectation of offsetting early losses or lower revenues with fees to be charged in future audits is a threat to the independence of the auditor" (The Commission on Auditors' Responsibilities 1978, xxx).

The elimination of the Institute's bans on competitive bidding, uninvited solicitation, and advertising, coupled with the apparent topping out of the audit market, all fundamentally changed the character of CPAs' relations with clients. Eli Mason, the managing partner of a medium-sized CPA firm in New York City who had long been a vocal critic of the big firms and the Institute, complained in 1985 that the practice of accounting was no longer a profession, but an industry: "Today, the media describes public accounting as an industry, seldom as a profession—and it does have all the earmarks of an industry including cut-throat competition, 'low-balling,' cheap advertising, and open solicitation by one CPA of another CPA's clients." Mason blamed the FTC and the Justice Department for creating this "unprofessional and undignified atmosphere" (Mason 1985, 732; also see Mason 1994).

Arthur W. Bowman, the editor of *Public Accounting Report*, documented some of the deep cuts in audit fees that companies negotiated in the early 1980s, which pitted the major accounting firms against one another in the sharply competitive bidding process. He reported tenders of between 25 and 50 percent under the previous year's audit fee charged by a company's current audit firm (Bowman 1985, 705–713). (Also see Berton 1985a; Berton 1985c; Berton 1985d, 12.) In a disquieting remark, he said, "If [companies] can get an audit for 0 dollars, they'd get them" (Bowman 1985, 720). Indeed, in 1991, Norman Lipshie, the president of the New York State Society of Certified Public Accountants, was quoted as saying, "I've seen three recent instances where Big Six firms

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were bidding zero to do audits" (Brenner 1991). (Following two mega-mergers in 1989, creating Ernst & Young and Deloitte & Touche, the Big Eight became the Big Six.)

In an interview in 1984, incoming Peat Marwick deputy chairman and chief operating partner Robert W. Beecher complained that other firms' practice of cutting fees "has dangerous implications" (An Interview with Our New Management Team 1984, 5). Price competition between audit firms existed in earlier years, but the firms sold quality as well as price. Clients prized audit quality, before they began to view the audit as a commodity. Leonard Spacek, the architect of the modern firm of Arthur Andersen & Co., wrote in 1984, reflecting the values of an earlier era:

> The competition [today] is in fees only. We always had such competition, but to offset it a firm can strengthen itself by the energetic position it takes to make it a leader. ... outstanding service is equally an offset, and both characteristics are prime offsets to price. I know because I practiced it for 20 years—saying publicly that we *were* the highest priced firm, but the higher price was more than matched by quality. Prospective clients seek these qualities to prove they risk the most thorough accounting tests.[17]

The heightened competitive climate in which the firms operated seemed to haunt partners' conduct in audit engagements. A gradual development within the Big Eight firms during the 1980s was a significant shift in the posture of audit partners toward their clients, probably spurred by their perceived pressure to retain valued clients. In previous years, partners conveyed a firm position on the propriety of any borderline accounting and disclosure practices adopted by the client, but increasingly in the 1980s partners would be seen huddling with the firm's technical specialists to find any means—perhaps restructuring a major vehicle, reconfiguring a transaction, or straining to rationalize the application of a suitable analogy—to enable the firm to approve the accounting treatment sought by the client. The "accommodation" or "negotiation" mentality fostered by this important shift in focus may have led many audit partners to incline toward compromise rather than invoke their principles even in routine discussions with clients. More will be said about this development later.

Management Advisory Services Come under SEC Fire

Consulting, then still known as management advisory services (MAS), increasingly became an issue in the 1970s. In 1969, *Business Week* reported the following anti-establishment view:

> "Some firms," says an unnamed senior partner of a big New York accounting firm, "say they draw the line against consulting that involves them in management decision making. But don't let anybody fool you. We take on any job." (Accountants Turn Tougher 1969, 124)

The term "scope of services" entered the profession's vocabulary, referring to the range of consulting services that an audit firm could render without surrendering its objectivity or independence. In the SEC's 1978 annual report to Congress submitted at the request of the Senate's Metcalf subcommittee, Chairman Harold M. Williams wrote as follows:

> Another important issue requiring immediate attention is the question of the appropriate range of services—other than the performance of the audit itself—which accounting firms should be permitted to offer to their audit clients ...
> In considering this issue, it will be necessary to resolve three basic questions:
>
> - Are there situations in which the magnitude of the potential fees from management advisory services are so large as to affect adversely an auditor's objectivity in conducting an audit?
> - Are there some services that are so unrelated to the normal expertise and experience of auditors that it is inconsistent with the concept of being an auditing professional for auditors to perform those services?

[17] Letter to the author dated December 20, 1984.

- Are there, conversely, some services so closely linked to the accounting function that, for the auditor to perform those services for his client means that, the auditor will, in conducting the audit, be in a position of reviewing his own work? (*Report to Congress* 1978, 12)

Even though these three policy questions were raised at the threshold of the era of the giant diversified services firms, they are still being raised today.

In June 1978, the SEC issued Accounting Series Release (ASR) No. 250, which mandated the disclosure in a company's proxy statement of the percentage relationship to audit fees of (1) aggregate nonaudit fees, and (2) the fee for each specific nonaudit service. A year later, the SEC promulgated ASR No. 264, "Scope of Services by Independent Accountants," a strongly worded document that was issued "without prior warning or discussion with the AICPA" (Olson 1982, 218). The Release had an unmistakable target:

> the growing array of nonaudit services offered by some independent public accountants—and the growing importance of management advisory services to the revenues, profits, and competitive position of accounting firms—are a cause for legitimate concern as to the impact of these activities on auditor independence, objectivity, and professionalism.

The Release was intended to "sensitize the profession and its clients to the potential effects on the independence of accountants of performance of nonaudit services for audit clients." Mark Stevens, a close student of the profession, wrote that it "also cautioned the CPAs to avoid supplanting client management's role, to be cautious of accepting engagements that involve an audit of their own work (such as a review of internal controls installed by the auditor's MAS arm), and that client audit committees should gauge the relative merits of the firm's auditor providing nonaudit services" (Stevens 1981, 210–211). The Release had a chilling effect on the profession, as the firms expected companies to pull back from drawing on such services from their audit firm. The Release was couched in such categorical language that Chairman Williams felt it necessary to assure the profession in a speech that the Commission did not intend to prohibit any particular kind of MAS engagement (Williams 1980, 422).

Reacting to Release Nos. 250 and 264, Harvey E. Kapnick, the chairman and chief executive of Arthur Andersen, proposed to his partners in 1979 that the firm be split into two related firms: auditing and consulting. He reported on his private discussions with SEC Chairman Williams, who, he said, would soon require all of the big firms to make such a split. Kapnick's proposal shocked his partners, and it met with stiff resistance. Although Kapnick did not accept the views of the SEC, he believed that this was the principled action to take before the SEC acted unilaterally. The heated controversy generated by his proposal led him to take premature retirement from the firm several weeks later (*A Vision of Grandeur* 1988, 150–151).[18]

In the end, however, both SEC Release Nos. 250 and 264 were rescinded by the Commission in 1981/82, reflecting the new federal policy of deregulation under President Ronald Reagan. Nonetheless, the Commission averred in ASR No. 296 (1981) that "its views [expressed in ASR No. 264] are unchanged." Because the Institute opposed both Releases, one supposes that it welcomed President Reagan's selection as SEC Chairman, John S. R. Shad, in May 1981.

The profession went on the offense by arguing that auditors rendering management advisory services to an audit client actually had a deeper knowledge of the client from an audit standpoint. John C. (Sandy) Burton, the immediate past SEC Chief Accountant, adopted this view and believed

[18] Also see Stevens (1991, 112–115) and "The Palace Revolt at Arthur Andersen" (1979). It was Kapnick who promoted an unprecedented openness of, and scrutiny over, his firm's operations. In 1973, under his leadership, Arthur Andersen became the first firm to issue an annual report (see Bows 1973), and in 1977 it was the first firm to publish audited financial statements. In 1974, Kapnick established a Public Review Board, composed of prominent outsiders, to review and report publicly on the firm's operations.

that the "scope of services" issue was mainly one of perception by those who do not possess an understanding of the audit process (Burton 1980, 51).

Yet, in 1979 the Public Oversight Board released a major study on *Scope of Services by CPA Firms*, in which it said:

> there is enough concern about the scope of services in responsible quarters so that the question cannot be dismissed as a "nonproblem." The Board believes that there is potential danger to the public interest and to the profession in the unlimited expansion of MAS to audit clients, and some moderating principles and procedures are needed. (Public Oversight Board 1979, 56)

The board concluded, however, that "at this time no rules should be imposed to prohibit specific services on the grounds that they are or may be incompatible with the profession of public accounting, might impair the image of the profession, or do not involve accounting or auditing related skills" (Public Oversight Board 1979, 5). In its second year of operation, the POB was not prepared to take on the profession.

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Exhibit C

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Randolph E. Paul

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History of Taxation in the United States

By RANDOLPH E. PAUL*

> "Human history becomes more and more a race between education and catastrophe." H. G. WELLS, *The Outline of History*, Ch. 15.

One has a job of selection when he tries to compress three centuries of American taxation into less than an hour of spoken summary. He has to omit much that he would like to say. He cannot afford the luxury of indecision about what is most important. He has to resist the temptation to give space to interesting and dramatic incidents which would crowd out more significant parts of a kaleidoscopic story. I am afraid that it is even necessary to make the courageous decision to be dull. But as I proceed with the task, I shall be curious, as perhaps you will be also, to see what I select out of a vast aggregate story as deserving of mention in a compact summary which requires that I cover nearly fifteen years in every two minutes of speaking.

You know the better part of the story. In the beginning our Colonial forefathers—who, Justice Cardozo once said, "knew more about ways of taxing than some of their descendants seem to be willing to concede."[1] —resorted to a faculty tax which has been called the ancestor of the modern income tax. At an early critical date in American history a group of the ablest of our forefathers, gathered at a convention, drafted a Constitution which with two amendments—one of which should have been unnecessary—has served the tax needs of the country ever

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since. Somewhat later Jefferson's administration abolished the elaborate system of excises set up by the Federalists and turned to the tariff as a source of revenue. This form of taxation was popular in the industrial North and was distasteful to the agricultural South, which was not interested in protecting manufacturing and agreed to tariffs just to get revenue. Moreover, the South was opposed to any policy which would increase the economic preponderance of the North. The tariff became inadequate as a source of revenue almost at the beginning of the War Between the States, and the country had a brief flirtation with progressive income and death taxation, which was constitutional in those days,[2] even though the permissive Sixteenth Amendment was required to enable Congress to do in the Twentieth Century what it had been permitted to do in 1861. "Normalcy" revisited the country quickly after the War, as it did after World War I, and Congress returned to the tariff as a revenue producer. It was a sufficient source of revenue for many years.

The Nineteenth Century ended on a note of turmoil and confusion. A highly articulate social and economic discontent with hard times in rural areas brought a populist chicken into the House in 1894, the year in which a disheartened Cleveland allowed the Wilson Tariff bill to become law without his signature. The income tax imposed by this bill carried the modest flat rate of two percent, but this was enough to arouse to fever pitch the anxieties of financial leaders in the eastern industrial states. Four of these states—New York, Pennsylvania, Massachusetts and New Jersey—had supplied four-fifths of the income tax collected in 1873, the eloquent Choate argued in the Supreme Court, and the "communist" march of income taxation would go on to dangerous destinations if Congress was "untrammeled and uncontrollable." This grim, hard warning was too much for a majority of the Supreme Court which after two long arguments held that the Federal government lacked the power to tax the instrumentalities of the states, which made a tax on the income from state bonds unconstitutional, and also that the entire 1894 Act was invalid because it was a direct tax upon real and personal property.[3]

But neither the arguments of leaders of the bar nor the susceptibility of an unreconstituted Supreme Court, nor any form of economic or fiscal isolationism, could permanently stay the powerful march of events in the rest of a fluid world. In other places than America the idea of income taxation was taking possession of unsuspecting electorates. In 1793 France had adopted a general income tax as a sporadic war measure. The British, led by Pitt, followed in 1799 with an income tax which was joyfully abolished in 1816 at the end of the Napoleonic

wars. These were war taxes. But peacetime acts came to other countries in the middle of the Nineteenth Century, and our own country succumbed in the War Between the States. By the end of the Century the "socialist" procession included Australia, New Zealand, Japan, Prussia and the Netherlands. In Britain a peacetime income tax came to dinner in England at the invitation of Sir Robert Peel in 1842, and never went home, even though Gladstone regarded it as a most unwelcome guest and longed for the "enviable lot" of abolishing the tax. Our own heretical Theodore Roosevelt echoed voices speaking from a distant wilderness in the early part of the Twentieth Century in favor of graduated income and inheritance taxation, and a little later the unheroic Taft, in a burst of campaign oratory, predicted that the country would some day resort to the income tax as a revenue measure. Much fat was soon in a consuming fire. In 1909 Congress passed an income tax on corporations which an ingenious Supreme Court sustained as an indirect excise tax.[4] In 1913 Taft's harmless 1909 gesture in favor of a constitutional amendment permitting a tax on incomes "from whatever source derived" turned into reality when Wyoming became the 36th ratifying state. Almost immediately a radical named Cordell Hull and some energetic Senators from the West and South accomplished the enactment of our first modern income tax.[5] The inevitable had quickly come to pass, speeded by the strenuous efforts of its friends.

The Sixteenth Amendment came none too soon. In 1909 Elihu Root had wanted his country "to have all the powers that any country in the world has to summon every dollar of the public wealth to its support if ever the time of sore need comes upon it." That hour came more quickly than even the far-sighted Root could have imagined. Early in April 1917, President Wilson, who in 1915 had said that "there is such a thing as a man being too proud to fight" and "such a thing as a nation being so right that it does not need to convince others by force that it is right," asked Congress to declare war on Germany. Taxes quickly entered a losing race with events. Deficits in millions became deficits in billions. The income tax soon became the "center and sheet anchor" of the American financial system. Excess profits taxation joined a growing list of public enemies, and World War I tax rates reached a high of seventy-seven percent for individuals and 80 percent for corporations. The real triumph of Mr. Choate's argument in the Pollock case was this fulfillment of his prophecy.

"The universal element in the soul of man" burnt dimly in the years following World War I. Reaction from the exertions, the strain, and the suffering came almost immediately. The people elected a genial poker-playing President who did not believe that a tax law could

repeal the "inexorable laws of nature." The next President believed that the prosperity of the lower and middle classes depended upon the good fortune and light taxes of the rich, and that "if we are to adopt socialism (which he identified with the use of income and death taxes to shift part of the burden of taxation from the poor to the rich) it should be presented to the people . . . as socialism and not under the guise of a law to collect revenue." For a time the economy raced ahead; in fact, the country went on a financial spree. But, before leaders in high places knew what was happening, the sun was sinking in a cloudy western sky. The storm arrived in the midst of forbidding calm. In the fall of 1929 the deluge descended upon an unbelieving people. Twelve years of tax reduction, budget balancing, and a decade of speculative debauch were at an end. Fear stalked a weary land from which a puzzled President had only recently promised that poverty would soon be forever abolished. A golden age had collapsed, and the people turned for leadership to another unorthodox Roosevelt. This one began a long career in the Presidency and an extended period of contact with taxation by telling the people that the only thing they had to fear was fear itself—"nameless, unreasoning, unjustified terror which paralyzes needed efforts to convert retreat into advance."

Retreat soon ceased, but advance was uncomfortably slow at first. Taxes climbed faster than prosperity and employment. Change with its long arm, its disturbing touch, its decree of things not yet manifest, was everywhere in surcharged air, and what was left of wealth was sorrowful and afraid. Newness acquired a new prevalence and scope and acceleration so that the years of our own lives began to measure not some small growth, or rearrangement or moderation of what we learned in childhood, but a great upheaval. The tree of government was bending to a sinister blast so that capital would not be broken. But reform reared a head that seemed ugly, and new brands of taxation found favor on Capitol Hill. In 1935 President Roosevelt suggested a tax upon inheritances "which bless neither those who bequeath nor those who receive," and Congress responded with increased estate tax rates. In 1936 the undistributed profits tax burst upon a startled business world to survive for only three years of hectic existence. In 1937 a revived Treasury Department, unreconciled as had been a former administration to tax avoidance deluxe, suggested stern measures for its prevention. An exciting decade ended with two opinions which proved that even a Supreme Court could change its mood. The opinion in one of these cases upheld the imposition of a Federal tax on salary of employees of the Port of New York Authority.[6] In the other case the opinion sustained the levy of a Federal excise tax upon admission to

State University football games.[7] These two opinions, together with another opinion handed down in 1939,[8] sustaining the constitutionality of a tax on the compensation of Federal judges taking office after June 6, 1932, indicated a disconcerting capacity in the Supreme Court for "self-correction,"[9] and suggested that the way was open under the Constitution for the taxation of interest on State and municipal securities.[10]

Nor were things quiet on the Potomac of economics. An English Economist named Keynes, who had acquired great wealth and was later to acquire a title, joined intellectual forces with an American banker named Eccles, who was also being unfaithful to his wealthy class, to preach strange doctrines of a compensatory economy. To these prophets of a new economic deal, and to many who followed in their rapidly moving footsteps, debts were the other side of investment and not in themselves sinful. Nor was saving an unadulterated virtue. The forces of supply and demand would not, as the classical economists thought, necessarily keep the economy at the full employment level. The interest rate was not a perfect mechanism which assured that demand for investment goods would always be forthcoming in an amount sufficient to utilize all resources not being used for meeting consumer demand. Investment sometimes needed the encouragement of governmental action; Government was an indispensable partner of business rather than a patron. Perhaps worst of all in some quarters, the new philosophy called for a tax system which would counteract tendencies toward a disproportionately fast rise in saving and promote tendencies to enlarge consumption to keep it in step with rises in productive capacity.

This was a persuasive rationalization of a progressive tax system which imposed a heavier burden upon high bracket incomes that are largely saved than upon low bracket incomes that are largely spent. It is hardly surprising that the higher incomes did not feel like taking these new heresies lying down. Opposition became fervent and almost religious; a national deficit became a criminal act; and a depression was preferable to profligate government spending. Protest took the form of vilification; in the vocabulary of most select clubs those who wished to experiment their way toward a distributed prosperity were at the mildest socialists. But the voters at least thought that they knew better, and the ultimate victory in modified form of many of the Keynesian doctrines illustrated the truth of Keynes' observation that "the power of vested interests is vastly exaggerated compared with the gradual encroachment of ideas—it is ideas, not vested interests, which are dangerous for good and evil," and rule the world. For Keynes commanded

the future from his study more than Napoleon from his throne. Many of his ideas triumphed in a cruel ideological battle, and have by this time translated themselves into action.

The people eventually learned that the government may by the proper use of public funds create a condition of full employment. And this new learning has become irreversible; the moving finger has written; and all our piety and wit cannot lure it back "to cancel half a line," nor all our tears "wash out a word of it." A finally obedient Congress embodied this "most important advance in human knowledge in modern times" in the Employment Act of 1946. Walter Lippman, who made this evaluation, added the grim warning: "Heaven help the administration which refuses to apply this knowledge in the postwar world."

There have been few necessities for applying this new knowledge since it was first painfully gained in the Thirties. A series of startling events intervened to supplement a rapid process of education by trial and error. German troops marched into Poland in September 1939, and —in the vivid metaphor of a Chinese statesman—the sky was suddenly "black with the wings of chickens coming home to roost." The inevitable quickly followed. Early on a Sunday morning in December 1941, a Japanese air squadron descended from the blue of the Hawaiian skies to cripple the American Navy. Government spending—a sinister threat in time of peace—was no longer a matter of choice in time of war. Enemy nations had forced prosperity upon a country which had searched long and vainly for a way out of the most dismal depression of all time.

The next decade changed the pace and scale of fiscal history. Experience taught an incredulous people that an internal debt of $275 billion does not wreck a prosperous nation. In one year the Federal budget rose to more than twice the amount of the national income of the depression year 1933, and to even more than the national income of the halcyon year 1929. Unemployment all but disappeared. The anemic purchasing power of the Thirties became an eager giant ready to devour much more than the country's suddenly busy industrial plant could produce. Goods, not buyers, were lacking; a sellers' market replaced a buyers' market of more than a decade. A country grown weary of deflation had more inflation than it wanted. The new objective was to find means of production to win the war and at the same time supply goods for the constantly increasing civilian spending power created by war activities. The war had two fronts.[11]

World War II years brought new meanings and values and magnitudes to taxation. It was out of all question to pay completely for the

war as we went. That would have wrecked the production effort, so essential to winning the war. The home front problem was inflation with danger potentials almost as great and as evil as war itself. A combination of direct controls—such as price and wage control, allocations of scarce materials, rationing, and regulation of consumer credit—went into partnership with taxation, and an unprecedented pattern of saving, to control inflation. There was some inflation, as you know, but military victory in the war abroad finally came to a country unravaged by inflation at home. Something else came too,—a realization on the part of many people (1) that a nation can thrive under a staggering burden of taxation, and (2) that taxation is one of the most valuable instruments of economic control the world has ever known. No longer would taxes be merely the exactions of a greedy government that spends and spends and spends, or even a government that fails to spend enough; no longer would taxes be for revenue only; thenceforth, the power to tax, in association with other governmental powers, would be a power to fulfill a better destiny for the American people.

Taxation would not have achieved increased value as an instrument of social and economic control during World War II but for another development. In the estimate of Professors Surrey and Warren, it "changed its morning coat for overalls." Switching their metaphors, and making their point doubly clear, Surrey and Warren added that the income tax spread from the country club group district down to the railroad tracks and then over to the other side of the tracks. The figures support this conclusion. The Civil War income tax affected only a top group of about 1 percent of the population. The high exemption levels of the World War I income tax saved from the impact of the income tax more than 100 million out of a total population of 106 million. The 1942 Act with its Victory tax put more than 50 million taxpayers on the rolls. It had become impossible to save the low incomes as well as the high incomes from a heavy tax burden and at the same time raise the revenue required to make the expenditures the Government would have to make for many years to come. The alternative of taxing the higher personal incomes had been nearly exhausted. Moreover, a tax limited to the high incomes would not have the impact upon the economy implicit in a tax with a broad base and low exemptions.

Postwar years furnished proof of the truth of Holmes' aphorism that a page of history is worth a volume of logic.[12] Logic told the economists, almost to the man, and many others who had known little but depression in their adult lives, that there would be grave problems of adjustment to postwar deflation. Congress, in fear of a business col-

lapse, rushed to repeal the ungainly excess profits tax. But instead of collapsing, business boomed after the war, and inflation continued to be a grave problem.

Altogether, the history of American taxation teaches a paradoxical lesson. Theoretically, high taxes should have an adverse effect upon the economy, since every tax is an impediment to action the taxpayer might otherwise take if he did not have to pay the tax.[13] But the historical record of the last 30 years should cultivate some distrust of strict logic in fiscal matters. In this instance its exactness has proved to be completely delusive.

My friend, Will Davis, has wisely said: "You can never argue about a fact; you can simply be ignorant of a fact." Let me briefly summarize the economic record of the last 35 years:

(1) After a period of low taxation in the Twenties the national income fell from a high of $80 billion in 1929 to a low of $40 billion in 1932. Unemployment rose to a high of 13 million.

(2) In the subsequent period of increasing taxes the American economy moved forward to the prosperity we are now enjoying. After adjustment for price changes the per capita income of the average American after taxes increased forty-two percent; farm income increased about fifty percent. Unemployment all but disappeared.

(3) In the record prosperous year 1953 taxes were virtually at World War II levels. Indeed, the combined corporate normal and surtaxes are even now at a level twelve points higher than the level they reached during World War II.

(4) In a period of high taxation we have established a Social Security program which provides a substantial cushion against the hazards of old age, dependency and unemployment. There has been a sensational increase in savings represented by bank deposits, U. S. savings bonds and life insurance.

These and many other statistics at least suggest the idea, dramatically expressed by Alvin Hansen, that we have "an Alice-in-Wonderland kind of economy in which the more we spend for defense, the more we have left for investment and consumption." And the historical record proves, I think, that American capitalism is not a house of cards which a slight gust of wind can blow away, but rather a tough institution which has taken a good deal of punishment in its stride, and which can continue to absorb heavy taxes if unavoidable international pressures so require.

The record of the American people as individuals is equal to the record of their corporations. They have demonstrated a willingness to

pay taxes that is almost unique in world history. No one yet knows the limit of their endurance or the boundaries of their capacity to make payment for a civilized society.[14] That a people so numerous, so scattered, and so individualistic annually assess themselves with a highly burdensome tax liability seems to me, as it once seemed to Mr. Justice Jackson, "a reassuring sign of stability and vitality of our system of self-government."[15]

Now as I come to the end of my allotted time, I suppose that I should turn from history to the present and the future. The value of history is not intrinsic; it is but a prologue to the future. Its virtue is that it provides perspective for those who must try to solve the many imponderable riddles presented by the tax and fiscal issues of the present time, and those which an intensely indeterminate future will bring to a country which has an appointed rendevous with destiny. Is it possible to appraise in realistic terms the product of all the fabulous industry and ingenuity that has contributed to the making of our existing tax system?

The Man from Mars might assert that Congress and the Treasury and the Courts had had time over a period of forty years to make our Federal tax structure almost perfect. That the system is full of defects needs no demonstration. And yet I cannot suppress a feeling of wonder that our tax system is as good as it is when I remember how it came into being. It consists in large part of a series of extemporized responses to the immediate emergencies of war and depression. To a marked degree it is the product of snap judgment. Rarely, until recently, have we tried to use taxes to shape events. Cause and effect have been the other way around. Our taxes have been the result of our times when our times should have been the result of our taxes. We have imposed taxes without realization of their economic and social consequences when we should have imposed taxes carefully designed to bring the economic and social consequences we desired. In different words but not a different sense, to a large degree our taxes have been mere revenue-raising devices lacking the dignity and utility that derives from more comprehensive and far-reaching purposes.

In recent years history has taught us that taxes can do much more than raise revenue for a passive government which performs the few restricted functions which occupied the American government of the Nineteenth Century. We have learned that taxes can be part of a plan to prevent inflation and instruments in a campaign against deflation. We know now that they can serve as a prophylactic agent against undue concentration of wealth, and that they can function as a distributor of the cost of special benefits, as do Social Security taxes. As a result the place of taxation and fiscal policy in the economic and social fabric

of the country has altogether changed from the lowly station it occupied in the days before the Sixteenth Amendment gave a new green light to Congress. In short, we have listened to the message of tax history and the astonishing events of the Twentieth Century—that taxes can thwart the growth of the kind of America we desire, or help to make that America.

In addition, our tax system seems remarkable from the standpoint of the ponderous machinery of Congressional committees, hearings, debates, and administrative and judicial interpretation that constitute the Federal taxing process. I believe that we have a better tax system than we have any right to expect from such an inefficient process. I know that the system is unduly complicated. But taken in its entirety, it is a fair and equitable system. It is not as progressive as it pretends to be,[16] but its emphasis is not wholly divorced from the principle of ability to pay. The recent shift away from taxes upon consumption, which by their very nature bear heavily upon the low income groups, to taxes upon individual income and corporate profits results in a more reasonable distribution of the burden caused by the vast expenditure the Soviets are now forcing upon this country. As a consequence, the tax system in its present form is serving its great purpose without great dislocation of the personal lives of most Americans and without unduly hurting business or destroying the incentives of the free enterprise system.

The principal danger faced by our tax system, as I visualize our eclectic future, lurks in the mystery that surrounds the subject of taxation. Its history should not be the dull, esoteric story that has often been told; no aspect of American history has so deeply affected the ordinary daily living of most Americans. Many fiscal decisions have been more important to the country's development than the outcome of some wars. Many things done on Capitol Hill have been more critical than many battles. The whole fiscal story is inextricably entwined with the remarkable development of the country; it is part of the texture of America. For the future taxation presents an area of critical decision which may determine, for better or worse, the answer to the question whether the great experiment initiated by our forefathers shall succeed or fail. More than anything else, I think that our tax system needs a more diffused knowledge in and among the American people of its content and policy implications. We know too much for one man, or even a few men, to know much. It is imperative that American citizens understand how taxation works; how the tax revenue is extracted from the economy; from whom it is being extracted; and what portion of the total is being paid by different groups in the country. The democratic

process requires intelligent discussion of taxation at the grass roots level as a basis for many critical political decisions to be made in the future if we are to progress toward increased prosperity and a better life for all Americans.

Let me end with an apparent, but I do not think a real, contradiction. In taxation policy must embrace several viewpoints and blend many considerations. Thoughts about taxation must run in the manner of the thought of John LaFarge's friend, Okakura, "as a stream runs through grass, hidden perhaps but always there;" and we will often feel uncertain in what direction the stream is flowing. This kind of thought is unsatisfactory to the longing for certainty and repose that lures many human minds into an acceptance of delusively exact answers put forward by theorists who sometimes disguise the difficulties of a problem by sweeping all the chessmen off the table. That kind of approach will only obstruct the solution of the novel and imponderable tax problems we face in these anxious times. "They do things better with logarithms" was the wail that escaped the bewildered Cardozo when he contemplated the finished product of the best that was in him by way of the analysis of some of the legal problems he tried to solve. But there is no push-button solution of the economic problems of this complex, troubled period. There seldom is to any of the real problems of life. These economic problems are different from problems in algebra or geometry or trigonometry. The science of taxation is a poor, inexact science with many pressures and shades of contradiction. The most honest opinions will often differ widely, and we must all find our ways as best we can with a fallible and groping wisdom through tangles of imperfectly understood situations, past conflicts of values that cannot be wholly resolved, to answers which have to do. In the end we may have to wager our salvation upon a process of judgment we cannot articulate in full detail.

In the meantime, we need to be beware of the heathen that would beguile us to their temples, and the sirens with their songs. Rules of thumb "are a lazy man's expedient for ridding himself of the trouble of thinking and deciding."[17] Experience is a better teacher than theory, but theory is indispensable too. There is an unending interplay between fiscal policy and a constantly reshaping society. The perpetually changing economic problems of modern life call for a flexible attitude which looks analytically at the past, realistically at the present, and hopefully toward the future with the knowledge that there must be constant adaptation to the new necessities of an expanding economy.

It is a little more than three centuries since the colony of new Plymouth, Massachusetts, passed a short vague statute which taxed its few

inhabitants "according to their estates or faculties, that is, according to goods lands improoued faculties and Psonnal abilities." It is not yet a year since the Congress of the United States passed a long, intensely specific, statute of 984 pages revising in wholesale fashion the internal revenue laws of the United States. What the Congresses of later days will do no man can tell; perhaps some day some Congress will better succeed in the task of making tax law "simpler and surer." But it is safe to guess that for too much law more law will have to be the cure, and that we are even now, after so much traveling, only at the end of the beginning of a long journey. Neither you in this audience, nor I on this platform, will be present at the beginning of the end of the journey. But, as long as strength survives, we can, at least, travel hopefully, which may, as Robert Louis Stevenson once suggested in another context, be better than to arrive.

Exhibit D

Calendar No. 563.

65th CONGRESS, 3d Session. | SENATE. | REPORT No. 617

REVENUE BILL OF 1918.

DECEMBER 6, 1918.—Ordered to be printed.

Mr. SIMMONS, from the Committee on Finance, submitted the following

REPORT.

[To accompany H. R. 12863.]

The Committee on Finance, to whom was referred the bill (H. R. 12863) to provide revenue, and for other purposes, having had the same under consideration, report it back with sundry amendments and recommend that the bill as amended do pass.

The revenue bill as passed by the House—which is fully explained in the appended copy of the report which accompanied its introduction into the House—was so framed as to yield in the first 12 months of the full operation of its several titles an estimated revenue of $8,182,492,000. This is possibly the largest tax budget ever voted by any legislative chamber in the history of the world, and the committee approached the task of its revision in a spirit appropriate to the gravity of the task before it: By securing through careful investigation and numerous hearings the advice not only of those who would be most vitally affected by the new law, but of those who by study and administrative experience were in position to offer helpful suggestions. These hearings fill a printed volume of over 650 pages which, with similar hearings of the Committee on Ways and Means, constitute a reference library of great value upon the entire subject.

Since the formulation of the House bill the scope and character of the prospective revenue act have been profoundly affected by two events of controlling importance. First, in order of time, was the adoption of regulations and legislation restricting the production and sale of alcoholic beverages. Beverage taxes under the House bill were estimated to yield for the first 12 months of their operation $1,137,600,000, and approximately $850,000,000 for the fiscal year 1919. At the present time, under the changed conditions, it is possible to count upon only $500,000,000 for the fiscal year 1918–19, and $93,000,000 for the fiscal year 1919–20, from this source. At

than obligations of the United States issued after September 24, 1917. This limitation is substantially the same as the one contained in the present law. The provision of the House bill which allows a deduction for interest on all indebtedness permits the taxpayer to make loans for purchases of wholly exempt securities and then deduct the interest paid on such loans from his otherwise taxable income, thereby reducing his tax. The limitation suggested above would operate to discourage this practice except in the case of the later issue of liberty bonds.

Under the present law and under the bill as passed by the House a nonresident alien individual or a foreign corporation is not allowed to deduct any taxes paid to a foreign country. Many such taxpayers are, however, subject to taxation abroad upon property or business which is producing income subject to taxation in the United States. It seems only fair that such taxes paid to a foreign country should be deducted in computing net income subject to taxation in the United States, and provision for such deduction has been inserted (sec. 214a, 3, and sec. 234a, 3).

NET LOSSES.

One of the most important provisions inserted by the committee is quite new to our tax laws. At the present time no recognition is given to net losses; that is, if in any year the losses and expenses of a taxpayer exceed his gross income the excess (or in other words, the net loss) can not be carried over into the next year. For purposes of taxation the settlement must be made upon the basis of each year's business by itself. The chief merit of the present plan is its simplicity of administration. But it does not adequately recognize the exigencies of business, and, under our present high rates of taxation, may often result in grave injustice. The committee has accordingly incroporated an amendment (sec. 204) which provides that under certain limitations net losses sustained in 1917 or in 1918 may be deducted in computing the net income of the taxpayer for the succeeding taxable year; that a net loss sustained in the future may be deducted from the net income of the preceding taxable year, and if it is in excess of the net income for such preceding taxable year, that such excess may be allowed as a deduction in computing the net income for the succeeding taxable year. Provision is made for the necessary adjustment of the taxes for the years involved, and for crediting or refunding to the taxpayer any amounts found due under such adjustment.

AMORTIZATION.

In the paragraph relating to amortization allowances (sec. 214a, 9, and sec. 234a, 8) it was feared that the language was not broad enough to include vessels devoted to war purposes, and provision has therefore been made for the amortization allowance in the case of vessels constructed or acquired on or after April 6, 1917, for the transportation of articles or men contributing to the prosecution of the present war. The clause limiting the amortization deduction of 25 per cent of the net income has been stricken out. The amount of the amortization allowance to which a taxpayer may fairly be entitled

Exhibit E

Calendar No. 705

72d Congress, 1st Session } SENATE { Report No. 665

REVENUE BILL OF 1932

MAY 9 (calendar day, MAY 11), 1932.—Ordered to be printed

Mr. SMOOT, from the Committee on Finance, submitted the following

REPORT

[To accompany H. R. 10236]

The Committee on Finance, to whom was referred the bill (H. R. 10236) to provide revenue, equalize taxation, and for other purposes, having had the same under consideration, report favorably thereon, with certain amendments, and as amended recommend that the bill do pass.

FEDERAL BUDGET REQUIREMENTS

We are faced with a deficit for the fiscal year 1933 of $1,241,000,000, exclusive of statutory debt retirement. The deficit for the current fiscal year had reached a total of more than $2,300,000,000 by the end of April. We incurred a deficit in 1931 of $903,000,000. By the end of the current fiscal year our public debt will have been increased by more than $3,000,000,000, rising from $16,185,000,000 at the end of the fiscal year 1930 to more than $19,000,000,000 on June 30 of this year.

Although occasional moderate deficits in the operation of a government are to be expected, recurring large deficits must be avoided. Continued reliance upon borrowing, and failure to provide for a balance as between income and expenditures, and eventually for systematic debt reduction, would inevitably undermine the credit of governments as well as individuals. The maintenance of unimpaired credit is essential.

Your committee is unanimous in the conclusion that the indicated deficit for 1933 of $1,241,000,000 (exclusive of debt retirement) must be covered by reduction in expenditures and by the provision of additional revenue. The bill as reported by your committee should make this accomplishment possible. It should increase revenues by $1,010,000,000 during the fiscal year 1933, and it is

NET LOSSES

The net loss provision of the existing law is one of the essential protections against excessive hardships inherent in a tax based upon an arbitrary annual accounting. Taxpaying ability does not exist if a substantial part of a year's profits are required to cover a prior year's losses. The existing law is equitable and fair. The House bill proposed to eliminate it. Your committee recommends that the existing law be retained, but limited to a carry-over for but one year, rather than for two years.

ESTATE AND GIFT TAXES

The existing estate tax rates are more than doubled. They are extended to 45 per cent, as compared with a maximum rate under the existing law of 20 per cent. The increase is not subject to the 80 per cent credit for State estate and inheritance taxes. As a protection to both estate and income taxes, a gift tax is imposed. The rates are approximately three-quarters of the estate-tax rates. The committee recommends no change.

MISCELLANEOUS EXCISE TAXES

The bill, as it passed the House, contains a large number of special excise taxes. Many of these taxes will produce very little revenue, involve difficulties of administration, and fall within the type frequently designated "nuisance taxes." Your committee is of the opinion that it would be much sounder to select a smaller group of commodities impose rates which will raise the required revenues, and eliminate many of the minor taxes proposed by the House bill. In selecting the subjects of tax, your committee attempted, as far as possible, to prevent undue burdens upon any particular industry; to guard against disturbances to competitive situations; to select commodities the purchase of which would indicate taxpaying ability; to impose taxes capable of simple and inexpensive administration; and to select commodities which would yield fairly substantial revenues.

Your committee quite appreciates the fact that each particular industry selected feels very keenly that it should be exempt from tax and the necessary revenue collected elsewhere. However, your committee is confronted with the necessity of raising more than $700,000,000 through selective excise or miscellaneous taxes. The field of selection is necessarily limited. Important industries must be included. Your committee appreciates that the industries selected, in common with all other industries, have been and are seriously affected by the depression and consequent decreases in business activity and profits. It is realized that additional burdens at this time may seem unjustifiable and almost insurmountable. It is not believed, however, that taxes at the rates proposed by the bill as reported by your committee impose undue burdens upon industry and commerce or will seriously retard a return to normal business conditions. The required revenues must be raised. Benefits to be derived from the reestablishment of Federal finances upon an unquestionably sound basis far surpass any possible disadvantages from the burden of additional taxes.

Exhibit F

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WGL Compl. Fin. Repg. & Forms ¶ 20,002

SEC Compliance: Financial Reporting and Forms

Regulation S-X Accounting Rules

Accounting Rules

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*1 [¶20,002] A brief history of U.S. GAAP.

A brief history of U.S. GAAP.

Over the years, U.S. GAAP has been promulgated by the American Institute of Certified Public Accountants (AICPA) and the Financial Accounting Standards Board (FASB).

The AICPA, through its Committee on Accounting Procedure, began issuing Accounting Research Bulletins (ARBs) in 1939. Eventually Bulletins No. 1 through No. 42 were compiled into ARB No. 43, which was a revision and restatement of the prior Bulletins and superseded them. In 1962, after ARB No. 51 had been issued the AICPA discontinued the issuance of ARBs and began in 1962 to issue Accounting Principles Board Opinions (APBs). By June 1973, they had issued APBs No. 1 through 31 and numerous interpretations of the APBs.

In addition to ARBs and APBs, the AICPA has issued other pronouncements on accounting matters, including Statements of Position, Industry Audit Guides and Industry Accounting Guides.

In 1973, the FASB succeeded the AICPA as the organization with the primary responsibility for the development and issuance of pronouncements related to accounting and reporting in financial statements. Through 2009, the FASB issued Statements of Financial Accounting Standards (SFASs) and interpretations of their statements and earlier AICPA pronouncements. In addition to Interpretations and Staff Positions (FSPs) formally approved by the Board, the FASB has issued Technical Bulletins prepared by the staff.

In July 2009, the FASB adopted the *Accounting Standards Codification* as the source of authoritative U.S. GAAP for non-governmental entities. Thus, all previously issued ARBs, APBs, SFASs, EITFs and other authoritative literature have been superseded by the Codification.

In 1984 the FASB created the Emerging Issues Task Force to aid in the early identification of implementation and emerging issues. The Chief Accountant of the SEC, or his representative, participates in all meetings of the Task Force and the SEC's position on the issues under discussion is included. A consensus of the Task Force that existing accounting literature is adequate and needs no further action by the FASB is regarded as authoritative by the SEC staff. For more information about the Task Force see PARA 23,031.

In FRR No. 1, Section 101, the SEC stated it will rely primarily on the FASB for the issuance of new pronouncements affecting accounting principles and standards and that its future accounting pronouncements will deal primarily with disclosure matters.

End of Document

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Exhibit G

Accounting Research BULLETINS

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Issued by the
Committee on Accounting Procedure,
American Institute of Accountants,
[illegible] Madison Avenue, New York 16, N. Y.
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February 1941 No. 8

Combined Statement of Income and Earned Surplus

IN RESEARCH BULLETIN No. 1 the committee called attention to the "increased recognition of the significance of the income statement" and the resulting "tendency to regard the balance-sheet as the connecting link between successive income statements and as the vehicle for the distribution of charges and credits between them." This led to a suggestion that the committee should give consideration to the general form of the income statement, with particular reference to the question of the influence of form upon effective presentation in the light of the enlarged conception of the functions of the statement.

The term "income statement" will be used throughout this memorandum though the committee recognizes that in some cases the term "profit and loss" is used instead of "income," and "account" instead of "statement." These differences in usage are under consideration by the committee on terminology.

The committee has noted, from examination of the published statements of a selection of 500 corporations, a considerable tendency toward the practice of closely combining the annual income statement with the statement of earned surplus. For the year 1939 the income statement was presented as a single integrated statement, running from sales to earned-surplus balance, in 19 per cent of the cases examined. In another 32 per cent the income statement and surplus statement were shown as two related exhibits on a single page of the published report. In 32 per cent of the examples the income statement and surplus statement were shown as separate exhibits but with their close relationship emphasized by presentation on facing pages of the report. In only 17 per cent of the cases were the earned-surplus analyses shown otherwise than as incorporated with or adjacent to the current operating data. Appendix A shows a tabulation of these data for 1939 and 1938.

There are decided advantages in such combined statements, but also some disadvantages. The committee therefore feels that a useful purpose will be served if it expresses approval of the practice where it is found feasible, without recommending its general adoption; at the

same time it points out certain considerations which must be borne in mind if undesirable consequences are to be avoided.

Advantages of the Combined Statement

The combined statement of income and earned surplus is designed to meet a dilemma which constantly confronts the accountant. Over the years it is plainly desirable that all costs, expenses, and losses of a business, other than those arising directly from its capital-stock transactions, be charged against income. If this principle could in practice be carried out perfectly, there would be no charges against earned surplus, except for distributions and appropriations of final net income. This is a theoretical ideal upon which all may agree, but because of conditions impossible to foresee, it often fails of attainment. From time to time charges are made against surplus which clearly affect the cumulative total of income for a series of years, even if their exclusion from the income statement of the current year is justifiable. There is danger that unless the two statements are closely connected such charges will be overlooked, or at any rate not given full weight, in any attempt on the part of the reader to compute a company's long-run income or its income-earning capacity. The combined statement of income and earned surplus minimizes the net disadvantage; while charges against earned surplus are effected within a segregated portion of the statement, yet charging them against earned surplus in this way does not completely lose them from view in any consideration of long-run income-earning capacity. In this sense the practice serves to emphasize the tentative character of the income statement.

In giving expression to these views, the committee would like to guard against misunderstanding. The committee recognizes the great importance of distinguishing between charges against income and charges against earned surplus. It does not here undertake to define proper charges against earned surplus. For purposes of this statement it simply takes cognizance of the fact that such charges are from time to time found to be a necessary though perhaps a debatable feature of accounts. It approves the current tendency to discourage such charges wherever possible.

There is a marked tendency to exaggerate the significance of the net income for a single year, and particularly the degree to which the net income can be exclusively identified with that one year. In so far as the combined form calls attention to the character of the income statement as a tentative instalment in the long-time financial results, it serves a useful purpose.

To summarize, the combined income and earned-surplus statement serves the purpose of showing in one statement both earnings applicable to the period proper, and also modifications of earned surplus on a long-run basis. It distinguishes charges and credits of the current period from charges and credits relating to other periods by placing them in different sections of the statement; but all are comprised within a single statement.

Disadvantages and Limitations

In the combined statement, the net income for the year will occur somewhere in the middle of the statement and not at the end. Such wording and arrangement should be adopted as will make this item unmistakably clear. The reader should be left in no doubt as to the point at which the net income has been determined. This figure will continue to be a most important item in the accounts; all concerned will look to the accountant to furnish the figure as exactly as he can.

While it is true that the net income amount, when expressed as "earnings per share," is often given an undue prominence and its significance is exaggerated, there nevertheless remains the responsibility for determination of net income by sound methods, and the duty to show it clearly. The adoption of the combined statement provides no excuse for less care than at present in distinguishing charges to income from charges to surplus. Any such use of this form of statement would immediately discredit it.

APPENDIX A

CLASSIFICATION OF FORM OF PRESENTATION OF INCOME STATEMENT AND EARNED SURPLUS STATEMENT IN 500 PUBLISHED REPORTS

	1939		1938	
	Number of Reports	Percentage of Total	Number of Reports	Percentage of Total
Combined statement of income and earned surplus	93	19	90	18
Separate statements of income and earned surplus on same page	160	32	158	32
Separate statements of income and earned surplus on facing pages	163	32	167	33
Other forms of presentation	84	17	85	17
Totals	500	100	500	100

The statement entitled "Combined Statement of Income and Earned Surplus" was adopted by the assenting votes of eighteen members of the committee. Two members, Messrs. Cranstoun and Seidman, dissented. One member did not vote.

The dissenting members hold that the above statement attaches undue importance to the question of combined or separate statements. They consider that the primary question is the determination of sound principles for the separation of income and surplus charges and credits, and fear that a statement recommending one form may be interpreted as implying that that form had solved this problem, which, as all members of the committee agree, it cannot do.

NOTES

1. *Accounting Research Bulletins represent the considered opinion of at least two-thirds of the members of the committee on accounting procedure, reached on a formal vote after examination of the subject matter by the committee and the research department. Except in cases in which formal adoption by the Institute membership has been asked and secured, the authority of the bulletins rests upon the general acceptability of opinions so reached. (See Report of Committee on Accounting Procedure to Council, dated September 18, 1939.)*

2. *Recommendations of the committee are not intended to be retroactive, nor applicable to immaterial items. (See Bulletin No. 1, page 3.)*

3. *It is recognized also that any general rules may be subject to exception; it is felt, however, that the burden of justifying departure from accepted procedures must be assumed by those who adopt other treatment. (See Bulletin No. 1, page 3.)*

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Exhibit H

Accounting Research BULLETINS

December, 1944 No. 23

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Issued by the
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Accounting for Income Taxes

THIS bulletin deals with a number of accounting problems which arise currently in the reporting of income and excess-profits taxes (hereinafter referred to as "income taxes") in financial statements. The problems arise largely where (a) material items entering into the computation of taxable income are not reflected in the income statement and (b) material items included in the income statement are not reflected in the computation of taxable income. The bulletin does not purport to cover the entire subject of the treatment of these taxes in such statements.

SUMMARY STATEMENT

(1) Income taxes are an expense which should be allocated, when necessary and practicable, to income and other accounts, as other expenses are allocated.

(2) Where an item resulting in a material increase in income taxes is credited to surplus, the portion of the current provision for income taxes which is attributable to such item should be applied in reduction of the credit to surplus and taken up as a credit in the income statement, specifically disclosed and appropriately described, either as a deduction from the aggregate current provision for income taxes or as a separate credit.

(3) Where an item resulting in a material reduction in income taxes is charged to surplus, the amount of the reduction should be applied against the charge to surplus and included as a charge in the income statement, specifically disclosed and appropriately described, either as an increase in the provision for income tax allocated to income included in the income statement, or as a portion of the item in question equal to the tax reduction resulting therefrom.

(4) Where an item resulting in a material reduction in income taxes is charged to or carried forward in a deferred-charge account,

or charged to a reserve account, it is desirable to include a charge in the income statement of an amount equal to the tax reduction in the manner set forth in paragraph (3) hereof. If it is impracticable to apply such procedures the pertinent facts should be clearly disclosed.

(5) Additional income taxes for prior years, or additional provisions therefor, should be included in the current income statement and, if material, should be shown separately. Refunds of such taxes, and provisions therefor no longer required, should be similarly treated as credits.[1]

(6) Amounts of income taxes paid in prior years which are refundable to the taxpayer as a result of the "carry-back" of losses or unused excess-profits credits, should be included in the income statement of the year in which the loss occurs or the unused excess-profits credit arises, provided that, if the amount is material, the net income resulting from the operations of the year should be shown without the inclusion thereof, and the amount should thereafter follow in the income statement as a separate item.[1]

(7) Where material amounts of losses or unused excess-profits credits of prior years are carried forward into the current tax return, the operating results for the current year should preferably be shown without inclusion of the tax reduction resulting therefrom, i.e., the current provision for income taxes should be computed and shown in the income statement without the benefit of such "carry-forward," and the amount of the tax reduction should be shown in the income statement as a separate item.[1]

(8) The provision for income taxes, or the portion thereof allocated to current income, may be included at the end of the income statement, immediately preceding the showing of net income for the period, or it may be appropriately classified as an operating expense.

(9) Provisions for income taxes for the current and prior years should generally be classified in the balance-sheet as current liabilities. Claims for refund under the "carry-back" provisions of the Internal Revenue Code may be shown as current assets if collection is reasonably assured.

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[1] In connection with paragraphs (5), (6), and (7) hereof, the charges and credits may be made directly to surplus if misleading inferences might be drawn from their inclusion in the income statement.

(10) Where credits are made to surplus, directly or through the income statement, of significant amounts as to which, because of differences in accounting methods, no income tax has been paid or provided for, disclosure should be made. If a tax is likely to be paid thereon, provision should be made therefor on the basis of an estimate of the amount thereof.

DISCUSSION

In view of the substantial increase during recent years in the number of taxes to which business is subject and in the rates and amount thereof, it is obvious that taxes are an item of major importance in statements of income, and that if such statements are to be of the maximum usefulness to readers, the facts with respect to taxes must be clearly set forth. The most important taxes are those based on income. The committee, therefore, has considered a number of problems of current importance arising in connection with such taxes which it believes should be dealt with in the manner hereinafter set forth.

Allocation of Income Taxes

Basic difficulties arise in connection with income taxes where there are material and extraordinary differences between the taxable income upon which they are computed and the income reported in the income statement under generally accepted accounting principles. Provisions may be made in the income statement which are not deductible in the tax return, as in the case of special war reserves; deductions may be taken in the tax return which are not included in the income statement, as in the case of charges against a reserve created in a prior period; gains subject to income tax may not be included in the income statement, as in the case of gain on the sale of property credited to surplus; credits in the income statement may not be subject to taxation, as in the case of a restoration of an unneeded reserve to income. As a result of such transactions the income tax legally payable may not bear a normal relationship to the income shown in the income statement and the accounts therefore may not meet a normal standard of significance. The committee believes that the solution of these problems is to be found in part at least by an application to income taxes of the principle of allocation.

In some cases the transactions result in gains; in others, they re-

sult in losses or net costs. Sometimes the reduction of tax is a major if not the predominant motive for the transaction. If all the effects of the transactions (including their effect on income tax) were reflected in the income statement the income would, of course, be increased where the transactions result in a gain, and reduced where they result in a loss or net cost. But where the effects are not all reflected in the income statement, and that statement indicates only the income tax actually payable, exactly the opposite effect is produced: where the special transactions result in a gain, the net income is reduced; and where they result in a loss, or net cost, the net income is increased. Such a result is not only repugnant to common sense but can readily be shown to be contrary to the principles of allocation which lie at the root of all accounting.

Financial statements are the result of allocations—of receipts, payments, accruals, and other financial events and transactions. Many of the allocations are necessarily based on assumptions, but no one suggests that allocations based on imperfect criteria should be abandoned in respect of expenses other than income taxes, or even that the method of allocation should always be indicated in footnotes. Income taxes are an expense that should be allocated, when necessary and practicable, to income and other accounts, as other expenses are allocated. What the income statement should reflect under this head, as under any other head, is the expense properly allocable to the income included in the income statement for the year. For instance, an item in an income statement, "Taxes other than income taxes—$N," does not imply that $N was the amount of such taxes paid or accrued during the year but that $N is the amount of such taxes properly chargeable in the income statement in respect of the year. The total taxes paid may have been $N plus $M, the latter amount having been charged to other accounts. A part may have been charged to capital-asset accounts (e.g., real estate taxes on uncompleted construction, social-security taxes on construction payroll, or import duties on machinery); a part to a deferred charge account (e.g., stamp taxes in connection with an issue of bonds); a part to inventories (e.g., import duties on unused goods); or a part to surplus (e.g., stamp taxes on a sale where the profit was carried to earned surplus).

As a matter of accounting principle, similar treatment of taxes that are measured by a statutory concept of net income is equally called for, and in many cases allocation is necessary if the income statement is to meet a normal standard of significance. This is true irrespective

of whether the income statement be regarded as a historical statement or a measure of earning capacity.

In cases in which the transactions not reflected in the income statement increase the income tax payable by an amount that is substantial and is determinable without difficulty, as in the case of a gain credited to surplus, an allocation of income tax between accounts is commonly made. Objection to allocation in other cases, as for instance the case of a loss charged to surplus, must, therefore, be on the ground that such allocations increase the tax chargeable in the income statement beyond the amount of the tax payable, or on the ground that the amount attributable to accounts other than income is not reasonably determinable.

The committee sees no objection to an allocation which results in the division of a given item into two parts one of which is larger than the item itself and is offset by the smaller. This consideration is especially persuasive where it is apparent that a reduction in income taxes was a major if not the predominant purpose of the transaction which has not been reflected in the income statement.

The argument that the effect of the special transactions on the amount of tax is not identifiable is usually without substantial merit. The difficulties encountered in allocation of the tax are not greater than those met with in many other allocations of expenses. In most cases, at least, the amount of income taxes to be allocated to the income statement should be the amount that would have been payable if the transactions in question had not occurred. It has also been suggested that allocation would require a determination of the effect on the tax of every separate transaction. No such need arises; all that is necessary in making an allocation is to consider the effect on taxes of those special transactions which are not reflected in the income statement.

The cases that are likely to call for allocation are those in which transactions which affect the income tax in a substantial manner are reflected in (a) surplus accounts; (b) deferred-charge accounts; (c) reserve accounts. Methods of implementing the allocation principle in these instances are set forth below.

Credits to Surplus

The committee has heretofore considered the general question of charges and credits to surplus and their effect on the income state-

ment and the presentation of earning capacity; it has approved the current tendency to discourage such charges and credits; it has called attention to the advantages of the combined statement of income and surplus in dealing with the problem;[2] and it has suggested that in some circumstances revised income statements be issued.[3] The committee recognizes, however, that in exceptional cases allocations may be made of charges and credits as between current income and surplus, and it believes that where such allocations are made of material items, the treatment of income taxes should follow as closely as possible the line of allocation of such charges and credits.

Where an item, resulting in a material increase in income taxes, is credited to surplus, the portion of the current provision for income taxes which is attributable to such item should, under the principle of allocation, be correspondingly charged. The committee suggests, however, that the provision for income taxes be shown in the income statement in full, and the portion thereof charged to surplus either be deducted from the amount of the tax or be shown as a separate credit item. The first of these is illustrated as follows:

Provision for income taxes	$1,000,000
Less portion thereof allocated to taxable gain in statement of surplus	200,000
Balance	$ 800,000

Charges to Surplus

Where an item resulting in a material reduction in income taxes is charged to surplus, the principle of allocation may be applied in the income statement in either one of two ways: (a) the current provision for income taxes may be shown as if the item in question were not deductible (the total amount of tax estimated to be legally due for the year being indicated) or (b) a charge may be included for a portion of such item equal in amount to the tax reduction resulting therefrom. In either case the amount charged to surplus would be reduced accordingly.

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[2] Accounting Research Bulletin No. 8.

[3] Accounting Research Bulletin No. 21.

The first method may be illustrated by presentation in the income statement as follows:

Provision for income taxes	$1,000,000
(The estimated tax liability is $800,000 by reason of a reduction of $200,000 in taxes resulting from a loss on condemnation of real estate. This loss has been charged to surplus and the related tax reduction has been treated as an offset thereto.)	

The second method may be illustrated by the inclusion of separate items in the income statement, as follows:

Provision for income taxes	$ 800,000
Portion of loss on condemnation of real estate equal to tax reduction attributable thereto (remainder charged to surplus)	200,000

Deferred-Charge and Reserve Accounts

The committee believes that the principle of allocation applies also in the case of deferred-charge and reserve accounts where a material tax reduction results from an item not reflected in the income statement.

With respect to deferred charges, the deduction for tax purposes in a given year of an item which is carried to, or remains in a deferred-charge account, will involve a series of charges in future income statements for amortization of the deferred charge, and these charges will not be deductible for tax purposes. Unless appropriate allocations are made, the net result will be to increase artificially the net income in the first year and to decrease it artificially in later years. The committee, therefore, recommends in such cases that a charge be made in the income statement of an amount equal to the tax reduction in the manner set forth above with respect to charges to surplus, that a corresponding credit be made in the deferred-charge account and that amortization charges thereafter be based on the net amount. This procedure in substance has beeen recommended by the committee where bonds are refunded and the entire balance of unamortized discount and debt expense with respect thereto is deducted in the tax return for the period in which refunding occurs, while it is spread over future periods in the income statement.[4]

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[4] Accounting Research Bulletins Nos. 2 and 18.

Where an item resulting in a material reduction in income taxes is charged to a reserve account, the principle of allocation may be applied in the income statement in three ways: (a) the current provision for income taxes may be shown as if the item in question were not deductible (the total amount of tax estimated to be legally due for the year being indicated), or (b) a charge may be included for a portion of such item equal in amount to the tax reduction resulting therefrom, or (c) the item in question may be charged in the income statement and a portion of the reserve equal in amount to the excess of such item over the related tax reduction credited in the income statement. In the case of either (a) or (b) the amount of the tax reduction will be reflected in the reserve or other appropriate account.

Where it is not practicable to adopt the foregoing procedures with respect to charges to deferred-charge and reserve accounts the pertinent facts should be clearly disclosed. Neither allocation nor disclosure is necessary, however, in the case of differences between the tax return and the income statement where there is a presumption that they will recur regularly over a comparatively long period of time.

Amortization of Emergency War Facilities

An outstanding example of difference between the tax return and the income statement arises where emergency war facilities are depreciated at normal rates in the income statement and at the special amortization rate in the income-tax return. Where the resulting reduction in current income tax is material the committee believes that a portion of the excess of the amortization over normal depreciation (equal in amount to the tax reduction resulting therefrom), should be included in the income statement either as additional depreciation or as a special charge and credited to an appropriate reserve or other account.

Additional Taxes and Refunds

An examination of current practices with respect to additional assessments (or refunds) of income taxes of prior periods and adjustments in provisions therefor, indicates that the prevailing treatment is fairly evenly divided between charging or crediting such items to surplus and including them in the income statement. The tendency seems to be toward the latter treatment.

The committee has heretofore considered the general question of corrections of estimates made in prior years, and, as indicated above, it approves the current tendency to discourage charges and credits to surplus.[5] It suggests that such corrections should be included in the income statement unless they are so large as to be likely to produce distorted interpretations of the statement; in the latter event they may be charged or credited to surplus with indication as to the period to which they relate.

Carry-back of Losses and Unused Excess-Profits Credits

Where taxpayers are permitted to carry back losses or unused excess-profits credits, and thus become entitled to a refund of taxes paid in prior years, a question arises whether the amount refundable is to be regarded as applicable to the year in which the tax was originally accrued or to the year in which the loss occurred or the unused excess-profits credit arose. The committee believes that as a practical matter, in the preparation of annual income statements, amount refundable should be included in the latter year. While claims for refund of income taxes should not ordinarily be included in the accounts prior to approval by the taxing authorities, a claim based on the carry-back provision, while not an allowable offset against the tax to be paid, presumably has as definite a basis as the computation of income taxes for the year; such claim should, therefore, be included in the income statement as indicated above. The committee recommends, however, that the income statement for that year indicate the results of operations before application of the claim for refund, which should then be shown as a final item before the amount of net income for the period; but if there is substantial reason to believe that misleading inferences might be drawn from such inclusion, the claims may be credited to surplus.

Carry-forward of Losses and Unused Excess-Profits Credits

Where taxpayers are permitted to carry forward losses or unused excess-profits credits, the committee believes that as a practical matter, in the preparation of annual income statements, the resulting tax reduction should be reflected in the year to which such losses or

[5] Accounting Research Bulletin No. 8.

unused credits are carried. The committee recommends, however, that the income statement for that period indicate the results of operations without inclusion of such reduction, which should be shown as a final item before the amount of net income of the period; but if there is substantial reason to believe that misleading inferences might be drawn from such inclusion, the tax reduction may be credited to surplus.

Position of Income Taxes in the Income Statement

It has been customary for companies other than utilities to show the provision for income taxes at the end of the income statement, immediately preceding the showing of net income for the period. In addition it has been customary for such companies to indicate "net income before income taxes" in order to emphasize the effect of such taxes on net income. The committee believes that the term "net income before income taxes" has unfortunate implications, and urges that the word "net" be eliminated therefrom.

The committee also recognizes that income taxes may properly be classified as operating expenses.

Income Taxes in the Balance-Sheet

Accrued income taxes for the current or prior periods should be classified in the balance-sheet as current liabilities, even though they may not have to be paid within one year (or such other period as is used to determine current liabilities) due to delays in final adjustment and settlement. Provisions for such taxes may, however, be excluded from current liabilities if the liability is considered to be merely contingent. Where there is doubt as to the amount of the tax liability, the accrual should include such amounts as appear to be reasonable on the basis of the evidence available. The existence of proposed additional assessments which are disputed by the taxpayer, should be disclosed by footnote or comment unless provision is made therefor.

Claims for refunds based on the carry-back provisions of the law may be shown as current assets if collection is reasonably assured.

Disclosure of Certain Differences Between Taxable and Ordinary Income

If credits of significant amounts are made to surplus (directly or through the income statement) as to which, because of differences

in accounting methods, no income tax has been paid or provided for, appropriate disclosure should be made, and if a tax is likely to be paid thereon, provision should be made for the estimated amount of such tax. This rule applies, for instance, to profits on instalment sales or long-term contracts which are deferred for tax purposes, and to cases where unrealized appreciation of securities is taken into the accounts by certain types of investment companies.

The statement entitled "Accounting for Income Taxes" was adopted by the assenting votes of eighteen members of the committee, as it was constituted at the time of the 1944 annual meeting of the Institute. Mr. Peloubet dissented. Mr. Towns dissented from paragraphs (6), (7), (8), and (9) of the summary statement and the related discussion. Mr. Cranstoun dissented from paragraphs (1), (3), and (4) of the summary statement and the related discussion.

Mr. Peloubet dissented because "the bulletin is a mandatory directive to the profession to apply an entirely novel method of allocation to an expenditure, the amount of which is almost never certain when first included in accounting statements. No expense other than federal income and profits taxes is allocated on the basis of applying to a given transaction so much of the expense as would not have occurred if the transaction to which the expense is attributed had not taken place. The usual method is to allocate a total expense ratably to given accounts or transactions on a consistent basis. The presentation of accounts on an 'as if' or 'giving effect to' or other hypothetical basis is often proper and useful but is not a substitute for accounts prepared on the basis of present facts. The consistent application of the bulletin to reserves would be difficult and confusing, requiring the use of charges or credits net of a tax, the amount of which was not known with any certainty. The principal objection to the bulletin is its mandatory character. It is a valuable service to point out the possibility of abuses inherent in the present tax situation. It is equally valuable to indicate a means of curing such abuses. The application of such means and methods, however, is a matter for the judgment of the individual practitioner in individual cases."

Mr. Towns dissented "with respect to those parts of paragraphs (6) and (7) which require showing separate income-tax items in the in-

come statement for benefits resulting from 'carry-backs' and 'carry-forwards' because, in view of other requirements, this will result in such complexity in the income statement, in numerous cases, that he believes the information can usually be more appropriately and clearly presented in a note; with respect to paragraph (8), because he is not convinced of the advisability of providing for the optional classification of income taxes there outlined and believes that, if such provision is to be made, it would be preferable to have a more complete presentation, with adequate statement of reasons; with respect to paragraph (9), because he believes that the paragraph, to be adequate, should require that collection of claims for refund be expected within a period of time appropriately related to the time for payment of current liabilities, if the claims are to be included as current assets."

NOTES

1. Accounting Research Bulletins represent the considered opinion of at least two-thirds of the members of the committee on accounting procedure, reached on a formal vote after examination of the subject matter by the committee and the research department. Except in cases in which formal adoption by the Institute membership has been asked and secured, the authority of the bulletins rests upon the general acceptability of opinions so reached. (See Report of Committee on Accounting Procedure to Council, dated September 18, 1939.)

2. Recommendations of the committee are not intended to be retroactive, nor applicable to immaterial items. (See Bulletin No.1, page 3.)

3. It is recognized also that any general rules may be subject to exception; it is felt, however, that the burden of justifying departure from accepted procedures must be assumed by those who adopt other treatment. (See Bulletin No. 1, page 3.)

COMMITTEE ON ACCOUNTING PROCEDURE (1943-1944)

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"TAX REDUCTIONS" IN STATEMENTS OF INCOME

The Use of Certain Procedures Suggested by Accounting Research Bulletin No. 23 in Statements Filed with the Securities and Exchange Commission

A Statement by the Research Department of the American Institute of Accountants

THE purpose of this statement is to draw attention to those conclusions of the Securities and Exchange Commission expressed in its Accounting Series Release No. 53 which relate to procedures recommended by the Institute's committee on accounting procedure in Accounting Research Bulletin No. 23 for the treatment of material items entering into the computation of taxable income which are not reflected in the income statement.

Accounting Research Bulletin No. 23, issued in December, 1944, deals with certain accounting problems of reporting income and excess-profits taxes in financial statements. As stated in that bulletin, special problems of reporting income taxes arise "where there are material and extraordinary differences[1] between the taxable income upon which they are computed and the income reported in the income statement under generally accepted accounting principles. . . . In some cases the transactions [which are the cause of the differences] result in gains; in others they result in losses or net costs. Sometimes the reduction of tax is a major if not the predominant motive for the transaction. If all the effects of the transactions (including their effect on income tax) were reflected in the income statement the income would, of course, be increased where the transactions result in a gain, and reduced where they result in a loss or net cost. But where the effects are not all reflected in the income statement, and that statement indicates only the income tax actually payable, exactly the opposite effect is produced: where the special transactions result in a gain, the net income is reduced; and where they result in a loss, or net cost, the net income is increased."[2]

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[1] Bulletin No. 23 emphasizes the fact that it deals only with material and unusual situations. The committee noted that "Neither allocation nor disclosure is necessary, however, in the case of differences between the tax return and the income statement where there is a presumption that they will recur regularly over a comparatively long period of time."

[2] Accounting Research Bulletin No. 23, pp. 185-186.

Among the problems discussed in Bulletin No. 23 are those arising in situations in which items resulting in a material reduction in income taxes were charged to surplus or to deferred-charge accounts. The Bulletin states that in those situations the tax effect of such items may be displayed in the income statement in either one of two ways: "(a) the current provision for income taxes may be shown as if the item in question were not deductible (the total amount of tax estimated to be legally due for the year being indicated) or (b) a charge may be included for a portion of such item equal in amount to the tax reduction resulting therefrom." In either case the amount charged to surplus or to deferred-charge accounts would be reduced accordingly. These alternative methods of presentation in the income statement are illustrated as follows:

Method (a)

"The first method may be illustrated by presentation in the income statement as follows:

"Provision for income taxes	$1,000,000
(The estimated tax liability is $800,000 by reason of a reduction of $200,000 in taxes resulting from a loss on condemnation of real estate. This loss has been charged to surplus and the related tax reduction has been treated as an offset thereto.)"	

Method (b)

"The second method may be illustrated by the inclusion of separate items in the income statement, as follows:

"Provision for income taxes	$ 800,000
Portion of loss on condemnation of real estate equal to tax reduction attributable thereto (remainder charged to surplus)	200,000"

The effect upon net income resulting from the application of either method is the same.

The Securities and Exchange Commission does not consider the two methods equally acceptable. In its Accounting Series Release No. 53, "In the Matter of 'Charges in Lieu of Income Taxes,'" the Commission states its opinion regarding the treatment of "tax reductions" resulting from certain items not reflected in the income statement. The Commission's discussion of its conclusions was developed by using the facts relating to a registration statement filed by a public

utility company in which a material reduction of income taxes was attributable to items charged to surplus and to a deferred-charge account. In its conclusions 1 and 3[3], the Commission rejects the first of the two methods of presentation suggested in Accounting Research Bulletin No. 23. It seems implicit, however, in the Commission's Release that it accepts the results reached by the second of the alternative methods suggested. The Commission states:

> "It may be appropriate, and under some circumstances such as a cash refunding operation it is ordinarily necessary, to accelerate the amortization of deferred items by charges against income when such items have been treated as deductions for tax purposes."[4]

In its conclusion 4[5], the Commission recognizes the propriety of a similar procedure where losses are deducted for tax purposes. In the course of the discussion of the progress of the case reviewed in the Release, the Commission states that it directed its staff to advise the registrant to the effect

> "That no objection would be raised to the inclusion in the income statement of an item of $4,148,050 representing so much of the refunding expenses and of the loss on disposition of property as was equal to the estimated reduction in income taxes attributable thereto, the remainder of both these items being charged directly to surplus; provided, however, (a) that the caption for the item indicate clearly the nature and amount of the item being charged off and (b) that the special charge be excluded from operating expenses and shown as a deduction from gross income."[6] [Reference by the Commission to "operating expenses" relates to that classification of accounts by a public utility company.]

Furthermore, in Exhibit D of the Release, there is shown a condensed certified statement of the company's income as finally amended, in

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[3] "1. The amount shown as provision for taxes should reflect only actual taxes believed to be payable under the applicable tax laws. . . .
"3. The use of the caption 'Charges or provisions in lieu of taxes' is not acceptable." Accounting Series Release No. 53, p. 2.

[4] The Commission's conclusion 2. Accounting Series Release No. 53, p. 2.

[5] "4. If it is determined, in view of the tax effect now attributable to certain transactions, to accelerate the amortization of deferred charges or to write off losses by means of charges to the income account, the charge made should be so captioned as to indicate clearly the expenses or losses being written off." Accounting Series Release No. 53, p. 2.

[6] Accounting Series Release No. 53, p. 11.

which the following item is displayed as a charge in the income statement immediately preceding the final figure reported as net income:

> "Special charges of those portions of premium and expenses on redemption of bonds ($2,091,177) and of loss on sale of property ($2,056,873) which are equivalent to resulting reduction in Federal excess profits taxes ..... $4,148,050"

The Commission recognizes the importance of drawing attention to such special charges and their effect upon the presentation of income. In the case discussed in the Release the registrant, in one of its amendments[7], included the statement "before special charges below" in captions of the income statement, as follows:

> "Total operating expenses and taxes (before special charges below)"
> "Net operating revenues (before special charges below)"

The staff of the Commission objected to this presentation and the parenthetical statements were removed in the final amendment filed by the registrant. However, the Commission reports its disagreement with its staff on this matter as follows:

> "In transmitting to the registrant our views on the income statement as set forth in the third amendment, the staff indicated that the use of the words 'before special charges below' in the several captions mentioned above was objectionable. We do not believe this position to be wholly sound. We feel that the existence of large special and unusual transactions ought properly to be forcefully brought to the attention of the reader of the statement. We feel also that the use of appropriate qualifying words such as 'see special charges' in connection with the pertinent captions is an appropriate means of warning the reader of the existence of such items as were present in this case."[8]

NOTE: As published in *The Journal of Accountancy* for February, 1946, this statement included an exhibit presenting the Securities and Exchange Commission's summary of its conclusions expressed in Accounting Series Release No. 53. To simplify the format of the present statement, that exhibit has been omitted and the pertinent conclusions of the Commission are herein presented as text material or footnotes.

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[7] Exhibit C, Accounting Series Release No. 53, page 32.
[8] Accounting Series Release No. 53, page 12.

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Exhibit I

BA-OAG-1 EXPENSES

I have been requested by you to give you my opinion as to my construction of the Section of the Code levying the so-called income tax on Banks.

Section 2676 of the Code of 1942 levies a tax upon, or with respect, to the entire net income of banks. This language includes all income from whatever source derived, even income from nontaxable securities. This is for the reason that the bank tax is a franchise tax for the privilege of operating, or doing business in this State, the amount thereof being measured by the entire net income.

For the above reason, it is my opinion that banks in this State filing returns required under this Section of the Code, are permitted to deduct all expenses incurred in the operation of their banks including Federal and State income taxes. (March 12, 1948)

Claude K. Wingate
Assistant Attorney General
SOUTH CAROLINA TAX COMMISSION

Exhibit J

CHAPTER 15

State Revenue Laws

ARTICLE 1. Income Tax, § 386.
ARTICLE 2. Inheritance Tax, § 430.
ARTICLE 3. Gasoline Tax, § 455.
ARTICLE 4. Miscellaneous State Revenue Laws, § 470.

ARTICLE 1

Income Tax

386. Citation of Article.
387. Definitions.
388. Tax on Individuals.
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389. Non-resident.
390. Corporation.
391. Exemptions.
392. Organizations Exempt.
393. Net Income.
394. Computation of Tax.
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400. Non-deductible Items.
401. Non-residents and Foreign Corporations.
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405. Returns When Income Year Changed.
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420–21. Power of Tax Commission.
422. Officers, Agents and Employees.
423. Oath and Acknowledgment.
424. Statistics and Other Data.
425. Secrecy Required of Officials.
426. Regulations.
427. Disposition of Proceeds.
428. Invalidity of Part of Article.
429. Federal Return Blanks.

§ 386. Citation of Article.—This Article shall be known and may be cited as the Income Tax Act of 1926.

1927, XXXV, 1.

§ 387. Definitions.—For the purposes of this Article and unless otherwise required by the context:

(1) The words "tax commission" mean the South Carolina Tax Commission.

(2) The word "taxpayer" means any individual, fiduciary, or corporation subject to the tax imposed by this Article.

(3) The word "fiduciary" means a guardian, trustee, executor, administrator, receiver, conserver, or any person, whether individual or corporate, acting in any fiduciary capacity for any person, estate or trust.

(4) The word "person" includes individuals, fiduciaries, partnerships or corporations.

(5) The word "corporation" includes joint-stock companies or associations and insurance companies.

(6) The word "business" includes trade, profession, occupation or employment.

(7) The words "tangible property" mean real property and corporeal personal property and do not mean money, bank deposits, shares of stock, bonds, credits, evidences of debt, choses in action or evidences of an interest in property.

(8) The words "intangible property" mean all property other than tangible property.

(9) The words "income year" mean the calendar year or the fiscal year, upon the basis of which the net income is computed under this Article; if no fiscal year has been established they mean the calendar year.

(10) The words "fiscal year" mean an income year ending on the last day of any month other than December.

(11) The word "paid" for the purpose of the deductions under this Article means "paid or accrued" or "paid or incurred," and the words "paid or accrued," "paid or incurred" and "incurred" shall be construed according to the method of accounting upon the basis of which the net income is computed under this Article. The word "received" for the purpose of the computation of the net income under this Article means "received or accrued," and the words "received and accrued" shall be construed according to method of accounting upon the basis of which the net income is computed under this Article.

(12) The words "foreign corporation" mean any corporation other than a domestic corporation.

1927, XXXV, 1.

§ 388. Imposition of the Income Tax on Individuals.—A tax is hereby imposed upon every individual residing in the State of South Carolina, which tax shall be levied, collected and paid annually with respect to the entire net income of the taxpayer, as hereinafter defined and upon income earned within the jurisdiction of this State of every nonresident having a business or agency in the State, or from the sale or rental of, or income from property within this State, computed at the following rates, after deducing the exemptions provided by this Article:

On the excess over the amount legally exempted up to two thousand dollars, one per cent.

On the excess above two thousand dollars and up to four thousand dollars, two per cent.

On the excess above four thousand dollars and up to six thousand dollars, three per cent.

On the excess above six thousand dollars and up to eight thousand dollars, four per cent.

On the excess above eight thousand dollars, five per cent.

1927, XXXV, 1; 1930, XXXVI, 1339.

§ 388-A. Officers and Employees of State and Subdivisions Liable to Income Tax.—All officers and employees of the State of South Carolina and all subdivisions thereof shall pay an income tax to the State of South Carolina at the same rate that all other individuals are taxed: *Provided,* That the tax imposed by this Section shall not apply to Constitutional officers during the present term for which they have been elected.

1926, XXXIV, 1050.

§ 389. Tax on Nonresidents.—Whenever a taxpayer other than a resident of the State has become liable to income tax to the State where he resides upon his net income for the taxable year, derived from sources within this State and subject to taxation under this Article, the South Carolina Tax

Commission shall credit the amount of income tax payable by him to the State where he resides as his income subject to taxation under this Article with such proportion of the tax so payable by him to the State where he resides as his income subject to taxation under this Article bears to his entire income upon which the tax so payable to such other state was imposed: *Provided,* That such credit shall be allowed only if the laws of said State (1) grant a substantially similar credit to residents of this State subject to income tax under such laws; or (2) impose a tax upon the personal income of its residents derived from sources in this State and exempt from taxation the personal incomes of residents of this State. No credit shall be allowed against the amount of the tax on any income taxable under this Article which is exempt from taxation under the laws of such other State.

1930, XXXVI, 1339.

§ 390. Tax on Corporations.—Every corporation organized under the laws of this State shall make a return and shall pay annually an income tax equivalent to four and one-half (4½) per cent of the entire net income of such corporation as herein defined received by such corporation during the income tax year; and, every foreign corporation doing business or having an income within the jurisdiction of this State shall make a return and shall pay annually an income tax equivalent to four and one-half (4½) per cent of a proportion of its entire net income, to be determined as hereinafter provided in this Article; *Provided,* The amount of tax shall not be less than would be produced by applying a rate of two per centum to a base consisting of the entire net income plus salaries and other compensation paid to all elected and appointed officers, and to any stockholder owning in excess of five per centum of the issued capital stock of the corporation, and after deducting from the base six thousand dollars and any deficit reported for the year.

(b) RAILROADS AND PUBLIC SERVICE CORPORATIONS.—Basis of ascertaining net income. The basis of ascertaining the net taxable income of every corporation engaged in the business of operating a steam or electric railroad, navigation company, waterworks company, light and gas company, power company, express, telephone or telegraph business, sleeping car company, or other form of public service, whether or not such company is required to keep records according to the standard classification of accounting of the Interstate Commerce Commission, shall be the "net operating income" of such corporation computed in accordance with the present standard classification of accounts, when their business is wholly within the jurisdiction of this State, and when their business is in part within and in part without the State their net income within the jurisdiction of this State shall be ascertained by taking their gross "operating revenues" within this State, including in this gross "operating revenues" within the jurisdiction of this State the equal mileage proportion within the jurisdiction of this State of their interstate business and deducting from their gross "operating revenues" the proportionate average of "operating expenses" or "operating ratio" for their whole business computed in accordance with the present Interstate Commerce Commission standard classification of accounts. From the net operating income thus ascertained shall be deducted "uncollectible revenue" and taxes paid in this State for the income year, other than income taxes, and the balance shall be deemed

to be their net income taxable under this Article: *Provided*, That rentals may be deducted from gross operating revenues in the event that they have not been deducted by the above provisions.

(c) CAR HIRE CONSIDERED.—In determining the taxable income of a corporation engaged in the business of operating a railroad under the preceding sub-section (Section (b)), in the case of a railroad located entirely within the jurisdiction of this State, the net income shall be increased or decreased to the extent of any credit balance received or paid, as the case may be, on account of car hire; and when a railroad is located partly within and partly without the jurisdiction of this State, then said net operating income shall be increased or decreased to the extent of an equal mileage proportion within the jurisdiction of this State of any credit or debit balance received or paid, as the case may be, on account of car hire.

(d) TAX ON FIDUCIARIES.—The tax imposed by this Article shall be imposed upon resident fiduciaries and upon non-resident fiduciaries having in charge funds or property for the benefit of a resident of this State, which tax shall be levied, collected, and paid annually with respect to:

(1) That part of the net income of estates or trusts which has not been distributed. (2) The net income received during the income year by deceased individuals who, at the time of death were residents and who have died during the tax year or income year without having made a return. (3) The entire net income of resident insolvent or incompetent individuals whether or not any portion thereof is held for the future use of the beneficiaries, where the fiduciary has complete charge of such net income. (4) The tax imposed upon a fiduciary by this Article shall be a charge against the estate or trust.

1927, XXXV, 1, 362; 1930, XXXVI, 1339, 1393.

§ 391. Exemptions.—There shall be deducted from net income the following exemptions:

(a) In the case of a single individual, a personal exemption of twelve hundred ($1,200.00) dollars.

(b) In the case of a married individual, living with husband or wife or the head of a household, twenty-two hundred ($2,200.00) dollars.

(b-1) If a husband and wife living together make separate income tax returns, the personal exemption of $2,200.00 may be taken by either or divided between them, but in no case shall a husband and wife living together receive but one personal exemption. If a husband and wife are legally separated each shall be entitled to the exemption allowed a single person.

(c) Four hundred ($400.00) dollars for each individual other than husband or wife dependent upon and receiving his chief support from the taxpayer if such dependent individual is under twenty-one years of age or is incapable of self-support because mentally or physically defective.

(d) In the case of a fiduciary if taxable under clause (a) supra, a personal exemption of twelve hundred ($1,200.00) dollars; if taxable under clause (b) supra, the same exemption as would be allowed the deceased if living; if taxable under clause (3) supra, the same exemptions to which the beneficiary would be entitled; *Provided*, That if the income is held in the estate undistributed the exemption shall be twelve hundred ($1,200.00) dollars.

1927, XXXV, 1; 1927, XXXV, 217; 1930, XXXV, 1339.

§ 392. Organizations that are exempt.—The following organizations shall be exempt from taxation under this Article:

(1) Fraternal beneficiary societies, orders or associations, (a) operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and (b) providing for the payment of life, sick, accident or other benefits to the members of such society, order or association or their dependents.

(2) Building and loan associations and cooperative banks without capital stock, organized and operated for mutual purposes and without profits, and insurance companies.

(3) Cemetery corporations and corporations organized for religious, charitable, scientific, or educational purposes of for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual.

(4) Business leagues, chambers of commerce, or boards of trade, not organized for profit and no part of the net earnings of which inures to the benefit of any private stockholder or individual.

(5) Civic leagues or organizations not organized for profit, but operated exclusively for the promotion of social welfare.

(6) Farmers or other mutual hail, cyclone, or fire insurance companies, mutual ditch or irrigation companies, mutual or cooperative telephone companies or like organizations of a purely local character, the income of which consists solely of assessments, dues, and fees collected from members for the sole purpose of meeting expenses.

(7) Farmers', fruit growers' or like organizations, organized and operated as sales agent for the purpose of marketing the products of members and turning back to them the proceeds of sales, less the necessary selling expenses, on the basis of the quantity of produce furnished by them.

(8) Labor, agricultural or horticultural organizations, no part of the net earnings of which inures to the benefit of any private stockholder or member.

1927, XXXV, 1.

§ 393. Net Income defined.—The words "net income" mean the gross income of a taxpayer less the deductions allowed by this Article.

1927, XXXV, 1.

§ 394. Computation of Tax.—(1) The words "gross income" mean the income of a taxpayer derived from salaries, wages or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, business, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains, or profits, and income derived from any source whatever. The amount of all such items shall be included in the gross income of the income year in which received by the taxpayer, unless, under the methods of accounting permitted under this Article, any such amounts are to be properly accounted for as of a different period.

(2) The words "gross income" do not include the following items which shall be exempt from taxation under this Article:

(a) The proceeds of life insurance policies and contracts paid upon the death of the insured to individual beneficiaries or to the estate of the insured.

(b) The amount received by the insured as a return of premium or premiums paid by him under life insurance, endowment or annuity contracts, either during the term or at the maturity of the term mentioned in the contract or upon surrender of the contract.

(c) The value of property acquired by gift, bequest, devise or descent (but the income from such property shall be included in gross income).

(d) Interest upon the obligations of the United States, or its possessions, or of the State of South Carolina, or any political subdivision thereof.

(e) Salaries, wages, or other compensation received from the United States by officials or employees thereof, including persons in the military or naval forces of the United States.

(f) Any amounts received through accident or health insurance or under workmen's compensation acts, as compensation for personal injuries or sickness, plus the amount of any damages received whether by suit or agreement, on account of such injuries or sickness.

1927, XXXV, 1.

§ 395. Basis of return of net income.—(1) The net income of a taxpayer shall be computed in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if such method does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Tax Commission does clearly reflect the income. Taxpayers whose accounting period of twelve months ends as of the last day of some month other than December and the books of such taxpayer are kept accordingly, may, with the approval of the Tax Commission, and subject to such rules and regulations as it may establish, return their net income under this Article on the basis of such fiscal year in lieu of that of the calendar year.

(2) A taxpayer may, with the approval of the Tax Commission and under such regulations as it may prescribe change the income year from fiscal year to calendar or otherwise, in which case his net income shall be computed upon the basis of such new income year: *Provided*, That such approval must be obtained from the Commission at least thirty days prior to the end of such income year.

(3) An individual carrying on business in partnership shall be liable for income tax only in his individual capacity, and shall include in his gross income his distributive share of the net income of the partnership for each income year, whether distributed or not.

(4) Every individual taxable under this Article who is a beneficiary of an estate or trust shall include in his gross income the distributive share of the net income of the estate or trust, received by him or distributable to him during the income year. Unless otherwise provided in the law, the will, the deed, or other instrument creating the estate, trust or fiduciary relation, the net income shall be deemed to be distributed to the beneficiaries (including the fiduciary as a beneficiary, in the case of income accumulated for future distribution) ratably in proportion to their respective interests.

1927, XXXV, 1.

§ 396. Determination of gain or loss.—For the purpose of ascertaining the gain or loss from the sale or other disposition of property, real, personal or mixed, the basis shall be in the case of property acquired before January first, one thousand nine hundred and twenty-one, the fair market price or the value of such property as of that date, and in all other cases, the cost thereof: *Provided*, That in the case of property which was included in the last preceding annual inventory used in determining net income in a return under this Article, such inventory value shall be taken in lieu of costs or market value.

The final distribution to the taxpayer of the assests of a corporation shall be treated as a sale of the stock or securities of the corporation owned by him, and the gain or loss shall be computed accordingly.

1927, XXXV, 1.

§ 397. Exchange of Property.—(1) When property is exchanged, whether or not of a like nature, the gain or loss shall be the difference between the cost or value January 1st, 1921, if acquired prior to that date, of the property exchanged and the value of the property received, whether the same be bonds, stocks, securities or other tangible or intangible property.

(2) In the case of the organization of a corporation, the stock or securities received shall be considered to take the place of property transferred thereto, and no gain or loss shall be deemed to arise therefrom.

(3) When in connection with the organization, merger, or consolidation of a corporation, a stockholder receives, in place of stock or securities owned by him, new stock or securities, the basis of computing the gain or loss, if any, shall be, in case the stock or securities owned were acquired before January first, one thousand nine hundred and twenty-one, the fair market price or value thereof as of that date, and in all other cases the cost thereof: *Provided, however*, that in a reorganization, consolidation or merger the exchange of stock or property for stock of a corporation a party to the reorganization, consolidation or merger shall not be deemed to result in gain or loss.

1927, XXXV, 1; 1928, XXXV, 1159.

§ 398. Inventory.—Whenever in the opinion of the Tax Commission it is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Tax Commission may prescribe, conforming as nearly as may be to the best accounting practice in the trade or business and most clearly reflecting the income.

1927, XXXV, 1.

§ 399. Deductions.—In computing net income there shall be allowed as deductions:

(1) All the ordinary and necessary expenses paid or accrued (in case the books are kept on the accrual basis) during the income year in carrying on any trade or business, including:

(a) As to individuals, reasonable wages of employees for service actually rendered in producing such income.

(b) As to partnerships, reasonable wages of employees and a reasonable allowance for copartners or members of a firm, for services actually rendered in producing such income, the amount of such salary allowance to be included in the personal return of the copartner receiving same.

(c) As to corporations, wages of employees and salaries of officers, if reasonable in amount, for services actually rendered in producing such income.

(2) Rentals or other payments required to be made as a condition to the continued use or possession, for the purpose of the trade, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

(3) All interest paid during the income year on indebtedness except interest on obligations contracted for the purchase of non-taxable securities or stock. Dividends on preferred stock shall not be deducted as interest.

(4) Taxes for the income year, except taxes on income, inheritance taxes, and taxes assessed for local benefit of a kind tending to increase the value of the property assessed.

(5) Dividends from stock in any corporation the income of which shall have been assessed and the tax on such income paid by the corporation under the provisions of this Article.

(6) Losses sustained during the income year on property used in trade or business, or of property not connected with trade or business, if arising from fire, storms, shipwrecks or other casualties, or theft and if not compensated for by insurance or otherwise.

(7) Debts ascertained to be worthless and actually charged off the books of the taxpayer within the income year.

(8) A reasonable allowance for the depreciation and obsolescense of property used in the trade or business; and in the case of mines, other natural deposits, and timber, a reasonable allowance for depletion: *Provided,* That in computing the deductions allowed under this paragraph, the basis shall be the cost plus any additions and improvements (including in the case of mines, and other natural deposits, the cost of development not otherwise deducted).

In the case of leases the deductions allowed may be equitably apportioned between the lessor and the lessee.

(9) Resident individuals and corporations having an established business in another State, or investment in property in another State, may deduct the net income from such business or investment. The deduction authorized in this subsection shall in no case extend to any part of the income of resident individuals and corporations from personal services, or mortgages, stocks, bonds, securities, and deposits.

(10) In the case of a non-resident individual, the deductions allowed in this Section shall be allowed only if, and to the extent that, they are connected with income arising from sources within the State; and the proper apportionment and allocation of the deductions with respect to sources of income within and without this State shall be determined under rules and regulations prescribed by the Tax Commission.

(11) There shall be allowed as deductions contributions or gifts made by individuals within the taxable year to corporations or associations operated exclusively for religious, charitable, scientific, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual, to an amount not in excess of fifteen (15%) per centum of the taxpayer's net income as computed without the benefit of this Section.

1927, XXXV, 1; 1927, XXXV, 217.

§ 400. Items not deductible.—In computing net income no deduction shall in any case be allowed in respect of:

(a) Personal, living, or family expenses.

(b) Any amount paid out for new buildings or for permanent improvements or betterments, made to increase the value of any property or estate.

(c) Any amount of expenses in restoring property for which an allowance is or has been made.

(d) Premiums paid on any life insurance policy.

1927, XXXV, 1.

§ 401. (1) Non-residents and foreign corporations.—If the entire trade or business of a non-resident individual or a foreign corporation is carried on in the jurisdiction of this State the tax imposed by this Article shall be computed upon the entire income of such non-resident individual or foreign corporation: *Provided, further,* Except as herein provided, each and every foreign corporation, non-resident individual engaged in the business of manufacturing within the jurisdiction of the State of South Carolina shall make returns and pay annually an income tax from business done and transacted within the State, computed on a proportion of its entire net income to be determined according to the following rules: The proportion shall be such a proportion of the entire net income derived from all sources as the fair cash value of the real estate and tangible personal property located, and actually used in the conduct of the business, in the State of South Carolina (no deductions on account of encumbrances) is to the cash value of the entire real estate and tangible personal property actually used in the conduct of the trade or business wheresoever located (no deduction on account of encumbrances). Such property shall be taken at its actual value, which in the case of property valued or appraised for purposes of inventory, depreciation, depletion, or other purposes shall be the highest amount at which so valued or appraised, and which in order cases shall be deemed to be its book value in the absence of affirmative evidence showing such value to be greater or less than the actual value. The average value during the taxable year or period shall be employed. The average value of property as above prescribed at the beginning and end of the taxable year or period ordinarily may be used, unless by reason of material changes during the taxable year or period, such average does not fairly represent the average for such year or period, in which event the average shall be determined upon a monthly or daily basis: *Provided, further,* That when a foreign corporation or non-resident individual shows to the satisfaction of the Tax Commission that their books of account are kept in such a manner as to reflect the true net income accruing or arising from business transacted within the State, the return may, with the approval of the Tax Commission, be based upon such books of account and the tax paid upon the net income so determined.

(2) Gross income derived from the sale of personal property by non-resident individuals of foreign corporations produced (in whole or in part) by the taxpayer without and sold within the State shall be treated as derived partly from sources within and partly from sources without the State, computed as follows:

The net income shall first be computed by deducting from the gross income derived from sources partly within and partly without the State the

expenses, losses, or other deductions properly apportioned or allocated thereto and a ratable part of any expenses, losses, or other deductions which cannot definitely be allocated to some item or class of gross income. Of the amount of net income so determined one-half shall be apportioned in accordance with the value of the taxpayer's tangible property within and without the State, the portion attributable to sources within the State being determined by multiplying such one-half by a fraction, the numerator of which consists of the value of the taxpayers' tangible property within the State and the denominator of which consists of the value of the taxpayers' tangible property both within and without the State. The remaining one-half of such net income shall be apportioned in accordance with the gross sales of the taxpayer within and without the State the portion attributable to sources within the State being determined by multiplying such one-half by a fraction, the numerator of which consists of the taxpayer's gross sales for the taxable year or period within the State, and the denominator of which consists of the taxpayer's gross sales for the taxable year or period both within and without the State. "Gross sales within the State" means the aggregate amount of all the sales made during the taxable year which were principally secured, negotiated or affected by employees, agents, offices, or branches of the taxpayer's business resident or located in the State.

(3) The term "tangible property" as used in this Article includes only the property held or used to produce income which is derived from sources partly within and partly without the State (excluding all property held or used to produce income which is allocated or apportioned to other classes of income). Such property should be taken at its actual value, which in the case of property valued or appraised for purpose of inventory, depreciation, depletion, or other purposes shall be the highest amount at which so valued or appraised and which in other cases shall be deemed to be its book value in the absence of affirmative evidence showing such value to be greater or less than the actual value. The average value during the taxable year or period shall be employed. The average value of property as above prescribed at the beginning and end of the taxable year or period ordinarily may be used, unless by reason of material changes during the taxable year or period such average does not fairly represent the average for such year or period, in which event the average shall be determined upon a monthly or daily basis.

(4) In a case where there is no real estate or tangible personal property, or a non-resident individual or foreign corporation is engaged in buying and selling, the net income attributable to the State shall be arrived at by taking such a proportion of the total net income as the gross sales within the State bear to the total gross sales.

(5) A rule shall not be deemed to be inapplicable merely because all of the real estate and tangible personal property is found to be situated outside the State, or because all of the gross receipts are found to have been received outside the State.

1927, XXXV, 1.

§ 402. Information returns.—All individuals, corporations and partnerships in whatever capacity acting, including lessees or mortgagees of real or personal property, fiduciaries, and employers making payment to another individual, corporation or partnership of interest, rent, dividends, salaries,

wages, emoluments, or other fixed or determinable gains; profits and income of $1,000 or more in any taxable year, or in the case of such payments made by South Carolina, the officers or employees of South Carolina having information as to such payments and required to make returns in regard thereto, shall render a true and accurate return to the Tax Commission under such regulations as the Tax Commission may prescribe, setting forth the amounts of such gains, profits and income and the name and address of the recipient of same.

1927, XXXV, 1.

§ 403. Persons and Corporations Required to Make Returns.—(1) Details of Returns. Every resident or non-resident having a net income during the income year taxable in this State of $1,200.00 and over, if single, or if married and not living with husband or wife; or having a net income for the income year of $2,200.00 or over, if married and living with husband or wife and every corporation except those specifically exempted, shall make a return oath, stating specifically the items of gross income and the deductions and exemptions allowed by this Article, and such other facts as the Tax Commission may require for the purpose of making any computation required by this Article. When the Tax Commission has reason to believe any person or corporation is liable for tax under this Article, it may require any such person or corporation to make return. If a husband and wife living together have an aggregate net income of $2,200.00, or over, each shall make a return, unless the income of each is included in a single joint return.

(2) If an individual taxpayer is unable to make his own return, the return shall be made by a duly authorized agent or by a guardian or other person charged with the conduct of the business of the taxpayer.

(3) The return by a partnership shall be made by any one of the partners and shall show the net income of the partnership and the amount of such income allocated to each partner.

(4) The return of the net income of a trade or business carried on by an estate or trust shall be made by the fiduciary and, under such regulations as the Tax Commission may prescribe, may be made by one of two or more joint fiduciaries, and such return shall show the net income of such estate or trust, and the distribution of such income to the beneficiaries.

(5) The return by a corporation shall be sworn to by the president or other principal officer and by the treasurer or assistant treasurer.

(6) The return of an individual who, while living, was carrying on trade or business in the State, during the income year and who has died before making the return, shall be made in his name and behalf by the administrator or executor of the estate and the tax shall be levied upon and collected from his estate.

1927, XXXV, 1; 1930, XXXVI, 1338.

§ 404. Consolidated Returns.—(1) Any taxpayer capable of exercising either directly or indirectly substantially the entire control of the business of another taxpayer, either by ownership or control of substantially the entire capital stock (if a corporation) of such other taxpayer or otherwise, may, under regulations to be prescribed by the Tax Commission, be permitted to make a consolidated return, showing the consolidated net income and such other

information as the Tax Commission may require in order to compute the net income properly attributable to the State and to impose the tax upon the taxpayers concerned.

(2) The Tax Commission may permit the filing of a consolidated return where substantially the entire control of two or more taxpayers liable to taxation under this Article is exercised by the same interests.

(3) Where the Tax Commission has reason to believe that any taxpayer so conducts the trade or business as either directly or indirectly to distort his true net income and the net income properly attributable to the State whether by the arbitrary shifting of income, through price fixing, charges for service or otherwise, whereby the net income is arbitrarily assigned to one or another unit in a group of taxpayers carrying on business under a substantial common control, it may require such facts as it deems necessary for the proper computation of the entire net income and the net income properly attributable to the State and in determining the same the Tax Commission shall have regard to the fair profits which would normally arise from the conduct of the trade or business.

1927, XXXV, 1.

§ 405. Returns when income year changed.—If a taxpayer, with the approval of the Tax Commission, changes the income year on the basis of which his net income is computed, he shall, at such time and in such manner as the Tax Commission may prescribe, make a separate return of his net income received during the period intervening between the end of his former income year and the beginning of the new income year in which return the specific deduction allowed in this Article shall be reduced to an amount which bears the same ratio to the full deduction thus allowed as the number of months in such period bears to twelve months.

1927, XXXV, 1.

§ 406. Time and place of filing returns.—Returns shall be in such form as the Tax Commission may from time to time prescribe and shall be filed with the Tax Commission on or before the fifteenth day of the third month next after the preceding income year. In case of sickness, absence or other disability, or whenever in its judgment good cause exists, the Tax Commission may allow further time for filing returns. There shall be annexed to the return the affidavit or affirmation of the taxpayer making the return, to the effect that the statements contained herein are true. The Tax Commission shall cause to be prepared blank forms for the said returns to be furnished upon application, but failure to receive or secure the form shall not relieve any taxpayer from the obligation of making the return.

1927, XXXV, 1.

§ 407. Failure to file returns—supplementary returns.—If the Tax Commission shall be of the opinion that any taxpayer has failed to file a return, or to include in a return filed, either intentionally or through error, items of taxable income, it may require from such taxpayer a return, or a supplementary return, under oath, in such form as it shall prescribe, of all items of income which the taxpayer received during the year for which the return is made, whether or not taxable under the provisions of this Article. If from a supplementary return or otherwise, the Tax Commission finds that any items of income taxable under this Article have been omitted from the original

return, it may require the items so omitted to be disclosed to it, under oath of the taxpayer, and to be added to the original return. Such supplementary return and the correction of the original return shall not relieve the taxpayer from any of the penalties to which he may be liable under any provision of this Article. The Tax Commission may proceed under the provisions of section 410 of this Article whether or not it requires a return or a supplementary return under this Section.

1927, XXXV, 1.

§ 408. Collection and enforcement of tax—Time and place of payment of tax.—(1) The full amount of the tax payable, as the same shall appear from the face of the return, shall be paid to the Tax Commission at the office where the returns is filed, at the time fixed by law for filing the return. If the time for filing the return shall be extended, interest at the rate of six per cent per annum, from the time when the return was originally required to be filed, to the time of payment, shall be added and paid.

(2) The Tax may be paid with uncertified check, during such time and under such regulations as the Tax Commission shall prescribe, but if a check so received is not paid by the bank on which it is drawn, the taxpayer by whom such check is tendered shall remain liable for the payment of the tax and for all legal penalties, the same as if such check had not been tendered.

1927, XXXV, 1.

§ 409. Examination of returns.—(1) As soon as practicable after the return is filed, the Tax Commission shall examine it and compute the tax, and the amount so computed by the Tax Commission shall be the tax. If the tax found due shall be greater than the amount heretofore paid, the excess shall be paid to the Tax Commission within ten days after notice of the amount shall be mailed by the Tax Commission.

(2) If additional tax is found to be due upon the examination of an income tax return and the return is made in good faith and the understatement of the tax is not due to any fault of the taxpayer, there shall be no penalty added because of such understatement, but interest shall be added to the amount of the deficiency at the rate of one-half of one per cent, for each month or fraction of a month from the date the tax was originally due until the date the deficiency is paid.

(3) If the understatement is due to negligence on the part of the taxpayer, but without intent to defraud, there shall be added to the amount of the deficiency five per cent thereof, and in addition interest at the rate of one per cent per month or fraction of a month.

(4) If the understatement is false or fraudulent, with intent to evade the tax, the tax on the additional income discovered to be taxable shall be doubled and one per cent per month or fraction of a month on such doubled shall be added.

(5) The interest provided for in this section shall in all cases be computed from the date the tax was originally due to the date of payment.

(6) If the amount of tax found due as computed shall be less than the amount theretofore paid, the excess shall be ordered refunded by the Tax Commission.

1927, XXXV, 1; 217.

§ 410. Additional Taxes.—If the Tax Commission discovers from the examination of the return or otherwise that the income of any taxpayer, or any portion thereof, has been not assessed, it may, at any time within five years after the time when the return was due, assess the same and give notice to the taxpayer of such assessment, and such taxpayer shall thereupon have an opportunity within thirty days, to confer with the Tax Commission as to the proposed assessment. The limitation of five years to the assessment of such tax or additional tax shall not apply to the assessment of additional taxes upon fraudulent returns. After the expiration of thirty days from such notification the Tax Commission shall assess the income of such taxpayer or any portion thereof which it believes has not heretofore been assessed and shall give notice to the taxpayer so assessed, of the amount of the tax and interest and penalties if any, and the amount thereof shall be due and payable within ten days from the date of such notice. The provisions of this Act with respect to revision and appeal shall apply to a tax assessed. No additional tax amounting to less than fifty cents shall be assessed, and no refunds for less than fifty cents shall be made.

1927, XXXV, 1.

§ 411. A Refund of Taxes Illegally Collected.—(1) If the South Carolina Tax Commission discovers from the examination of the return or otherwise that the income tax, penalty or interest paid by any taxpayer is in excess of the amount legally due, then said South Carolina Tax Commission shall have the power and authority to issue to said taxpayer its voucher to the Comptroller General for the refund of such illegally collected income tax, penalty or interest together with the interest provided for in subdivision 2 of this Section. Upon receipt of said voucher, properly executed and endorsed, the Comptroller General shall issue his warrant to the State Treasurer for the payment to said taxpayer of such refund, out of any income tax funds in his possession or out of any such funds that may come into his possession: *Provided,* The Tax Commission shall keep in its files a duplicate of said voucher and also a statement which shall set forth the reasons why such refund shall have been ordered.

(2) Upon the allowance of a credit or refund of any tax, penalty or interest erroneously, improperly or illegally paid, interest shall be allowed and paid on the amount of such credit or refund at the rate of one-half of one per centum per month from the date such tax, penalty or interest was paid to the date the order for refund or credit is issued.

(3) This Section shall be in addition to any remedies for the abatement or refund of taxes that may now be provided by law.

1929, XXXVI, 1048.

§ 412. Warrant for the collection of taxes.—If any tax imposed by this Article or any portion of such tax be not paid within sixty days after the same becomes due, the Tax Commission shall issue a warrant under its hand and official seal directed to the Sheriff of any county of the State, commanding him to levy upon and sell the real and personal property of the taxpayer found within his county for the payment of the amount thereof, with the added penalties, interest and the cost of executing the warrant, and to return such warrant to the Tax Commission and to pay to it the money collected by virtue thereof by a time to be therein specified, not more than sixty days after the receipt of the warrant, and to file with the Clerk of Court of his county

a copy thereof, and thereupon the clerk of the court shall enter in the judgment docket, in the column for judgment debtors, the name of the taxpayer mentioned in the warrant, and in appropriate columns the amount of the tax or portion thereof and penalties for which the warrant is issued and the date when such copy is filed, and thereupon the amount of such warrant so docketed shall become a lien upon the title to an interest in real property or chattels real of the taxpayer against whom it is issued in the same manner as a judgment duly docketed in the office of said clerk. The said Sheriff shall thereupon proceed upon the same in all respects with like effect, and in the same manner prescribed by law in respect to executions issued against property upon judgments of a court of record, and shall be entitled to the same fees for his services in executing the warrant, to be collected in the same manner. If a warrant be returned not satisfied in full, the Tax Commission shall have the same remedies to enforce the claim for taxes against the taxpayer as if the people of the State had recovered judgment against the taxpayer for the amount of the tax.

1927, XXXV, 1.

§ 413. Tax a debt.—Every tax imposed by this Article and all increases, interest, and penalties thereon, shall become from the time it is due and payable, a personal debt, from the person or persons liable to pay the same, to the State of South Carolina.

1927, XXXV, 1.

§ 414. Action for recovery of taxes.—Action may be brought at any time by the Attorney-General of the State, in the name of the State, to recover the amount of any taxes, penalties, and interest due under this Article.

1927, XXXV, 1.

§ 415. Tax upon settlement of fiduciary's account.—(1) No final account of a fiduciary shall be allowed by the probate court unless such account shows, and the judge of said court finds, that all taxes imposed by the provisions of this Article upon said fiduciary, which have become payable, have been paid, and that all taxes which may become due are secured by bond, deposit or otherwise. The certificate of the Tax Commission and the receipt for the amount of the tax therein certified shall be conclusive as to the payment of the tax, to the extent of said certificate.

(2) For the purpose of facilitating the settlement and distribution of estates held by fiduciaries, the Tax Commission, with the approval of the Attorney-General, may, on behalf of the State agree upon the amount of taxes at any time due or to become due from such fiduciaries under the provisions of this Article, and payment in accordance with such agreement shall be full satisfaction of the taxes to which the agreement relates.

1927, XXXV, 1.

§ 416. Penalties.—(1) If any taxpayer without intent to evade any tax imposed by this Article, shall fail to file a return of income or to pay a tax, if one is due, at the time required by or under the provisions of this Article, but shall voluntarily file a correct return of income and pay the tax due, there shall be added to the tax an additional amount equal to five per cent thereof, and an additional one per cent for each month or fraction of a month during which the tax remains unpaid.

(2) If any taxpayer fails voluntarily to file a return of income or to pay a tax, if one is due, within sixty days of the time required by or under the provisions of this Article, the tax shall be increased by twenty-five per cent.

(3) The Tax Commission shall have power, upon making a record of its reason therefor, to waive or reduce any of the additional taxes or interest provided in subdivisions (1) and (2), (5) and (6) of this section, or in subdivisions (2), (3) and (4) of Section 409.

(4) If any taxpayer fails to file a return within sixty days of the time prescribed by this Article, any judge of the Circuit Court, upon petition of the Tax Commission, shall issue a writ of mandamus requiring such person to file a return. The order of notice upon the petition shall be returnable not later than ten days after the filing of the petition. The petition shall be heard and determined on the return day or on such day thereafter as the court shall fix, having regard to the speediest possible determination of the case, consistent with the rights of the parties. The judgment shall include costs in favor of the prevailing party. All writs and processes may be issued from the clerk's office in any county, and except as aforesaid, shall be returnable as the court shall order.

(5) Any person who, without fraudulent intent, fails to pay any tax or to make, render, sign or verify any return, or to supply any information, within the time required by or under the provisions of this Article, shall be liable to a penalty of not more than $1,000.00, to be recovered by the Attorney General, in the name of the people, by action in any court of competent jurisdiction.

(6) Any person or any officer or employee of any corporation or member or employee of any partnership, who, with intent to evade any requirement of this Article, or any lawful requirements of the Tax Commission thereunder, shall fail to pay any tax or to make, sign or verify any return or to supply any information required by or under the provisions of this Article, or who, with like intent, shall make, render, sign or verify any false or fraudulent return or statement, or shall supply any false or fraudulent information, shall be liable to a penalty of not less than $500.00 or more than $500.00 to be recovered by the Attorney General in the name of the people, by action of any court of competent jurisdiction, and shall also be guilty of a misdemeanor and shall upon conviction, be fined not to exceed $5,000.00 or be imprisoned not to exceed five years or both, at the discretion of the court.

(7) The Tax Commission may compromise any civil or criminal case arising under the provisions of this Article instead of commencing suit thereon, and may compromise any such case with the consent of the Attorney-General after suit thereon has been commenced. Where any case is compromised the Tax Commission shall keep on file in the office of the Tax Commission reasons for settlement of any case by compromise, together with a statement of the amount of tax assessed, the amount of additional tax or penalty or interest imposed by law in consequence of the neglect or delinquency of the person against whom the tax is assessed, and the amount actually paid in accordance with the terms of the compromise.

(8) The failure to do any act required by or under the provisions of this Article shall be deemed an act committed in part at the office of the Tax Commission in Columbia, South Carolina. The certificate of the Tax Com-

mission to the effect that a tax has not been paid, that a return has not been filed, or that information has not been supplied as required by or under the provisions of this Article, shall be *prima facie* evidence that such tax has not been paid, that such return has not been filed and that such information has not been supplied.

(9) If any taxpayer who has failed to file a return or has filed an incorrect or insufficient return, and has been notified by the Tax Commission of his delinquency, refuses or neglects within twenty days after such notice to file a proper return, or files a fraudulent return, the Tax Commission shall determine the income of such taxpayer according to its best information and belief and assess the same at not more than double the amount so determined. The Tax Commission may in its discretion allow further time for the filing of a return in such case.

1927, XXXV, 1.

§ 417. Revision Remedies and Proceedings for Relief of Taxpayers—Revision by Tax Commission.—A taxpayer may apply to the Tax Commission for revision of the tax assessed against him, at any time within one year from the time of the filing of the return, or from the date of the notice of the assessment of any additional tax. The Tax Commission shall grant a hearing thereon and if upon such hearing, it shall determine that the tax is excessive or incorrect, it shall re-settle the same accordingly. The Tax Commission shall notify the taxpayer of its determination and shall refund to the taxpayer the amount, if any, paid in excess of the tax found by it to be due.

1927, XXXV, 1.

§ 418. Collection not Prevented by Court order.—The collection of income taxes as provided in this Article or in prior Articles, shall not be stayed or prevented by any injunction, writ or order issued by any court or judge thereon; and no writ, order or process of any kind whatsoever staying or preventing the South Carolina Tax Commission from taking any step or proceeding in the assessment or collection of any income tax whether such tax is legally due or not will in any case be granted by any court or the judge of any court; but in all cases whatsoever the person against whom any income tax shall stand charged by the South Carolina Tax Commission shall be required to pay the same in such funds and moneys as the said South Carolina Tax Commission shall be authorized to receive by any Act of the General Assembly, and thereupon shall have his remedy as is hereinafter provided.

1927, XXXV, 1.

§ 419. Payment under Protest.—In all cases in which any income taxes are now or shall be hereafter charged by the South Carolina Tax Commission against any person, and the South Carolina Tax Commission shall claim the payment of the taxes so charged, or shall take any step or proceeding to collect the same, the person against whom such taxes are charged, or against whom such steps or proceedings shall be taken, shall, if he conceives the same to be unjust or illegal for any cause, pay the said taxes, which shall include the penalties, notwithstanding, under protest in writing in such funds and moneys as the said South Carolina Tax Commission shall be authorized to receive; and upon such payment being made the South Carolina Tax Commission shall pay the taxes, and penalties, if any, so collected into the State

Treasury as now provided by law giving notice at the time to the State Treasurer that the payment was made under protest; and the person so paying said taxes may at any time within thirty days after making such payment, but not afterwards, bring an action against the South Carolina Tax Commission for the recovery thereof in the Court of Common Pleas for any county having jurisdiction; and if it be determined in said action that such taxes, and penalties if any, were wrongfully or illegally collected, for any reason going to the merits, then the court before whom the case is tried shall certify of record that the same were wrongfully collected and ought to be refunded, and thereupon the South Carolina Tax Commission shall issue its order to the State Treasurer to refund the said taxes, and penalties if any, so paid in conformity with the order of the court, which shall be paid in preference to other claims against the State Treasury; there shall be no other remedy in any case of the illegal or wrongful collection of income taxes or attempt to collect such taxes than that provided in this Article.

1927, XXXV, 1.

§ 420. Tax Commission to Administer this Article.—The Tax Commission shall administer and enforce the tax herein imposed.

1927, XXXV, 1.

§ 421. Power of Tax Commission.—The Tax Commission for the purpose of ascertaining the correctness of any return or for the purpose of making an estimate of the taxable income of any taxpayer, shall have power to examine or cause to be examined by any agent or representative designated by it for that purpose, any books, papers, records or memoranda bearing upon the matters required to be included in the return. Where any person who is required to make a return under this Article fails so to do at the the time required, or delivers any return which, in the opinion of the Tax Commission is erroneous or refuses to allow any regularly authorized agent of the Tax Commission to examine his books and records, it shall be lawful for the Tax Commission to summons such person or any other person having possession, care or custody of books of account containing entries relating to the business of such person, or any other person it may deem proper to appear before the Tax Commission and to produce such books at a time and place named in the summons and to give testimony and answer questions under oath, respecting any object of income liable to tax on the return thereof; such summons shall in all cases be served by an authorized agent of the Tax Commission by an attested copy delivered to such person in hand, or left at his last or usual place of abode allowing such person one day for each twenty-five miles he may be required to travel computed from the place of service to the place of examination; when the summons requires the production of books and returns, it shall be sufficient if such books are described with reasonable certainty; and whenever any person summoned under the provisions of this Section, neglects or refuses to obey such summons as required, the Tax Commission may apply to any Circuit Judge of the South Carolina Circuit Court for an attachment against him for contempt. It shall be the duty of such Judge to hear the application and if satisfactory proof is made, to issue an attachment directed to the Sheriff of the county in which the person resides for the arrest of such person and upon his being brought before him to proceed to a hearing of the case, and upon such hear-

ing the Judge shall have power to make such order as he shall deem proper not inconsistent with existing laws for the punishment of contempt to enfore obedience to the requirements of the summons and to punish such person for his default or disobedience.

1927, XXXV, 1.

§ 422. Officers, Agents and Employees.—(1) The Tax Commission may appoint and remove a person to be known as the Income Tax Director, who under its direction, shall have the supervision and control of the assessment and collection of the income taxes provided in this Article; the Tax Commission may also appoint such other officers, agents, deputies, clerks and employees as it may deem necessary, such persons to have such duties and powers as the Tax Commission may from time to time prescribe.

(2) The salaries of all officers, agents and employees employed by the Tax Commission shall be such as it may prescribe, not to exceed such amounts as may be appropriated therefor by the Legislature, and the members of the Tax Commission and such officers, agents and employees shall be allowed such reasonable and necessary traveling and other expenses as may be incurred in the performance of their duties, not to exceed the amount appropriated therefor by the Legislature.

(3) The Tax Commission may require such of the officers, agents and employees as it may designate, to give bond for the faithful performance of their duties in such sum and with such sureties as it may determine, and all premiums on such bonds shall be paid by the Tax Commission out of moneys appropriated for the purpose of this Article.

1927, XXXV, 1.

§ 423. Oath and acknowledgment.—The members of the Tax Commission and such officers as it may designate, shall have the power to administer an oath to any person or to take the acknowledgment of any person in respect of any return or report required by this Article, or the rules and regulations of the Tax Commission.

1927, XXXV, 1.

§ 424. Publication of statistics.—The Tax Commission shall prepare and publish annually statistics reasonably available with respect to the operation of this Article, including amounts collected, classifications of taxpayers, and such other facts as are deemed pertinent and valuable.

1927, XXXV, 1.

§ 425. Secrecy required of officials, penalty for violation.—(1) Except in accordance with proper judicial order or as otherwise provided by law, it shall be unlawful for the members of the Tax Commission, any deputy, agent, clerk or other officer or employee, to divulge or make known in any manner the amount of income or any particulars set forth or disclosed in any report or return required under this Article. Nothing herein shall be construed to prohibit the publication of statistics, so classified as to prevent the identification of particular reports or returns and the items thereof, or the inspection by the Attorney-General or other legal representative of the State, of the report or return of any taxpayer who shall bring action to set aside or review the tax based thereon, or against whom an action or proceeding has been instituted to recover any tax or any penalty imposed

by this Article. Reports and returns shall be preserved for five years and thereafter, until the Tax Commission orders them to be destroyed.

(2) Any offense against subdivision one of this section shall be punished by a fine of not exceeding one thousand ($1,000.00) dollars or by imprisonment not exceeding one year, or both, at the discretion of the Court, and if the offender be an officer or employee of the State, he shall be dismissed from office and be incapable of holding any public office in this State for a period of five years thereafter.

(3) Notwithstanding the provisions of this section, the Tax Commission may permit the Commissioner of Internal Revenue of the United States, or the proper officer of any State imposing an income tax similar to that imposed by this Article, or the authorized representative of either such officer, to inspect the income tax returns of any taxpayer, or may furnish to such officer or his authorized representative an abstract of the return of income of any taxpayer or supply him with information concerning any item of income contained in any return, or disclosed by the report of any investigation of the income or return of income of any taxpayer; but such permission shall be granted or such information furnished to such officer or his representative, only if the statutes of the United States or of such other State, as the case may be, grant substantially similar privileges to the proper officer of this State charged with the administration of this Article.

1927, XXXV, 1.

§ 426. Regulations.—The Tax Commission may from time to time, make such rules and regulations, not inconsistent with this Article, as it may deem necessary to enforce its provisions, and the same shall have full force and effect of law.

1927, XXXV, 1.

§ 427. Payment by Commission to State Treasurer the Tax.—The Tax Commission shall pay to the State Treasurer to the credit of the general fund, all taxes, interest, and penalties collected under this Article as appears from lists made and returns filed. Said payment shall be made by check drawn in favor of the State Treasurer, and signed by the Director of the Income Tax Division and countersigned by the Chairman of the Tax Commission or by the two other members of the Tax Commission.

1927, XXXV, 1; 1930, XXXVI, 1361.

§ 428. Unconstitutionality or invalidity.—If any clause, sentence, paragraph or part of this Article shall, for any reason, be adjudged by any court of competent jurisdiction to be invalid, such judgment shall not affect, impair, or invalidate the remainder of this Article, but shall be confined in its operation to the clause, sentence, paragraph or part thereof directly involved in the controversy in which such judgment shall have been rendered. No caption of any section or set of sections shall in any way affect the interpretation of this Article or any part thereof.

1927, XXXV, 1.

§ 429. Use of Federal Return Blanks.—The South Carolina Tax Commission shall use as far as possible and practicable for filing returns for income tax, blanks as used by the United States down to the net income part of said blanks.

1927, XXXV, 1.

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Exhibit K

C. Section 1359, of Article 1, of Chapter 15, of Title 65, Code of Laws of South Carolina for 1952, as amended, is hereby amended by adding thereto Sub-division (5), which shall read as follows:

"(5). Every person engaged in the business of renting or leasing or otherwise furnishing any tangible personal property for a consideration, either by lease or rental or other form of agreement."

Notwithstanding any other provision of law, the license and the sales and/or use tax imposed by Chapter 15, of Title 65, Code of Laws for 1952, as amended, is hereby imposed upon the fair market value of tangible personal property manufactured within South Carolina or imported into South Carolina by the manufacturer thereof for the purpose of renting or leasing the same or for storage, use or consumption within South Carolina by said manufacturer.

This section shall become effective on the first day of the first month following the approval of this Act by the Governor.

SECTION 5

Section 65-222, 1952 Code, amended—tax on corporations increased:

That Section 65-222, Code of Laws of South Carolina for 1952, be and the same is hereby amended by striking out all of said Section 65-222 and inserting in lieu thereof the following which shall be Section 65-222:

"Section 65-222. Every corporation organized under the laws of this State shall make a return and shall pay annually an income tax equivalent to five percent of the entire net income of such corporation received by such corporation during the income tax year and, except as otherwise provided, every foreign corporation doing business or having an income within the jurisdiction of this State shall make a return and shall pay annually an income tax equivalent to five percent of a proportion of its entire net income to be determined as provided in this chapter; provided, that the amount of such tax shall not be less than would be produced by applying a rate of three per cent to a base consisting of the entire net income plus salaries and other compensation paid to all elective and appointed officers and to any stockholder owning in excess of five per cent of the issued capital stock of the corporation, after deducting from the base six thousand dollars and any deficit reported for the year."

This section shall be effective as to income tax accounting periods ending after June 30, 1955.

SECTION 6

Section 65-259, 1952 Code, amended—subsection (13) added—additional deduction for persons establishing a new business or industry:

Section 259 of Chapter 5 of Title 65, Code of Laws for 1952, as amended, is hereby amended by adding thereto a new Subsection to be known as Subsection 13.

"(13) With respect only to taxpayers who have established a new business or industry in South Carolina during the calendar year 1955 and thereafter, in addition to other deductions allowed by this Chapter, there shall be allowed as a deduction from gross income a net operating loss carry over under the following rules:

(A). The net operating loss as herein defined for any year ending on or after December 31, 1955, may be carried forward to the next succeeding taxable year and annually thereafter for a total period of three years next succeeding the year of such operating loss, or until such net operating loss has been exhausted or absorbed by the taxable income of a succeeding year. The net operating loss deduction herein allowed shall be allowable only for the first three years of the operation of the said new business or industry in South Carolina.

(B) As used herein the term "taxable income" or "net income" shall be deemed to be the net income computed without the deduction of income taxes, personal exemption, and credit for dependents. The net income of the taxable period to which the net operating loss deduction as adjusted is carried shall be the net income before the deduction of income taxes, personal exemption, and credit for dependents, and such income taxes, exemption, and credits shall not be used to increase the net operating loss which may be carried to any other taxable period.

(C). As used in this Subsection the term "net operating loss" is hereby defined as the excess of allowable deductions over gross income for the taxable year arising from the operation of such new business or industry. In the case of a taxpayer other than a corporation, deductions, including personal exemptions and credit for dependents and income taxes, not attributable to the operation of a trade or business shall be eliminated from the deductions otherwise allowable for the taxable year to the extent that they exceed gross income not derived from such trade or business.

(D). Notwithstanding any other provision of Law, if the Tax Commission discovers from the examination of the return or other-

wise that the income of any taxpayer or any portion thereof has not been assessed with respect to any return in which a net operating loss is sustained or is claimed as a deduction, in whole or in part, it may at any time within five years from the date of the return which finally absorbs the net operating loss deduction is filed, assess such income and give notice to the taxpayer of such assessment and the taxpayer shall thereupon have an opportunity within thirty days to confer with the Commission as to the proposed assessment. After the expiration of thirty days from such notification the Commission shall assess the income of such taxpayer or any portion thereof which it believes has not theretofore been assessed and shall give notice to the taxpayer so assessed of the amount of the tax and interest and penalty, if any, and the amount thereof shall be due and payable within ten days from the date of such notice. The provisions of this Chapter with respect to revision and appeal shall apply to a tax so assessed. The limitation herein provided for shall not apply to the assessment of additional taxes upon fraudulent returns, nor shall it apply to the assessment of taxes with respect to returns not filed in accordance with requirements of Law."

SECTION 7

Delinquent taxpayers—employers to withhold compensation upon notice from Tax Commission:

Notwithstanding any other provision of law, South Carolina Tax Commission may give notice to any employer doing business or having an income within this State or having an employee rendering a service within this State, to the effect that a taxpayer employed by said employer is delinquent with respect to income taxes or has failed to pay income taxes, penalties or interest with respect to income taxes. Notice may be served either by mail or by delivery by any duly authorized representative of the Tax Commission. Upon receipt of the notice of the delinquency or failure to make payment, the employer and the person having control of compensation of the taxpayer shall withhold from compensation due or to become due to the taxpayer the total amount shown by the notice, provided that the Tax Commission or its duly authorized representative in their discretion may arrange between employer and employee for a deduction of an amount not less than twenty (20%) percent of the total amount due the employee each pay period until the total amount as shown by the notice has been withheld. In the event that the taxpayer leaves the employ of employer or gives notice of his intention so to do, employer

shall withhold all of the compensation due said taxpayer or so much of the same as may be necessary to equal the balance then due by the taxpayer. In any case where the taxpayer ceases to be employed by the employer before the full balance has been withheld by the employer, the employer shall immediately notify the Tax Commission in writing and shall remit at the same time the full amount withheld from the taxpayer. Except where taxpayer's services terminated as above provided for, the employer shall remit to the Tax Commission or its duly authorized representative the full amount due South Carolina as shown by the notice as soon as its collection is completed. Any amount withheld from an employee by an employer shall be a first lien against all property both real and personal, tangible or intangible, of employer, which lien shall take precedence over all others, it being specifically intended that the funds withheld by the employer shall be considered funds held in trust by said employer. Should any person after notice fail to withhold any sum due taxpayer in accordance with the notice, or fail to remit such sum in accordance with the provisions of this Act, then and in that event the person so failing shall become liable for the total of the notice in the same manner and with like effect as though the said amount as shown by the notice was due by the person as a direct obligation to the State. Where a person fails to withhold or to remit after withholding in accordance with the provisions of this Act, the amount of the notice shall be due and payable by such person in the same manner as now is provided for the collection of income taxes and this Act. South Carolina Tax Commission is hereby authorized and directed upon failure of the person to pay the amount of the notice which was not withheld in accordance with this Act, to issue its warrant for distraint to a duly authorized representative of South Carolina Tax Commission who shall proceed to the collection of the warrant in the manner now provided by law and this Act.

No person shall have any right of action against his employer in respect of any monies withheld and paid to South Carolina Tax Commission or its duly authorized representative in compliance or intended compliance with the provisions of this Act.

As used in this Section, the word "taxpayer" shall mean any individual, fiduciary or corporation subject to the tax imposed by the Income Tax Act of 1926, as amended. The word "person" as used in this Section shall mean and include individuals, partnerships, corporations and fiduciaries in whatever capacity acting. "Employer" as used in this Section shall mean and include individuals, partner-

ships, corporations and fiduciaries acting as employer of taxpayer and having directly or indirectly control of compensation due or to become due to any taxpayer; the word "employer" as herein used shall include the State of South Carolina or any agency or instrumentality or authority thereof, and any political subdivision of the State and any municipality located within the State, and the United State Government and any agency or instrumentality thereof.

The provisions of this Section shall, upon approval by the Governor, become effective with respect to any warrant or tax execution at that time directed to any sheriff or tax collector and which has not been paid, and to any warrant or tax execution at that time directed to any duly authorized agent of the South Carolina Tax Commission and which is not paid. The provisions of this Section also, upon approval by the Governor, shall become effective with respect to any income taxes, penalties, or interest, delinquent or unpaid.

SECTION 8

Article 2 of Chapter 3 of Title 37, 1952 Code, relating to license fees of insurance companies, amended—sections added relating to imposition of additional fees:

(A). Domestic life insurance companies—additional license fee:

(B). All other domestic insurance companies—additional license fee:

(C). Tax Commission—collect additional fees—make rules and regulations:

(D). Date returns to be filed—payment to accompany:

(E). Income Tax Act of 1926—applicable to this act:

(F). Deposit of proceeds:

(G). Time effective:

Article 2, of Chapter 3, of Title 37, Code of Laws of South Carolina for 1952, is hereby amended by adding thereto new Sections, properly designated, to read as follows:

(A). "In addition to any and all other license fees or taxes, there is hereby imposed upon each domestic life insurance company of any class licensed by the Insurance Commissioner and incorporated under the laws of this State, an additional and graded license fee in an amount equal to two percent (2%) of the total premiums, that is, total premium income or total premium receipts, from insurance contracts issued to residents of South Carolina or paid from a point located within this State, less any dividends or bonuses paid in cash

or applied in abatement of premiums or credited to policy holders of such company, as collected from citizens of or residents of this State during the year next preceding the date of the return. Such premiums shall not include considerations received from annuity contracts. The additional and graded license fee herein imposed shall not exceed five percent (5%) of the net income of the company as determined under the provisions of the Income Tax Act of 1926, as amended, provided that in addition to the deductions allowed by the Income Tax Act of 1926, as amended, there shall be allowed in computing net income any addition to policy reserves as may be required by the Insurance Commissioner but no more than such required amount."

(B). "In addition to any and all other license fees or taxes, there is hereby levied upon each domestic fire insurance company, each domestic accident and health insurance company, each domestic casualty or surety company, and all other domestic insurance companies of any class, licensed by the Insurance Commissioner and incorporated under the laws of South Carolina not hereinbefore specifically mentioned, an additional and graded license fee in amount equal to two percent (2%) of the total premiums, that is, total premium income or total premium receipts from insurance contracts issued to residents of South Carolina or paid from a point located within this State, less return premiums on risks and less dividends paid or credited to policy holders in this State during the year next preceding the date of the return. The additional and graded license fee herein imposed shall not exceed five percent (5%) of the actual net income as determined under the provisions of the Income Tax Act of 1926, as amended, provided that in addition to the deductions allowed by the Income Tax Act of 1926, as amended, there shall be allowed in computing net income any addition to unearned premium reserves as may be required by the Insurance Commissioner, but no more than such amount required."

(C). "The additional license fees provided for in Subsections (A) and (B) of this Section shall be administered and collected by South Carolina Tax Commission. South Carolina Tax Commission is hereby authorized to make such rules and regulations, not inconsistent with law, necessary for the proper administration and collection of tax herein imposed, and such rules and regulations shall have full force and effect of law."

(D). "Returns in such form as may be prescribed by South Carolina Tax Commission shall be filed with the Commission on or before

the fifteenth day of the third month following the close of the accounting period of the insurance company. The tax herein imposed shall be paid in full to South Carolina Tax Commission at the time the return is filed. Where it is shown to the Tax Commission that good cause exists, a reasonable extension of time may be granted for the filing of the return and the payment of the tax due thereon, provided that interest at the rate of six percent (6%) per annum shall be paid on any tax due from the date the return and tax was originally due to the date of payment."

(E). "For the purposes of the computation of net income and the assessment, enforcement and collection of the tax herein imposed, all the provisions of the Income Tax Act of 1926, as amended, insofar as may be applicable, are hereby adopted and made a part of this Act."

(F). "The taxes herein imposed shall be paid to the State Treasurer by the South Carolina Tax Commission for credit to the General Fund."

(G). "This section shall become effective as to accounting periods ending on and after December 31, 1955."

SECTION 9

Section 37-235, 1952 Code, amended—license fees for local insurance agents, increased:

Section 37-235, Code of Laws of South Carolina for 1952 is amended to read as follows:

"Section 37-235. The following fees shall be applicable to agents' licenses: each local agent, state, or special agent $5.00; General agent $10.00. The fees shall be paid in advance."

SECTION 10

(A). Section 65-732, 1952 Code, amended—tax on beer, increased:

(B). Section 65-733, 1952 Code, amended—tax on beer, increased:

(C). Article 4 of Chapter 10 of Title 65, 1952 Code, amended—section added—persons acquiring beer from without state subject to payment of tax if not already paid:

(D). Section 4-211, 1952 Code, amended—retail beer permits increased:

(E). Licensed beer dealers—take inventories—submit inventory and additional tax to Tax Commission:

(F). Time effective:

this Act shall within ten (10) days from the date of the receipt by him of notice of favorable action by the Commission or within ten (10) days from the effective date of this Act, either (a) file with the Commission a bond payable to the State in form approved by the Tax Commission in the penal sum of twenty-five thousand dollars ($25,000.00) with some surety or guaranty company duly authorized to do business in South Carolina and approved by the Commission as surety conditioned upon the lawful operation of the business covered by the license and the prompt payment of all taxes imposed by this Act, or (b) deposit with the State Treasurer cash in the amount of twenty-five thousand dollars ($25,000.00) or securities sufficient in the opinion of the State Treasurer to secure adequately the amount of twenty-five thousand dollars ($25,000.00) which deposit shall be made upon the same condition as that required to be set forth in such bond, and such deposit shall be held by the State Treasurer without interest.

(g) Wholesale and retail liquor dealers are hereby prohibited from selling alcoholic liquors on credit.

(h) All Acts or parts of Acts inconsistent with the provisions of this Section are hereby suspended to the extent of such inconsistency for the period commencing on the first day of the month following approval of this Act and ending on June 30, 1956.

SECTION 13

Sub-Division (3) of Section 4-32, 1952 Code, amended—additional residential requirements:

Section 32 of Article 3, of Chapter 1, of Title 4, Code of Laws for South Carolina for 1952, is hereby amended by striking out all of Sub-Division (3) of said Section and inserting in lieu thereof the following which shall be Sub-Division (3):

"(3) Has not been a bona fide actual resident of and maintained his principal place of abode in the County in which the proposed business is to be located and operated or an adjoining County for at least one year prior to the date of application."

SECTION 14

Section 4-22, 1952 Code, amended—Tax Commission—employ additional inspectors—additional authority:

Section 22 of Article 2, of Chapter 1, of Title 4, Code of Laws for 1952, is hereby amended by striking out all of said Section and inserting in lieu thereof the following, which shall be Section 22:

SECTION 23

(a) State to issue notes—amount—purpose:
(b) Sale—maturity—interest.
(c) Execution—form—exempt from taxes:
(d) Payment—pledge of revenues not to preclude revision of tax:

(a) Within the limitations imposed by this section, and with the approval of the State Budget and Control Board having been first expressed by proper resolution, the Governor and the State Treasurer shall be empowered to issue notes of the State to the extent of not exceeding $1,000,000.00 (one million dollars) for permanent improvements at Whitten Village, in Laurens County, and the John G. Richards Industrial School, in Richland County. Not exceeding $750,000.00 (seven hundred fifty thousand dollars) shall be expended at Whitten Village and not exceeding $250,000.00 (two hundred fifty thousand dollars) shall be expended at the said John G. Richards Industrial School. In both instances expenditures for the improvements authorized hereby shall be made upon the order of the respective superintendent of each of the aforesaid institutions under such conditions, rules and regulations as the said State Budget and Control Board may from time to time prescribe.

(b) Such notes shall be sold under such conditions and on such terms as the State Budget and Control Board may prescribe. They shall mature in ten successive annual installments; the first installment shall fall due not later than May 1, 1957 and the last installment shall fall due not later than May 1, 1966. The notes shall bear interest payable annually at such rate or rates as the said State Budget and Control Board shall prescribe.

(c) All notes issued under this Act shall be signed by the Governor and the State Treasurer. The great seal of the State shall be affixed to or reproduced upon each of them, and each shall be attested by the Secretary of State. The delivery of the notes so executed and authenticated shall be valid notwithstanding any changes in officers or seal occurring after such execution or authentication. The said notes shall be in such form as the State Budget and Control Board shall prescribe.

The principal and interest on the notes issued pursuant to this Act shall have the tax exempt status prescribed by Act No. 730 of 1952; and it shall be lawful for State funds and pension funds to be invested in said notes.

Exhibit L

CODE OF LAWS
OF
SOUTH CAROLINA
1952

IN EIGHT VOLUMES

ANNOTATED

Prepared under the supervision and direction of the Code Commissioner and the Committee on Statutory Laws of the General Assembly of South Carolina

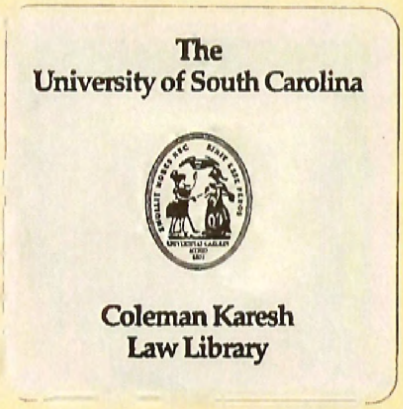
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VOLUME 6

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THE MICHIE COMPANY
Charlottesville, Va.
THE LAWYERS CO-OPERATIVE PUBLISHING CO.
Rochester, N. Y.
1952

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to such other state was imposed. But such credit shall be allowed only if the laws of such other state (a) grant a substantially similar credit to residents of this State subject to income tax under such laws or (b) impose a tax upon the personal income of its residents derived from sources in this State and exempt from taxation the personal income of residents of this State. No credit shall be allowed against the amount of the tax on any income taxable under this chapter which is exempt from taxation under the laws of such other state.

1942 Code § 2439; 1932 Code § 2439; 1930 (36) 1339.

ARTICLE 4.

Gross and Net Income; Deductions.

§ 65-251. Gross income defined.

The words *"gross income"* mean the income of a taxpayer derived from salaries, wages or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, business, commerce, sales or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property, and also from interest, rent, dividends, securities or the transaction of any business carried on for gain or profit and income derived from any source whatsoever. The amount of all such items shall be included in the gross income of the income year in which received by the taxpayer unless, under the methods of accounting permitted under this chapter, any such amounts are to be properly accounted for as of a different period.

1942 Code § 2444; 1932 Code § 2444; 1927 (35) 1.

§ 65-252. Income of beneficiaries of trusts.

Every individual taxable under this chapter who is a beneficiary of an estate or trust shall include in his gross income the distributive share of the net income of the estate or trust received by him or distributable to him during the income year. Unless otherwise provided in the law, will, deed or other instrument creating the estate, trust or fiduciary relation, the net income shall be deemed to be distributed to the beneficiaries (including the fiduciary as a beneficiary, in the case of income accumulated for future distribution) ratably in proportion to their respective interests.

1942 Code § 2445; 1932 Code § 2445; 1927 (35) 1.

§ 65-253. Items not included in gross income.

The words *"gross income"* do not include the following items which shall be exempt from taxation under this chapter:

(1) The proceeds of life insurance policies and contracts paid upon the death of the insured to individual beneficiaries or to the estate of the insurer;

(2) The amount received by the insured as a return of premium or premiums paid by him under life insurance, endowment or annuity contracts, either during the term or at the maturity of the term mentioned in the contract or upon surrender of the contract;

(3) The value of property acquired by gift, bequest, devise or descent (but the income from such property shall be included in gross income);

(4) Interest upon obligations of the United States or its possessions or of this State or any political subdivision thereof;

(5) The rental value of a dwelling house and appurtenances thereof furnished a minister of the Gospel as part of his compensation; and

(6) Any amounts received through accident or health insurance or under workmen's compensation acts, as compensation for personal injuries or sickness, plus the amount of any damage received whether by suit or agreement on account of such injuries or sickness.

1942 Code § 2444; 1932 Code § 2444; 1927 (35) 1; 1942 (42) 1855; 1943 (43) 88.

§ 65-254. Compensation for certain military service not included.

No part of the compensation received by the members of the South Carolina National Guard from the State or from the Federal Government or by members of the reserve components of the armed forces of the United States who are residents of this State from the Federal Government for services in performing their duties shall be considered as any part of the income, gross or net, of the respective members in computing income taxes payable to the State of South Carolina. But the provisions of this section shall not be applicable to income derived from tours of active military duty extending beyond the customary training periods established for national guard and reserve units.

1950 (46) 2499.

§ 65-255. Net income defined.

The words *"net income"* as used in this chapter mean the gross income of a taxpayer less the deductions allowed by this chapter.

1942 Code § 2443; 1932 Code § 2443; 1927 (35) 1.

§ 65-256. Net income of public service corporations.

The basis of ascertaining the net taxable income of every corporation engaged in the business of operating a steam or electric railroad, navigation company, waterworks company, light or gas company, power company, express service, telephone or telegraph business, sleeping car company or other form of public service, whether or not such company is required to keep records according to the standard classification of accounting of the Interstate Commerce Commission or the Federal Communications Commission, shall be the net operating income of such corporation computed in accordance with the present standard classification of accounts when their business is wholly within the jurisdiction of this State and, when their business is in part within and in part without the State, their net income within the jurisdiction of this State shall be ascertained by taking their gross operating revenues within this State, including in this gross operating revenues within the jurisdiction of this State the equal mileage proportion within the jurisdiction of this State of their interstate business, and deducting from their gross operating revenues the proportionate average of operating expenses or operating ratio for their whole business computed in accordance with

Exhibit M

TAX MANAGEMENT

PORTFOLIOS

Gross Income: Overview and Conceptual Aspects

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501-4th

This Portfolio revises and supersedes 501-3rd T.M. Portfolio 501-3rd T.M. should be discarded.

DETAILED ANALYSIS

I. Introduction

A. *Overview*

1. *The Nature of Gross Income*

Gross income is a fundamental ingredient in the determination of federal income tax liability. Generally, items included in gross income increase taxable income by that amount,[1] although where gross income limitations or adjusted gross income limitations apply, taxable income may increase by more or less than the amount of the gross income inclusion.[2] Similarly, an item that is excluded from gross income usually does not increase tax liability.[3]

Generally, gross income includes all income unless otherwise specifically excluded.[4] Many items are specifically included in gross income under provisions set forth in § 71 through § 90, various other Internal Revenue Code provisions, and under judicial precedents. Exclusions are set forth in § 101 through § 139D, various other Code provisions, as well as in miscellaneous provisions in federal statutes other than the Code. Each of these provisions is described in this Portfolio. Some are discussed in detail in this Portfolio, while others are discussed in detail in other portfolios, to which the necessary references are made where appropriate.

In many instances, determining whether something is included in, or excluded from, gross income also requires an analysis of tax law provisions involving accounting, timing, pass-through entities, nonrecognition provisions, recapture provisions, and a wide variety of other issues. Where necessary, this Portfolio describes these provisions as well and provides the necessary references to the portfolios in which they are discussed in detail.

2. *Significance of Gross Income*

Gross income is not only the starting point in the computation of federal taxable income, as discussed in II.A., below, but also is, either itself or as adjusted, an element in the computation of many deductions or deduction limitations, as discussed in II.C., below. It serves as a measure for administrative matters, such as return filing requirements and extended statutes of limitation, as discussed in II.B., below. It also is used as a computational base for certain exclusions or deductions, and as an eligibility factor for particular tax benefits, such as the dependency exemption, as discussed in II.C., below.

3. *Concept and Scope of Gross Income*

Although the concept of gross income is very expansive, an item must be a clearly realized accession to wealth to constitute gross income, as discussed in III.A., below. Moreover, there are constitutional provisions that limit the extent to which the concept of gross income can be expanded; these constitutional issues are discussed in III.B., below.

Despite these limits, the scope of the gross income concept is very expansive, as illustrated by the broad area of imputed income, including income from services performed or goods produced for one's self, owners' use of their own property, interest imputed on below market loans, original issue discount or unstated interest. Imputed income is discussed in III.C. below.

Gross income even includes income from transactions where there is a limitation on the taxpayer's use of a receipt, as discussed in IV.B., below. It does not matter that the taxpayer receives economic value in exchange for something other than money or services, as discussed in IV.C., below, or that the taxpayer receives it under a claim of right rather than absolute entitlement, as described in IV.D., below. Under some circumstances, gross income arises through the application of one of several recapture provisions, as described in IV.G., below.

In contrast, recovery of an amount expended in an earlier taxable year is not included in gross income to the extent the earlier transaction did not generate a tax benefit, as described in IV.E., below. Similarly, if a transaction qualifies under one of many nonrecognition provisions, discussed in IV.F., below, the inclusion of a receipt in gross income is in effect postponed until an appropriate event occurs in a later taxable year. Similarly, the tax accounting and timing provisions have an impact on the determination of not only when, but whether, there is gross income, as described in V, below.

Jurisdictional restrictions as well as congressional policy decisions place limitations on the taxation of gross income derived by nonresident aliens and foreign corporations, as well as on the tax treatment of gross income generated outside the United States by citizens, residents, and domestic entities, as described in VI, below. Gross income of certain entities, such as partnerships, estates, trusts, and controlled foreign corporations, is passed through to the members, owners, or other appropriate related persons, and included in their gross incomes, as described in VII, below.

4. *Applicability to Various Transactions*

The extent to which gross income applies to compensation transactions is discussed in VIII, below. Among those transactions are the receipt of wages, salaries, similar remuneration, fringe benefits, retirement payments, public benefits, uniformed services pay, and employer reimbursements.

The extent to which gross income applies to trade or business operations is discussed in IX, below. In addition to normal operations, also discussed are contributions to corporate capital, dealings in tax-exempt securities, specific businesses (such as farming and life insurance underwriting), business

[1] *See* § 63. Unless otherwise specified, all section references are to the Internal Revenue Code of 1986, as amended, and the regulations promulgated thereunder.

[2] *See, e.g.*, § 67, § 165(h), § 213(a).

[3] *See* § 63.

[4] *See* § 61(a).

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ISBN 978-1-61746-980-0

insurance and damages recoveries, antitrust judgments, and a variety of miscellaneous business transactions.

The extent to which gross income applies to investment transactions is discussed in X, below. These transactions include the receipt of interest, dividends, rents, royalties, loan proceeds, and annuities, the forgiveness of indebtedness, the disposition of property, and the receipt of life insurance proceeds.

The extent to which gross income applies to personal transactions is discussed in XI, below. Among those transactions are the receipt of alimony, gifts and inheritances, personal injury damages, windfalls, illegal gains, scholarships, prizes and awards, and living expense reimbursements.

The extent to which gross income applies to miscellaneous transactions is discussed in XII, below. These transactions include the income of Native Americans, payments under cost-sharing programs, social welfare payments, and illegal federal irrigation subsidies.

5. Assignment of Gross Income

An analysis of gross income not only involves determining whether a transaction generates gross income, it also involves ascertaining the taxpayer to whom the gross income is attributable. Generally, gross income from services is attributable to the person performing the services and gross income from property is attributable to the person who owns the property.[5]

B. Historical Background

1. Introduction

The history of gross income is coterminous with the history of the federal income tax. Much of the early history of gross income entails the judicial exploration of the constitutional and definitional limitations on federal taxation of income. The current status of those issues is discussed further at III, below.

2. Early Federal Income Tax Statutes

a. The First Civil War Income Tax Act

The first federal income tax was enacted in 1861 (the "1861 Act") in response to the government's inability to finance the Civil War effort with customs revenues, which had financed the government from its formation.[6] In this statute, there was no concept of gross income; rather, income was defined as income "derived from any kind of property, or from any profession, trade, employment, or vocation carried on in the United States or elsewhere, or from any other source whatever."[7]

In light of the fact that the bill explicitly allowed as deductions only taxes assessed on the property generating the income, a concern was expressed on the Senate floor that the Treasury Department might interpret income to mean gross rather than net income. The bill's floor manager replied that the meaning of income could not be mistaken, that it meant net profits, and that the Treasury would provide the ways and means to ascertain it.[8]

The 1861 Act was not put into effect and it was superseded in 1862.[9]

b. The Second Civil War Income Tax Act

The second federal income tax was enacted in 1862 (the "1862 Act") to supersede the 1861 Act. It, too, contained no concept or definition of gross income, but instead imposed the tax on "the annual gains, profits, or income of every person residing in the United States, whether derived from any kind of property, rents, interest, dividends, salaries, or from any profession, trade, employment, or vocation carried on in the United States or elsewhere, or from any other source whatever. . . ."[10]

House sponsors of the 1862 Act stated that they intended to incorporate a net income concept in the phrase "gains, profits, or income," because, as they explained it, "the words 'gain' and 'income' mean the same thing. They are equivalent terms."[11] In 1863, a deduction was added for the rent paid by a taxpayer for his or her dwelling house.[12]

c. The Third Civil War Income Tax Act

The federal income tax was re-enacted in 1864 (the "1864 Act"). Like the 1862 Act, it contained the phrase "gains, profits, or income" in its imposition provision. It also strengthened the net income concept by allowing deductions for losses on the sale of real estate purchased within the year and for certain business expenses in the nature of interest, repairs, and salaries.[13] The concept of gross income remained unexplored.

In 1867, the 1864 Act was amended to expand deductions to include certain taxes, certain casualty losses, losses incurred in the taxpayer's trade, bad debt losses, and rent paid for the premises occupied as a residence by a taxpayer and his or her family.[14]

The 1864 Act was challenged on constitutional grounds, but in *Springer v. U.S.*,[15] the Supreme Court held that the tax was not a direct tax lacking apportionment but rather was within the category of an excise or duty.[16] By the time the decision was issued, the federal income tax had been repealed.

d. The Reconstruction Era Income Tax Act

The federal income tax was again re-enacted in 1870 (the "1870 Act").[17] Like its predecessors, the 1870 Act contained the phrase "gains, profits, or income" in its imposition provision. No reference to or definition of gross income was provided. The 1870 Act added flood losses as allowable deductions but was repealed in 1872.

[5] The assignment of income doctrine is discussed further in 502 T.M., *Gross Income: Tax Benefit, Claim of Right and Assignment of Income.*
[6] Act of August 5, 1861, c. 45, 12 Stat. 292, 309.
[7] *Id.*
[8] Cong. Globe, 37th Cong., 1st Sess. 315 (1861).
[9] Act of July 1, 1862, c. 119, 12 Stat. 432.
[10] *Id.*
[11] Cong. Globe, 37th Cong., 2d Sess. 1531 (1862).
[12] Act of March 3, 1863, c. 74, 12 Stat. 709, 713, § 11.
[13] Act of June 30, 1864, c. 173, 13 Stat. 223.
[14] Act of March 2, 1867, c. 169, 14 Stat. 471, § 117.
[15] 102 U.S. 586 (1880).
[16] *Id.* at 602.
[17] c. 255, 16 Stat. 256.

Changes and Analysis of New Developments appear in the front of this Portfolio.
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ISBN 978-1-61746-980-0

V. Timing Rules

A. *In General*

The conclusion that an item is includible in the taxpayer's gross income is insufficient to permit determination of the tax consequences of that conclusion, because the taxable year in which the item is included in gross income is an integral part of that determination.[643]

Note: Timing affects not only the recognition of gross income, but also the allowance of deductions. In some instances, one is dependent on another. One of the principal consequences of timing determinations is the availability of deferral. For most taxpayers it is advantageous to postpone the inclusion of an item in gross income for as long as the tax law allows. One manifestation of this deferral concept is the issue of whether an accession to wealth has been realized, as discussed in III.A., above. Another is the issue of whether a nonrecognition provision applies to a transaction, as discussed in IV.F., above.

The various rules for determining the timing of gross income inclusions are summarized in this Portfolio, and discussed further in:

- 565 T.M., *Installment Sales*;
- 570 T.M., *Accounting Methods — General Principles*;
- 572 T.M., *Accounting Methods — Adoption and Changes*; 574 T.M., *Accounting Periods*;
- 578 T.M., *Inventories: General Principles; LIFO Method*;
- 608 T.M., *Reporting Farm Income*;
- 576 T.M., *Uniform Capitalization Rules: Inventory; Self-Constructed Assets; Real Estate*; and
- 577 T.M., *Uniform Capitalization Rules: Special Topics; Method Change Rules.*

Comment: Some of the timing rules involve elections by the taxpayer that control, to a limited extent, the taxable year of inclusion.[644] Although deferral generally is beneficial, not every taxpayer in every situation benefits from deferral, and, thus, careful analysis must be made before a taxpayer makes an election that affects timing and deferral.

B. *Method of Accounting*

1. *In General*

Generally, the timing rules are dependent on the taxpayer's method of accounting.[645] There are many methods of accounting, but among the vast majority of taxpayers, only a few are used.[646]

The method of accounting used for tax purposes is the method by which the taxpayer regularly computes income in keeping the books.[647] If there is no regularly used book method, or if the method used does not clearly reflect income, the taxpayer must use the method prescribed by the IRS.[648] Subject to those general principles, taxpayers are permitted to use the cash method, the accrual method, any other method permitted by statute, or any combination of these methods permitted by the IRS.[649]

2. *Principal Methods*

Under the cash method of accounting, gross income is recognized when cash or its equivalent is actually or constructively received.[650] Under the accrual method of accounting, transactions are taken into account when all events have occurred that fix, with reasonable certainty, the taxpayer's rights or obligations with respect to the transaction. In addition, for certain expenses to be deducted, an economic performance requirement must be satisfied.[651]

3. *Restrictions on Method*

Restrictions apply in the selection of a method of accounting. If inventory is a material part of the determination of gross income, the accrual method of accounting must be used.[652] Corporations and partnerships with corporate partners engaged in the trade or business of farming must use the accrual method of accounting in determining the taxable income from most kinds of farming, unless they are S corporations or corporations with gross receipts of less than certain specified amounts.[653] Corporations, partnerships, and tax shelters may not use the cash method of accounting unless, in the case of corporations and partnerships other than tax shelters, they are in the farming business, are qualified personal service corporations, or have gross receipts of less than certain specified amounts.[654]

The restrictions on the choice of a method of accounting are discussed in 565 T.M., *Installment Sales*; 570 T.M., *Accounting Methods — General Principles*; and 572 T.M., *Accounting Methods — Adoption and Changes.*

C. *General Rule for Inclusion in Gross Income*

Under § 451(a), an item of gross income is included in the taxpayer's gross income for the taxable year when it is received by the taxpayer, unless the taxpayer's method of accounting

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[643] *See generally* § 451.
[644] *See, e.g.*, § 451(d) and § 453(d), § 454, § 455(c), § 456(c) and § 458(a).
[645] *See, e.g.*, § 451(a).
[646] *See* § 446(c).
[647] § 446(a).
[648] § 446(b).
[649] § 446(c).
[650] Reg. § 1.446-1(c)(1)(i).
[651] Reg. § 1.446-1(c)(1)(ii). Methods of accounting and their selection are discussed further in 565 T.M., *Installment Sales*; 570 T.M., *Accounting Methods — General Principles*; and 572 T.M., *Accounting Methods — Adoption and Changes.*
[652] Reg. § 1.446-1(c)(2)(i).
[653] § 447.
[654] § 448.

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dictates that the item be included in a different taxable year.[655] Special exceptions exist for amounts accrued by reason of the death of an accrual method taxpayer,[656] employee tips,[657] crop insurance proceeds and disaster payments,[658] proceeds from sales of livestock occurring on account of drought, flood, or other weather-related condition,[659] sales of utility services by accrual method taxpayers,[660] interest on frozen deposits in qualified financial institutions,[661] qualified prizes,[662] and sales or dispositions to implement Federal Energy Regulatory Commission or State Electric Restructuring policy.[663]

D. *Installment Method*

1. *In General*

Income from an installment sale is taken into account under the installment method.[664] A taxpayer can elect not to use the installment method with respect to a particular installment sale.[665] The installment method does not apply to sales on revolving credit plans,[666] sales of stock or securities traded on an established securities market,[667] or sales of property, other than stock or securities, traded on an established market.[668]

The installment method is discussed further in 565 T.M., *Installment Sales*.

2. *Installment Sale*

An installment sale is a disposition of property where at least one payment is to be received after the close of the taxable year in which the disposition occurs.[669] Installment sales do not include dealer dispositions[670] and dispositions of personal property required to be included in inventory.[671] There are two types of dealer dispositions.[672] The first is any disposition of personal property by a person who regularly disposes of personal property of the same type on the installment plan.[673] The second is any disposition of real property held for sale to customers in the ordinary course of the taxpayer's trade or business.[674] However, dealer dispositions do not include dispositions on the installment plan of any property used or produced in the trade or business of farming,[675] or of certain timeshares and residential lots.[676]

3. *Computation of Amount Included in Gross Income*

Under the installment method, the income from a disposition included in gross income for a particular taxable year is the total payment received in that year multiplied by the gross profit ratio.[677] The gross profit ratio is the gross profit divided by the total contract price.[678]

4. *Limitations and Accelerations*

Special rules limit the application of the installment method or accelerate, in whole or in part, the recognition of gross income. These rules apply if any of the following occur:

- an installment sale to a related person who disposes of the property before all the installment payments have been made;[679]
- an installment sale to a related person where it is not demonstrated that tax avoidance was not a principal purpose of the sale;[680]
- a distribution of an installment obligation in certain corporate liquidations;[681] or
- an installment sale of property with respect to which there is depreciation recapture.[682]

E. *Obligations Issued at a Discount*

Under § 454(a), a taxpayer who owns certain obligations issued at a discount can elect to treat the increase in redemption price that occurs during a taxable year as gross income in that year, even though, in the absence of the election, there would be no gross income in that year.[683] The election applies to all such obligations owned by the taxpayer as of the beginning of the taxable year for which the election is first made and thereafter acquired, and applies to all subsequent taxable years unless the IRS permits a change.[684] In the taxable year for which the election is first made, there is included in the taxpayer's gross income the increase in redemption price that occurred since the taxpayer acquired the obligation.[685]

Obligations subject to the election include non-interest bearing obligations issued at a discount and redeemable for fixed amounts increasing at stated intervals.[686] They also include U.S. series E bonds, other than current income bonds, and

[655] § 451(a).
[656] § 451(b).
[657] § 451(c).
[658] § 451(d).
[659] § 451(e).
[660] § 451(f).
[661] § 451(g).
[662] § 451(h).
[663] § 451(i).
[664] § 453(a).
[665] § 453(d).
[666] § 453(k)(1).
[667] § 453(k)(2)(A).
[668] § 453(k)(2)(B).
[669] § 453(b)(1).
[670] § 453(b)(2)(A).
[671] § 453(b)(2)(B).
[672] § 453(l)(1).
[673] § 453(l)(1)(A).
[674] § 453(l)(1)(B).
[675] § 453(l)(2)(A).
[676] § 453(l)(2)(B).
[677] § 453(c).
[678] § 453(c).
[679] § 453(e).
[680] § 453(g).
[681] § 453(h).
[682] § 453(i).
[683] § 454(a).
[684] *Id.*
[685] *Id.*
[686] *Id.*

Changes and Analysis of New Developments appear in the front of this Portfolio.
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ISBN 978-1-61746-980-0

U.S. obligations obtained through a nonrecognition transaction in which a series E bond is surrendered.[687]

Special rules apply to short-term obligations issued by the U.S., a state, possession, or any of their subdivisions, the District of Columbia, or an Indian tribal government.[688] Special rules also apply to matured U.S. savings bonds.[689]

F. Prepaid Income

1. Prepaid Subscription Income

Under § 455, if the taxpayer so elects, prepaid subscription income is included in gross income for the taxable year in which the taxpayer has the liability to furnish or deliver a newspaper, magazine, or periodical.[690] An election may not be made with respect to a trade or business for which the cash method of accounting is used.[691] The election is applicable for the taxable year for which first made and for all subsequent taxable years, unless the IRS permits revocation.[692]

2. Prepaid Membership Dues

Under § 456, if the taxpayer so elects, prepaid membership dues income is included in gross income for the taxable year during which the taxpayer has the liability to render services or make available membership privileges.[693] This rule does not apply if the period to which the prepaid dues relates is more than 36 months.[694] An election may not be made with respect to a trade or business for which the cash method of accounting is used.[695] The election is applicable for the taxable year for which first made and for all subsequent taxable years, unless the IRS permits revocation.[696]

Prepaid membership dues are discussed further in 572 T.M., *Accounting Methods — Adoption and Changes.*

G. Certain Returned Merchandise

Under § 458(a), if the taxpayer so elects, gross income does not include income attributable to qualified sales of any magazine, paperback, or record that is returned to the taxpayer before the close of the merchandise return period.[697] A sale is qualified if the taxpayer has a legal obligation to adjust the sales price of the item if it is not resold and the sales price is in fact adjusted because of a failure to resell.[698] The merchandise return period is, for magazines, the period of two months and 15 days first occurring after the close of the taxable year and, for paperbacks and records, four months and 15 days,[699] unless the taxpayer selects a shorter period.[700] The election is applicable for the taxable year for which first made and for all subsequent taxable years, unless the IRS permits revocation.[701]

The amount excluded from gross income is the lesser of the amount of the taxpayer's legally required price adjustment or the actual adjustment made.[702] Special rules require the maintenance of suspense accounts under certain circumstances.[703]

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[687] § 454(a), § 454(c)(2).

[688] § 454(b). *See* § 7871(a)(6)(C) (tribal government treated as state for this purpose).

[689] § 454(c). Timing issues involving gross income from obligations issued at a discount are discussed further in 535 T.M., *Time Value of Money: OID and Imputed Interest.*

[690] § 455(a), § 455(d)(1) and § 455(d)(2).

[691] § 455(c)(1).

[692] § 455(c)(4). Prepaid subscription income is discussed further in 572 T.M., *Accounting Methods — Adoption and Changes.*

[693] § 456(a), § 456(e)(1), § 456(e)(2).

[694] § 456(e)(2).

[695] § 456(c)(1).

[696] § 456(c)(4).

[697] § 458(a).

[698] § 458(b)(5).

[699] § 458(b)(7)(A).

[700] § 458(b)(7)(B).

[701] § 458(c)(3).

[702] § 458(b)(6).

[703] § 458(e).

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ISBN 978-1-61746-980-0

STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

Synovus Bank, Petitioner, vs. South Carolina Department of Revenue, Respondent.	Docket No. 17-ALJ-17-0418-CC **RESPONDENT SOUTH CAROLINA DEPARTMENT OF REVENUE'S SUPPLEMENTAL BRIEF**

Respondent South Carolina Department of Revenue (Department) hereby submits this Supplemental Brief in response to several questions raised by the Court during a status conference with counsel for Petitioner and Respondent on January 30, 2020. In particular, the Department understood the Court's questions generally to be the following:

(1) **Was there a period in the 1940s or 1950s where South Carolina permitted net operating loss carryforwards for corporations?**

(2) **What impact, if any, does the 1955 amendment to the corporate income tax have on the interpretation of the phrase "entire net income" as used in the bank tax?**

(3) **What authority limits a company's income statement to a twelve-month accounting period?**

(4) **Does the statute use "net income" where it could just as easily have used "income"?**

The Department provides this supplemental brief to answer those questions for the Court.

ANALYSIS

1. **Was there a period in the 1940s or 1950s where South Carolina permitted net operating loss carryforwards for corporations?**

   Answer: No.

As will be discussed further below, the net operating loss (NOL) carryforward deduction was first enacted by the South Carolina Legislature in 1955. The Department has been unable to locate

any legislative history or other authoritative guidance indicating that South Carolina law explicitly permitted corporations to claim NOL carryforwards prior to 1955.[1]

2. **What impact, if any, does the 1955 amendment to the corporate income tax have on the interpretation of the phrase "entire net income" as used in the bank tax?**

Answer: If the definition of "entire net income" inherently includes the ability for a corporation to claim a NOL carryforward deduction under generally accepted accounting principles, there would have been no need for the Legislature to amend the corporate income tax in 1955 to specifically authorize a NOL carryforward deduction. At the time of the 1955 amendment, the bank tax shared the same tax base ("entire net income") as the corporate income tax. If an express statutory authorization for a NOL deduction was required for the corporate income tax on entire net income, the same is true for the bank tax (also based on entire net income). Thus, the 1955 amendment demonstrates the mere definition of "entire net income" alone is insufficient to grant Synovus a NOL carryforward deduction; instead, an express statutory authorization of such deduction is required.

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[1] The South Carolina Legislature first enacted an income tax in 1922, when it imposed an income tax on the "net income" of individuals and corporations. *See* Act No. 502, 1922 S.C. Acts § 2 (1922 Act), a copy of which is attached hereto as Exhibit A). Importantly, this South Carolina income tax was calculated as a percentage of the amount required to be paid as an income tax to the United States government, and therefore the 1922 Act incorporated by reference "laws made and to be made by Congress and regulations made and to be made thereunder by federal officers." *Santee Mills v. Query*, 122 S.C. 158, 115 S.E. 202, 205 (1922). As such, any additions to or deductions from income for federal tax purposes— including net operating loss deductions, if applicable— would have indirectly factored into a calculation of the South Carolina income under the 1922 Act. *See Lancaster Cotton Mills v. S.C. Tax Comm'n*, 132 S.C. 466, 129 S.E. 429, 432 (1925) ("The state tax commission will therefore make its books and rules and regulations conform to the federal statute and the federal rules and regulations promulgated in pursuance of the statute."). However, the 1922 income tax provisions were repealed by the 1926 Act discussed below, and the 1926 Act did not include any provisions authorizing NOL deductions. *See* Act No. 1, 1927 S.C. Acts § 42 ("That on the passage of this Act, the Income Tax Act approved the 13th day of March, 1922, as amended, is repealed to take effect January 1st, 1925). Thus, it was not until the 1955 amendments to the corporate income tax that the Legislature expressly authorized a net operating loss deduction for income tax purposes.

The sole issue in this contested case hearing is whether a bank can carry forward NOLs incurred in one year and claim those excess losses as a deduction in calculating its South Carolina bank tax in future years. Throughout the entire administrative appeal process and leading up to the contested case hearing, Synovus contended the NOLs granted under the Internal Revenue Code (IRC) and the conformity statutes in the South Carolina corporate income tax provided the statutory authority for banks to claim such NOLs.[2] This argument was grounded on the fundamental premise that NOLs are only the result of statutory authority permitting such NOLs— a fact undisputed by both parties' experts. (Hr'g Tr. 110:21–112:14, 177:15–179:4, 229:8–20) (testimony from experts for both parties agreeing that the ability to take a net loss and use it to reduce net income in future years exists ***only*** by virtue of federal or state law). In light of this undisputed premise, Synovus argued that the corporate income tax and bank tax were inextricably linked because they shared the same tax base (entire net income), and therefore any deductions permitted under the corporate income tax— including NOL deductions— should also apply to the bank tax.

Once this Court rejected Synovus' conformity argument, Synovus then argued— for the first time— a new theory at the contested case hearing: rather than linking the NOL deduction in the corporate income tax to the bank tax, Synovus argued the statutory authority to claim a NOL carryforward deduction was found in the definition of the term "entire net income." In other words, Synovus now claims the concept of "entire net income" itself must be interpreted to include losses or

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[2] *See* Hr'g Joint Ex. 20, p.5 (Synovus Protest) ("The deductions permitted with respect to the [corporate income tax]— including NOL deductions— must apply equally to the Bank Tax."), a copy of which is attached as Exhibit B; Synovus Pre-Hearing Statement, p. 1 ("Synovus asks this Court to determine that, through conformity with the tax federal tax code, the South Carolina Legislature granted corporations, including banks, the ability to deduct NOL carryforwards on their South Carolina tax returns."); Synovus Response to DOR MSJ, p. 3 ("The statute that 'authorizes' the NOL carryforward deduction is found in the IRC and applicable to corporations and banks equally based on conformity."); *see also* Synovus MSJ, p. 11 ("The General Assembly specifically states that carryforward deductions are allowed for taxpayers in South Carolina [in Section 12-6-1130], and specifically denies NOL carryback deductions)."

expenses that were incurred in years other than the tax year in question— regardless of whether such a deduction was authorized by the IRC or in the corporate income tax chapter. *See* Synovus Proposed Order, p. 12 ("When the normal definition of "entire" is applied to income and expenses, there is no reasonable interpretation to be made other than that all income and all expenses must be deducted. . . If all such expenses cannot be deducted in a specific year, said expenses must be carried over to the subsequent tax year."). Remarkably, this argument essentially renders Synovus' previous conformity argument entirely unnecessary because the phrase "entire net income"— a phrase that has been included in both the corporate income tax and the bank tax from its inception— provides sufficient statutory authority to permit a NOL deduction. Not only is this interpretation wholly inconsistent with the position Synovus previously advanced, it is unsupported by the legislative history of the phrase "entire net income."

a. <u>Both the corporate income tax and bank tax were initially based on the "entire net income" of the taxpayer.</u>

i. The Income Tax Act of 1926 was based on "entire net income."

As this Court is well aware, the genesis of South Carolina's bank tax finds its origins in The Income Tax Act of 1926 (1926 Act). The 1926 Act imposed an income tax on corporations, including for-profit banks, as follows:

> Every corporation organized under the laws of this State shall pay annually an income tax, with respect to carrying on or doing business equivalent to four percent of the ***entire net income*** of such corporation, ***as herein defined***, received by such corporation during the income year . . . .

See Act No. 1, 1927 S.C. Acts § 4(a) (a copy of which is attached hereto as Exhibit C); *see also id.* at § 3 (imposing tax on individuals residing in South Carolina based on the "entire net income" of the individual taxpayer).

Although the imposition statute used the phrase "entire net income . . . as herein defined," when the 1926 Act defined that term it used only the phrase "net income." *Id.* at § 7 (explaining the

"Computation of tax—Net income defined" and providing that "[t]he words "net income mean the gross income of a taxpayer less the deductions allowed by this Act."). The term "gross income" was further defined by the statute to include all manner of "income derived from any source whatever" and to exclude certain items (such as interest upon the obligations of the United States, South Carolina, or any political subdivision thereof). *Id.* at § 8. The net income of the taxpayer was to be computed in accordance with the method of accounting regularly employed in keeping the books of the taxpayer. *Id.* at § 9. The statute provided certain deductions. *Id.* at § 13. In short, under the 1926 Act, the terms "entire net income" and "net income" were interchangeable, as illustrated below:[3]

Imposition of tax: **Entire net income (§ 4)**

Calculation of tax: **Net income (§ 7) = gross income (per the taxpayer's books) (§§ 8, 9) – deductions (deductions allowed by this Act) and exemptions (§ 5)**

ii. The Bank Tax Act of 1937 was based on "entire net income."

When the Legislature enacted a separate bank tax in 1937, it again used "entire net income" as the starting point for the tax base:

> A tax is hereby imposed upon every bank engaged in business in the State of South Carolina, which tax shall be levied, collected and paid annually, with respect to the

[3] In fact, the imposition statute in §§ 3 (individuals), 4(a) (corporations), and 15 (non-residents and foreign corporations) appear to be the only places in the 1926 Act to use the term "entire net income." Throughout the rest of the 1926 Act the Legislature used the shorter term "net income." *See, e.g., 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.

> ***entire net income*** of the taxpayer doing a banking business within this State, or from the sales or rentals of property within this State, computed at the following rate: Four and one-half (41/2%) per centum of the ***entire net income*** of such bank or taxpayer.

See Act No. 349, 1937 S.C. Acts § 2 (1937 Act) (emphasis added), a copy of which is attached as Exhibit D. In other words, "[w]hen the Bank Tax was originally enacted, both the [corporate income tax] and the Bank Tax used "entire net income" as their base." Joint Hr'g Ex. 20, p. 4 (Synovus Protest). Unlike the earlier 1926 Act, the 1937 Act did not provide a definition of "net income." However, there is no reason to assume the Legislature intended to calculate "net income" for purposes of the bank tax differently from the corporate income tax. The starting point for computing both taxes was the taxpayer's net income (i.e. gross income less any allowed deductions).[4]

b. <u>The 1955 amendment to the corporate income tax—to include a limited NOL carryforward deduction—was unnecessary if the term "entire net income" already included such NOL deductions.</u>

The 1926 Act and 1937 Act were codified in Chapter 5 (§ 65-201 et seq., attached as Exhibit E) and Chapter 6 (§ 65-401 et seq., attached as Exhibit F), respectively. In the 1952 version of the South Carolina Code, both acts continued to use the term "entire net income" in the imposition provisions of the income and bank taxes:

<u>Income Tax</u> S.C. Code Ann. 65-222 (1952):	<u>Bank Tax</u> S.C. Code Ann. 65-402 (1952):
"Every corporation organized under the laws of this State shall make a return and shall pay annually an income tax equivalent to four and one-half per cent	A tax is imposed upon every bank engaged in business in the State which shall be levied, collected, and paid annually with respect to the ***entire net***

[4] The parties have always agreed that both the corporate income tax and bank tax—as originally enacted—started with the same tax base of "entire net income." *See* Hr'g Joint Ex. 20, p.4 (Synovus Protest) (arguing the starting point for determining a bank's tax liability is the same as the corporate income tax—net income defined as the gross income of the taxpayer less the deductions allowed by the act"). Where the parties disagree is whether banks—as part of the calculation of that base—can claim deductions authorized for corporations in Chapter 6 that are not specifically authorized for banks in Chapter 11.

of the ***entire net income*** of such corporation and received by such corporation during the income tax year	***income*** of the taxpayer doing a banking business within this State . . . .

The 1952 version of the corporate income tax contained definitions of "net income" (§ 65-255) and "gross income" (§ 65-253) that were nearly identical to the original 1926 Act.

In 1955, the Legislature amended certain provisions of the corporate income tax, including adding a new deduction in Section 65-259, Code of Laws of South Carolina for 1952:

> (13) With respect only to taxpayers who have established a new business or industry in South Carolina during calendar year 1955 and thereafter, in addition to other deductions allowed by this Chapter, **there shall be allowed as a deduction from gross income a net operating loss carry over** under the following rules . . . .

See Act No. 234, 1955 S.C. Acts § 6 (1955 Act), a copy of which is attached as Exhibit G. A net operating loss was defined as "the excess of allowable deductions over gross income for the taxable year arising from the operation of such new business or industry."[5] *Id.* The net operating loss could

[5] This illustrates an important distinction: a "net loss" or "operating loss" is a financial accounting term used to describe a situation in which a company's annual expenses and losses exceed its revenues and gains. **Under book accounting, net losses are never carried forward to future years.** (Hr'g Tr. 177:9–14) ("For financial accounting purposes, you do not take expenses from one year and apply them against net income for another year.").

By contrast, a "net operating loss" is a tax law concept that is technically used to describe a situation in which a taxpayer's deductions exceed its taxable income. *See* Act No. 234, 1955 S.C. Acts § 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"). Because this identifies a tax law scenario in which a company has more tax deductions than taxable income, legislatures have statutorily permitted those excess deductions (NOLs) to be carried forward and deducted from income in future years. *See* Act No. 234, 1955 S.C. Acts § 6 ("The net operating loss as herein defined . . . may be carried forward to the next succeeding taxable year . . ."); *see also* 26 U.S.C.A. § 172("The entire amount of the net operating loss for any taxable year . . . shall be carried to the earliest of the taxable years to which . . . such loss may be carried.).

The two concepts are related, but distinct. (Hr'g Tr. 178:1–179:4) (expert testimony that where a company's expenses exceed its revenue "[t]hat is a net loss in financial accounting terms. Net operating loss is a product of tax law. . . There are two different things."). This distinction is important in understanding the Department's interpretation of how "entire net income" is calculated. Because

be carried forward a certain number of years, and was only allowable for the first three years of the operation of the new business or industry. *Id.*

The 1955 Act marked the first time the Legislature had included a statutory provision authorizing a NOL carryforward deduction for income tax purposes.[6] *See* Joint Hr'g Ex. 20 (Synovus Protest) ("Since 1955, the South Carolina [corporate income tax] has included a provision permitting taxpayers to deduct NOLs."). The 1955 Act specifically authorized the NOL carryforward as a deduction from gross income. As discussed above, the version of the Code at the time of the 1955 Act computed entire net income as the gross income of the taxpayer less the deductions allowed by the chapter, so entire net income could only have included a NOL carryforward if it was a specific deduction from gross income as statutorily authorized in that chapter. The fact that the Legislature specifically amended the statute to include a NOL deduction demonstrates the NOL deduction was ***not included*** within the meaning of "entire net income" prior to the 1955 amendment.

Thus, Synovus' interpretation of "entire net income" is inconsistent with the legislative history of the 1955 Act. Synovus has always contended that the phrase "entire net income" as used in the bank tax describes the same tax base as "entire net income" used in the corporate income tax. If so, the plain language of the 1955 Act demonstrates why the definition of "entire net income" in the bank

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the bank's tax base (entire net income) is computed in accordance with the method of accounting regularly employed in keeping the books of such taxpayer (i.e. its book income based on financial accounting principles) less any deductions specifically authorized by the Act, *see* Act No. 1, 1927 S.C. Acts §§ 7–9, 13, a bank is only permitted to claim a NOL deduction (a tax law concept) if that deduction is specifically authorized by statute. (Hr'g Tr. 110:21–112:14, 177:15–179:4, 229:8–20) (testimony from experts for both parties agreeing that the ability to take a net loss and use it to reduce net income in future years exists ***only*** by virtue of federal or state law). Because this Court has already agreed that there is no such statutorily authorized deduction for the bank tax, the term "entire net income" alone cannot form the basis for claiming such a deduction.

[6] Two decades later the Legislature amended the NOL deduction to extend it to "all taxpayers." *See* S.C. Code Ann. § 12-7-400(12A)(Supp. 1979) (providing that the NOL deduction "shall be allowed to all taxpayers").

tax cannot be interpreted to include a NOL deduction. By providing that "there shall be allowed as a deduction from gross income a net operating loss carry over under the following rules," the 1955 Act can only be construed to mean that the Legislature was creating a NOL deduction in 1955 that did not previously exist. If the mere definition of "entire net income" permitted a taxpayer to carry over to subsequent tax years any expenses that cannot be deducted in a specific tax year, there would have been no need for the Legislature to specifically enact a NOL deduction in 1955— nearly 30 years after the Legislature first used the term "entire net income."

c. **Case law analyzing the 1955 NOL carryforward deduction illustrates why the argument that a NOL deduction is inherently part of "entire net income" is inconsistent with the NOL deduction statutorily authorized by the Legislature.**

In the years following the 1955 amendment, the South Carolina Supreme Court had several opportunities to examine the NOL carryforward deduction. *See Chronicle Publishers, Inc. v. S.C. Tax Comm'n*, 244 S.C. 192, 136 S.E.2d 261 (1964) (determining whether the taxpayer had "established a new business or industry in this State" within the meaning of Section 65-259(12)); *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); *C. W. Matthews Contracting Co. v. S.C. Tax Comm'n*, 267 S.C. 548, 230 S.E.2d 223 (1976) (finding that whether a company has established a new business or industry must be determined after the company's initial year of operation in the state). Each of these three cases illustrate several fundamental principles relating to NOL deductions that are relevant for the Court's analysis in the instant matter.

First, the case law demonstrates that NOL deductions are limited. The 1955 amendment granted the NOL deduction only to certain taxpayers (those who established a new business or industry in South Carolina) during a certain time period (during 1955 or after). *See, e.g., Chronicle Publishers*, 244 S.C. at 194, 136 S.E.2d at 262 ("According to the terms of the statute, the deduction is allowed only in favor of a taxpayer who has 'established a new business or industry in this State.'"). In

addition, the 1955 amendment also limited how many years the NOL could be carried forward. *See* Act No. 234, 1955 S.C. Acts § 6. Contrast this to Synovus' interpretation of "entire net income" that if expenses cannot be deducted in a specific year, those expenses must be carried over to subsequent tax years. Under Synovus' theory, *any* taxpayer taxed on its "entire net income" would be permitted to claim a NOL carryforward deduction, without any limitation as to *when* the taxpayer could claim the NOL or *how long* the NOL could be carried forward.[7]

Second, the case law demonstrates that the taxpayer was required to take affirmative steps to claim the NOL deduction authorized by the 1955 amendment. In particular, the taxpayer had to make an election to report the net loss on a separate accounting basis, and the election must be made in writing to the Commission in the first income tax return filed after the establishment or completion of the new facility. *Wasson*, 252 S.C. at 488, 167 S.E.2d at 312. Failure to meet these requirements barred the taxpayer from claiming the deduction. *Id.* By contrast, Synovus' claim that NOL carryforward deductions are embedded within the meaning of "entire net income" (as it existed at the time of the 1955 amendment) contains no written requirement or separate election on the front end; presumably, it could be claimed on the return or simply included in the taxpayer's balance sheet.

Third, and perhaps most importantly, the case law reaffirmed the important principle that a deduction," and specifically a NOL carryforward deduction, "is a matter of legislative grace; and that a statute allowing a deduction, if ambiguous, is construed strictly against the taxpayer." *C. W. Matthews*

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[7] Nothing about Synovus' theory of "entire net income" would limit the time-period in which a taxpayer could claim the NOL carryforward deduction. Yet every time Congress has statutorily created or modified the NOL carryforward deduction for federal income tax purposes, it has specifically limited the NOL carryforward to specific taxpayers or for limited time-periods. *See* J.K. Lasser, *Loss Carryovers Under the Internal Revenue Code*, 33 Cornell L. Rev. 51–52 (1947) (noting that although the basic concept of the net operating loss carryover has been the same over time, numerous amendment and changes to the federal NOL laws have varied the scope and application of the NOL carryforward). The same is true for the South Carolina legislature, both in the 1955 Act and the later conformity statutes.

Contracting, 267 S.C. at 557, 230 S.E.2d at 227. Thus, whether under its conformity argument or its interpretation of "entire net income," Synovus has the burden to prove that the Legislature intended to grant banks the benefit of a NOL carryforward deduction. *Id.*

3. **What authority limits a company's income statement to a twelve-month accounting period?**

Answer: A company's income statement reflects a twelve-month accounting period because of general accounting principles combined with federal and state taxing statutes and regulatory reporting requirements.

An "accounting period" refers to a predetermined range of time during which various accounting functions are performed. Because financial accounting is primarily concerned with providing relevant financial information to various external users (i.e. investors who want to make informed business decisions based on the financial health of a given company), those users need periodic information in order to make decisions. "This need for periodic information requires that the economic life of an enterprise (presumed to be indefinite) be divided into artificial time periods for financial reporting." DAVID SPICELAND ET AL., INTERMEDIATE ACCOUNTING 28 (3rd ed. 2004).

Many companies report on a calendar year basis, while other companies use a fiscal year—either way, the length of the accounting period is typically twelve months. Moreover, the "accounting profession and the Securities and Exchange Commission advocate that companies adopt a fiscal year that corresponds to their natural business year. A natural business year is the 12-month period that ends when the business activities of a company reach their lowest point in the annual cycle." *Id.* The SEC requires publicly traded companies, such as Synovus, to report their financials on a quarterly (Form 10-Q) and annual (Form 10-K) basis. *Id.*; *see also* Hr'g Tr. 132:10–133:7 (testimony by expert regarding Synovus' regulatory reports with the SEC, which contain an income statement and a number of references to the bank's "net income"); Joint Hr'g Ex. 44, p. 48, 50, 85, 87 (containing Synovus' 2014 annual report, which includes its Form 10-K and reports on "Selected Financial Data" and

"Consolidated Financial Highlights" from its income statement and its "net income(loss)" for each tax year/calendar year from 2010 to 2014). (*See* Ex. 44, pp. 48, 50, 85, 87). In fact, Synovus acknowledges in its proposed order that GAAP utilizes the double-entry accounting system, which includes an income statement and balance sheet, and that the "net income" shown on the income statement is the profit calculated "***at the end of the year.***" (Synovus Proposed Order, p. 13).

The fact that an accounting period is typically limited to twelve months is consistent with the "accounting methods and periods" enacted as part of the 1926 Act that was later codified in Chapter 65. An income tax is an annual tax, and the 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* Act No. 1, 1927 S.C. Acts § 2, *codified 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). In other words, the Legislature presumed the ***annual tax*** would be computed based on the standard ***annual accounting period.*** *See id.* at § 65-282 ("Taxpayers whose ***accounting period of twelve months*** ends as of the last day of some month other than December and whose books are kept accordingly . . . [may apply for approval from the Tax Commission to] return their net income under this chapter on the basis of such fiscal year in lieu of that of the calendar year."). *See* Hr'g Tr. 228:11–20) (expert testimony establishing that taxes are calculated annually and income statements are based on 12 month periods).

Because the income statement is the element of a company's financial statements that reflects its net income during the accounting period, it follows that the income statement is limited to showing only the revenues and losses from that one-year accounting period. *See* SPICELAND, at 26 ("Revenues and gains less expenses and losses for a period equals net income or net loss, the so-called bottom line of the income statement."); *see also* Hr'g Tr. 127:2–12 ("Q: An income statement, does it cover a certain

period of time? A: Generally, it's a one-year period."), *and* "fiscal year." *Investopedia.com*, 2020, *available at* https://www.investopedia.com/terms/f/fiscalyear.asp (last visited Feb. 20, 2020) (noting that a "fiscal year is a one-year period chosen by a company to report its financial information" and that "financial reports, external audits, and federal tax filings are based on a company's fiscal year"). Moreover, because taxes are paid on an annual basis and publicly-traded companies are required to report their financials on an annual basis, 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 U.S. GAAP, and providing the "fiscal years may not exceed 12 months").

In its proposed order, Synovus claimed that "entire net income" has long been interpreted "to mean all income earned minus all expenses deducted, *without limitation to only those expenses that can be taken in a single year*." (Synovus Proposed Order, p. 10) (emphasis added). Synovus provided no factual or legal support for this conclusory assertion, and as illustrated above this assertion is wholly inconsistent with general accounting principles and South Carolina law. There is nothing about the plain language of the 1926 Act, the 1937 Act, or the 1955 Act that suggests "entire net income" would include anything other than the income and expenses of that particular twelve-month tax year (whether calendar or fiscal).

Importantly, Synovus also makes the critical concession in its proposed final order that "if the Legislature intended for only the profit from a single year as reflected on the income statement to be considered . . . the term used in the statute would be 'net income.'" (Synovus Proposed Order, p. 12).

In fact, as discussed above (*see* footnote 2, *supra*), that is precisely the term the Legislature used. Although Synovus contends that "net income" and "entire net income" must refer to completely different concepts, when viewed in its entirety the statutory scheme (and its specific definition and repeated use of "net income") suggests that "entire" is merely a descriptor of the term "net income." Thus, a reasonable construction of the statute is that it imposed a tax "on all of the net income of the taxpayer, as herein defined."

4. **Does the statute use "net income" where it could just as easily have used "income"?**

   Answer: No.

As discussed above, the 1926 Act imposed an income tax upon the "entire net income" of a corporation, and defined "net income" to mean "the gross income of a taxpayer less the deductions allowed by this Act." *See* Act No. 1, 1927 S.C. Acts § 7, *codified at* S.C. Code Ann. §§ 65-255 (1952). The definition of "gross income" included various types of income (e.g. "income derived from any source whatever"), but the statute specifically excluded certain types of income from "gross income" (e.g. interest on government obligations). *Id.* at § 65-251, -253.

"Income" is generally understood to include money that an individual or business receives in exchange for providing a good, service, or capital investment— a concept more akin to the meaning of "gross income" as defined in the statute. By contrast, "net income" as defined in the 1926 Act is a more specific term, meaning "gross income" (as defined in the statute) minus deductions (as defined in the statute). Thus, although the 1926 Act repeatedly refers to "net income" throughout the statute, *see* footnote 2, *supra*, because the Legislature had provided a specific definition of "net income" it could not just as easily have used the term "income" in these sections without significantly changing the intended meaning of those provisions.

CONCLUSION

From 1926 through 1955, the corporate income was imposed on the "entire net income" of a corporation. Similarly, from 1937 through 1955, the bank tax was imposed on the "entire net income" of a bank. Although the taxes existed in different chapters and the calculation of a corporation's entire net income evolved over time in a way the calculation for banks did not (e.g. as exemptions and deductions were added to the corporate income tax which were not added to the bank tax), the starting point for both taxes was identical in 1955.

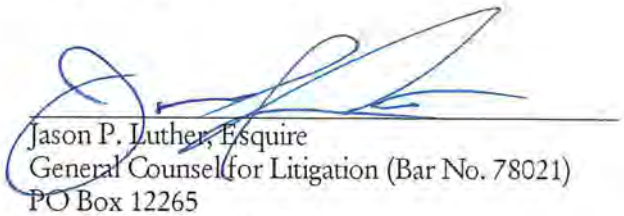
As the Department has argued throughout this disputed matter, NOLs are "tax law" concepts that exist only by virtue of express statutory authorization. The Legislature expressly authorized an NOL carryforward in 1955 by amending the corporate income tax to include such a deduction. Because the corporate income tax was based on a corporation's "entire net income" at the time of the amendment, the amendment to include a NOL deduction would have been superfluous if a corporation could already claim a NOL carryforward deduction simply through calculating its "entire net income" in accordance with accounting practices it employed in keeping its books. The only reasonable interpretation of the 1955 amendment is that "entire net income" did not—at the time—include an NOL carryforward deduction.

To this day, the bank tax continues to use "entire net income" as the starting point for calculating the tax base. The Legislature has never enacted a NOL carryforward deduction for purposes of calculating a bank's tax base and, as the 1955 amendment demonstrates, the phrase "entire net income" does not include a NOL carryforward deduction. Thus, Synovus' claim that "entire net income" should be construed to constitute an express statutory authorization for claiming a NOL carryforward deduction for bank tax purposes is inconsistent with the legislative history of that term.

Finally, because accounting standards and South Carolina taxes are generally based on one-year periods, Synovus has the burden of proving that it should be allowed to take losses incurred in

one accounting period/tax year and apply them against its income earned in a different accounting period/tax year. The only authority to allow this exception to the general rule is a statutorily authorized NOL carryforward. Because Synovus has failed to meet its burden of proving that the Legislature has provided such statutory authority for purposes of the bank tax, the Department respectfully requests this Court affirm its Department Determination.

Respectfully submitted,



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Columbia, South Carolina
February 21, 2020

Exhibit A

rosette to obtain aid or assistance or any other benefit or advantage unless he shall be entitled so to wear or use the same under the constitution, by-laws, rules and regulations of such order or society shall be guilty of a misdemeanor.

§ 82. Desecration of U. S. Flag a Misdemeanor.—Every person who, for exhibition or display shall cause to be placed upon or affixed to any flag, standard, color or ensign of the United States, or upon a flag, standard, color or ensign purporting to be such, any inscription, design, device, symbol, name, advertisement, words, characters, picture, mark or notice whatever; or shall display or exhibit any such flags, standard, color or ensign to which any such inscription, design, device, symbol, name, advertisement, word, characters, photographs, mark or notice whatever; or who shall publicly mutilate, trample upon, deface, jeer at or defy any such flag, standard, color or ensign shall be guilty of a misdemeanor.

§ 83. Repealing Clause—Proviso.—All Acts or parts of Acts inconsistent with this Act are hereby repealed; *Provided,* That nothing herein contained shall interfere with or affect any franchise or corporate right held by any military organization, or organizations, of the city or county of Charleston; nor shall it affect the levy of taxes within the county of Charleston for the maintenance and support of any military organization thereof.

§ 84. This Act shall take effect immediately upon its approval by the Governor.

Approved the 22nd day of March, A. D. 1922.

No. 502.

AN ACT to Raise Revenue for the Support of the State Government by the Levy and Collection of a Tax Upon Income.

Section 1. Income Tax Levied—Incomes Taxable.—Be it enacted by the General Assembly of the State of South Carolina: That for the purpose of raising additional revenue to pay the expenses of the government of the State of South Carolina, an income tax is hereby levied and assessed upon each and every person, firm, partnership, corporation, guardian, trustee, administrator,

executor, receiver and any and all other person or persons, acting in any fiduciary capacity for any person, trust or estate, upon the net income arising or accruing from every such person, firm, partnership, corporation, guardian, trustee, administrator, executor and receiver, resident or citizen of the State of South Carolina, whether in this State or elsewhere, said income tax is hereby levied and assessed upon the net income from all interest received, property owned, and on each business, trade or profession carried on in the State of South Carolina by every such person, firm, partnership, corporation, guardian, trustee, administrator, executor and receiver, residing within the said State or elsewhere, who shall receive an income from property within this State.

§ 2. Taxable Net Income—U. S. Acts and Regulations, Adopted—Provisos.—That for the purpose of determining the amount of net income, upon which income taxes are to be paid under the provisions of this Act, and for the purpose of fixing the amount of the said income tax, the payment and collection thereof, all of the provisions of an Act of Congress of the United States of America, entitled "An Act to reduce and equalize taxation, to provide revenue and for other purposes," approved November 23, 1921, relating to levy, assessment and collection of income tax by the United States Government, and Acts amendatory thereto, relating to income tax and the collection thereof, which have been passed and approved prior to the time of the approval of this Act; the assessing and collecting of said tax and surtaxes, and all rules and regulations promulgated by the Department of Internal Revenue under and by virtue of said Acts be, and the same are hereby, adopted and enacted, together with all of the provisions thereof applicable to the enforcement of the same, which are not in conflict with any of the provisions of this Act, and declared to be the method, means and manner by and under which the amount of the net income of any taxpayer shall be ascertained and the amount of income tax due the State of South Carolina computed subject to the exemptions and limitations hereinafter set out in this Act, the same as if the said Act and all Acts amendatory thereto were set forth in full in *totidem verbis*: *Provided*, That foreign corporations, non-resident persons or firms doing business within this State, not required nor making returns to the government of the United States of incomes as accruing from business done and transacted within this State, shall make returns under oath to the Tax Commissioner of their incomes accru-

ing from business done and transacted within the State by them, or any of them, in the same manner and form as now required by the government of the United States for the purpose of computing the amount of tax on their incomes due the State hereunder; and should any of them fail to make such returns as hereby required, then the Tax Commission be, and it is hereby, required to make such returns for any of them so failing, and such returns shall constitute the true basis for computing the amount of tax due the State by such foreign corporation, non-resident persons or firms: *Provided*, That all insurance companies or associations be exempt from the provisions of this Act: *Provided, further*, In case reformation is made in any income, or any tax on income by the government of the United States, a like proportionate reformation shall be allowed on behalf of the State by the Tax Commission, and any additional tax accruing to the State by reason of such reformation shall be collectable in the same manner as is herein provided for, for the collection of tax incomes.

§ 3. Tax Returns—Amount of Tax—Affidavit for 1922.— That for the purpose of determining the amount of income tax to be paid to the State of South Carolina, under the provisions of this Act, all persons, firms, partnerships, corporations, guardians, trustees, administrators, executors and receivers who are now, or shall hereafter be required by the said Act of Congress or Acts amendatory thereto, which have been passed and approved by Congress prior to the approval of this Act, to make an income tax return to the United States Government, or who shall be liable for the payment of an income tax under the provisions of said Act of Congress, and Acts amendatory thereto relating to income tax, and that for the purpose of equalizing and graduating the said income tax herein assessed and levied the schedules prescribed in the Act of Congress, and the amendments thereto hereinbefore referred to, are hereby adopted and made a part of this Act, the same as if the provisions were inserted herein *totidem verbis*, subject to the exemptions and limitations hereinafter set out, and who by the terms of this Act are required to make said income tax return, shall at the same time as required by the Act of Congress to make said return to the United States Government, make out a return under oath to the State Tax Commission, which said return shall in all particulars be indentical with the original filed with the United States Government in so far as said return shall show how net income is arrived at, and at the time of filing

the said income tax return with the government of the United States, shall also file with the State Tax Commission a duly verified copy of the tax return as made to the United States Government, together with a copy of the receipt from the Collector of Internal Revenue, and shall pay to the State Treasurer at the time of the filing of said return or at such time as is fixed by the Tax Commission, a sum equal to thirty-three and one-third (33 1-3%) per cent. of the amount required to be paid to the United States Government, subject to the exemption hereinafter set out, as income tax including normal, sur and excess profit taxes to the State of South Carolina: *Provided,* That in no case shall income tax paid to the State of South Carolina be less than thirty-three and one-third (33 1-3%) per cent. of the income tax including normal, sur and excess profit taxes paid to the government of the United States, subject to the exemptions and limitations hereinafter set out: *Provided, further,* That for the year 1922 an affidavit of each and every person, firm, partnership, corporation, guardian, trustee, administrator, executor and receiver in form as follows shall be a sufficient return, viz:

State of South Carolina, }
County of ..... }

Personally appeared before me ..... who, being first duly sworn, deposes and says: I have made an income tax return or returns to the United States Government for the year 1921, showing that I have a net taxable income for the entire year from December 31, 1920, to December 31, 1921, regardless of whether I have used the calendar or fiscal year in the computation of my taxes, of ..... ($.....); that of my said gross income, the sum of..... .....($.....) was had and received as salary, interest and emoluments from the United States Government.

That I am due to the State of South Carolina as income tax for the year ....., the sum of ..... ($.....).

That the foregoing is true to the best of my knowledge and belief.

Sworn to and subscribed before }
me this..... day of..... } .....Taxpayer.

.....
(Official title.)

That in the event the return is made by a corporation or partnership the form of the above affidavit may be altered or changed to conform.

The taxpayer shall include in the above affidavit the entire amount of taxes which accrued during the year 19..... to the Federal Government, whether or not the same is calculated and paid on a basis of a fiscal or calendar year, and regardless of the manner in which the same was paid to the Federal Government.

§ 4. Duties and Powers of Tax Commission—Salaries and Interest From U. S. Exempt.—That all of the duties, powers and authority given the Commissioner of Internal Revenue of the United States, and all authority given to the Internal Revenue Department for the enforcement and collection of an income tax under the said Act of Congress, and Acts amendatory thereto, are hereby imposed, conferred and devolved upon the Tax Commission of this State, in so far as applicable to the enforcement of the provisions of this Act, and the said State Tax Commission is hereby authorized and empowered to make such rules and regulations not inconsistent with law for the enforcement of the powers and authority given under the terms of this Act, as in their discretion they may deem necessary: *Provided*, That in calculating the amount of tax due the State, there shall be excluded all salaries and emoluments received from the United States Government, and all income received as interest or other revenues received from any bonds or other obligations of the United States Government.

§ 5. Inspection of Returns.—That all income tax returns made to the State Tax Commission under the provisions of this Act shall be open to inspection by the United States Commissioner of Internal Revenue or his representative, upon request, and for the purpose of enforcing the provisions of this Act, the proper State officers (as required by Act of Congress) shall obtain permission to inspect income tax returns made by citizens of this State to the Commissioner of Internal Revenue.

§ 6. Penalties for Non-return and Non-payment.—If a return is not filed at the time fixed by this Act or by the Tax Commission of South Carolina there shall be imposed upon the taxpayer for such non-return a penalty of twenty-five (25) per cent. of the amount of tax that may afterward be found to be and if said tax is not paid at the time required for payment

of same a further penalty of twenty-five (25%) per cent. shall be added and collected for non-payment of said tax at such required time, and the penalty shall be collected in the same form and manner as the income tax is collected under the provisions of this Act.

§ 7. Collection of Tax.—That if any tax imposed by this Act, or any portion of such tax, shall not be paid within sixty days after the same becomes due, and no extension is applied for or granted, the Tax Commission shall issue a warrant under its hand and official seal, directed to the Sheriff of any county of the State, commanding him to levy upon and sell the real and personal property of the taxpayer found within his county, for the payment of the amount thereof, with the added penalties, interest and cost of executing the warrant, and shall return such warrant to the Tax Commission, and pay to it money collected by virtue thereof, by a time therein specified, not less than sixty days from the date of the warrant. The Sheriff shall, within five days after receipt of the warrant, file with the Clerk of Court a copy thereof and thereupon the Clerk shall enter on the judgment docket a similar record in the column for judgment debtors, the name of the taxpayer mentioned in the warrant and in the appropriate column, the amount of tax thereof and penalties for which the warrant is issued, and the date when said copy is filed, and thereupon the amount of such warrant so docketed, shall become a first lien upon the title to any interest in real property or chattels of the taxpayer against whom it was issued, in the same manner as a judgment duly docketed in the office of such Clerk. The said Sheriff shall thereupon proceed upon the same in all respects, with like effect and in the same manner prescribed by law in respect to executions issued against property upon judgments of the Clerk of records, and shall be entitled to the same fees for his services in executing the warrant, to be collected in the same manner. If the warrant be returned not satisfied in full the Tax Commission shall have the same remedies to enforce the claim against the taxpayer as if the people of the State had recovered judgment against the taxpayer for the amount of the tax.

§ 8. Duties of County Auditors.—That the County Auditors of this State are hereby required to furnish the State Tax Commission with all information requested by said Tax Commission in reference to tax returns made by any person, firm or corpora-

tion within their respective counties, and to assist and aid the said Tax Commission in ascertaining who are, or who shall be liable to the payment of an income tax under the provisions of this Act.

§ 9. Duties and Powers of County Treasurers. — The County Treasurers of the State are hereby made the agents of the Tax Commission for the purpose of collecting the tax imposed herein. If any one of them or the Tax Commission finds that a taxpayer designs quickly to depart from the State to remove his property therefrom, or to conceal himself or his property therein, or to do any other act tending to prejudice or render wholly or partly ineffective proceedings to collect the tax for the taxable year then last past, or taxable year then current, unless such proceedings be brought without delay, and the County Treasurer shall advise the Tax Commission and it shall declare the taxable period for such taxpayer immediately terminated and such tax due, and cause notice of such finding and declaration to be given to the taxpayer together with a demand for immediate payment of the tax for the taxable year, and such tax shall become immediately due and payable. Upon receiving such information the County Treasurers, or either of them, are hereby required to advise the Tax Commission of his findings, whereupon the Tax Commission shall, under its official seal, issue its warrant for the enforcement of the collection of such tax as hereinbefore provided.

§ 10. False Return Perjury—Penalty.—That any person or persons making a false return as required by the provisions of this Act, or false affidavit, shall be deemed and adjudged guilty of perjury and shall be punished by a fine and imprisonment in the discretion of the Court.

§ 11. Procedure Against Delinquents.—Should any person, firm, corporation, agent, trustee or company, by whatever name known or called, fail or refuse to make the affidavit as herein required, or fail or refuse to make a return to the Collector of Internal Revenue, and in the opinion of the Tax Commissioner such person, firm, corporation, agent, trustee or company, by whatever name known, is liable to the payment of, and is due to pay an income tax, the Tax Commission may issue its subpoena requiring such supposed delinquent taxpayer to appear before it in person, and testify under oath, and make true exhibit under oath of all records and transactions bearing upon and touching the

income of such supposed delinquent taxpayer, and if it is found that a tax is due and payable when computed in the manner herein provided the Tax Commission shall prepare a return, and require the payment of any taxes due, in addition to the penalties provided in Section 6, and shall further assess against and require the delinquent taxpayer to pay all the costs of the investigation.

§ 12. Certain Income Exempt.—That compensation on account of injuries or disability sustained by members of the military and naval forces and marines of the United States or of the Confederate States, nor bonuses, pensions or insurance received from the Federal or State Government by such persons in recognition of military or naval service, nor compensation received as salary or wages by any ex-service men employed as officers or employees of posts and departments of the American Legion on account of services to such posts or departments shall be exempt from the taxes and returns required under the provisions of this Act.

§ 13. Income from Operations or Property in this State Liable to Tax.—Where any person, firm or corporation operates and does business and receives income in South Carolina and another, or other States, such person, firm or corporation shall pay to the Tax Commission an income upon all net earnings accrued and received from operations or other sources in this State.

§ 14. That all Acts or parts of Acts in conflict with the provisions of this Act are hereby repealed.

§ 15. That this Act shall take effect immediately upon its approval by the Governor.

Approved the 13th day of March, 1922.

No. 503.

AN ACT to Fix the Powers of Circuit Judges at Chambers.

Section 1. Powers of Circuit Judges at Chambers as to Writs, Demurrers, etc.—Be it enacted by the General Assembly of the State of South Carolina: The Judges of the Court of Common Pleas shall have power at Chambers to grant writs of prohibition, mandamus and certiorari, and to hear and determine demurrers and motions to set aside or stay execution in the same manner,

Exhibit B

Exhibit C to Form C-245 – SYNOVUS BANK

TO: Ricky Taylor, Audit Administrator - South Carolina Department of Revenue

FROM: Mike Petrik – Alston & Bird LLP
Clark Calhoun – Alston & Bird LLP
Ray Stevens – Parker Poe Adams & Bernstein LLP

CONFERENCE REQUESTED

This document ("Exhibit C") summarizes the position of Synovus Bank ("Synovus") with respect to two Proposed Notices of Adjustment ("PNOA") issued by the South Carolina Department of Revenue (the "Department") against Synovus for tax years 2009 to 2014 (the "Assessment Period"). The Department issued its PNOAs against Synovus after first paying refunds in response to refund claims that Synovus filed for those same tax years. Synovus filed those refund claims based on the position that it is entitled to utilize net operating loss carryforwards ("NOLs") in computing its taxes due under the South Carolina Income Tax on Banks, S.C. Code § 12-11-10 *et seq.* (the "Bank Tax"). Synovus now appeals from the PNOAs pursuant to S.C. Code § 12-60-10 *et seq.*

The dominant substantive issue in this appeal is whether Synovus is entitled to utilize NOL carryforwards in computing its Bank Tax liability. Synovus recognizes that the Department has taken the position that NOLs are not an allowable deduction for purposes of the Bank Tax; however, the Department's position is contrary to both South Carolina statutes and generally-accepted banking and tax policy, as detailed in this Exhibit. Accordingly, Synovus requests that the Department recognize Synovus's right to utilize NOLs in computing its annual Bank Tax liability and withdraw the PNOAs.

Brief Summary of Facts

Synovus is engaged in a banking business within the State of South Carolina. In 2010, the National Bank of South Carolina ("NBSC") merged into Synovus (which was formerly known as Columbus Bank and Trust Company). At the time of the merger, for federal income tax purposes, the combined NBSC and Columbus Bank and Trust Company had net operating losses that—if applicable to the Bank Tax—could be apportioned to South Carolina and carried forward to future taxable years.

Synovus filed its original Bank Tax return for the tax year ending December 31, 2011, on September 14, 2012. Because of subsequent adjustments on its 2011 federal return, Synovus filed a first amended return on June 27, 2013, and a second amended return on December 20, 2013. Neither the first nor the second amended return affected Synovus's Bank Tax liability for 2011.

On December 19, 2014, Synovus filed a third amended Bank Tax return for tax year 2011 on which it claimed the ability to utilize NOL carryforwards that were

generated during 2009 and 2010.[1] For tax year 2011, utilization of such NOLs would result in a recapture of otherwise-utilized credits in the amount of $116,000.00.

Synovus later filed Bank Tax returns claiming refunds of overpaid Bank Taxes as a result of the utilization of carryforward NOLs. Those returns claimed refunds of Bank Taxes that were paid as follows:

Tax Year	Amount Claimed	Amount Paid	Date Paid
2012	$566,543.00	$0	NOT PAID[2]
2013	$446,415.00	$446,415.00	Aug. 4, 2015
2014	$968,585.00	$968,585.00	Jan. 21, 2016
TOTALS	$1,981,543.00	$1,415,000.00	

Soon thereafter, on March 4, 2016, the Department issued two PNOAs to Synovus: one for "valuation adjustment" purposes for the 2009 and 2010 years, and a second for the 2012-2014 years, with a proposed assessment of $1,937,187 in tax, plus $138,286 in interest and $484,297 in penalties. Those PNOAs effectively reversed the Department's payment of the refunds to Synovus on the basis that Synovus is not entitled to utilize NOLs in computing its Bank Tax liability.[3]

On April 6, 2016, the Department issued a revised report for the 2012-2014 years to remove the penalty from the original PNOA, resulting in a proposed assessment of $1,937,187 in tax and $139,138 in interest. The Department explained that the interest must be computed from the original due date of Synovus's returns because the Department booked the interest as having been paid to Synovus, even though by law

[1] Synovus relied on the provisions of the Corporate Income Tax (S.C. Code Ann. § 12-6-10 *et seq.*, hereinafter, the "Corporate Income Tax" or the "CIT") and its related regulations for specific details regarding the computation of NOLs for each year in which it claimed a refund.

[2] Synovus received a notice from the Department dated Aug. 14, 2005 stating that Synovus's Bank Tax refund for the 2012 year had been "held for refund verification" on account of an outstanding withholding tax balance in the amount of $72.35. After a levy and seizure of the withholding tax liability, the Department's notice stated that Synovus's refund amount of $566,543.00 had been reduced to $566,470.65 and would be held for verification. However, Synovus never received that amount.

[3] The Department adjusted the timing of Synovus's utilization of certain credits in connection with the PNOA for the 2012-2014 years, but the PNOAs are otherwise simply a reversal of the Department's decision to pay the refund claims for 2013 and 2014. Synovus does not object to the Department's adjustment of the timing of the utilization of its credits.

those interest amounts were used for specified state programs and were never paid to Synovus.[4]

Analysis and Authorities

I. Because the Bank Tax Chapter Adopts the Provisions of the CIT, the CIT's Provisions Must Apply to the Bank Tax.

A. The Bank Tax functions only by relying on provisions of the CIT.

The Bank Tax is levied on "every bank engaged in business" in South Carolina, and South Carolina law imposes the Bank Tax in lieu of the CIT on banks doing business in the state. *See* S.C. Code Ann. §§ 12-11-20, 12-11-30, 12-6-550(1).

The statutes governing the Bank Tax are brief, consisting of only six sections and 338 substantive words. Accompanying regulations add a mere 213 words of guidance. *See* S.C. Code Regs. 117-1500 - 117-1500.5. Consequently, these governing provisions leave numerous essential concepts undefined and numerous procedures unspecified. In particular, no statute or regulation defines the *base* of the Bank Tax. Section 12-11-20 imposes the tax on "the entire net income of the taxpayer"; however, the Bank Tax statutes say nothing further about "entire net income," and Bank Tax regulations provide only that the phrase includes "income from any source whatsoever," with virtually no discussion of any Bank Tax-specific adjustments that may apply. S.C. Code Regs. 117-1500.1. Moreover, the Bank Tax statutes are silent on the topic of *any* deductions, including a taxpayer's ability to deduct NOLs.

Nevertheless, the computation of the Bank Tax is not a mystery. In lieu of providing substantive provisions regarding the base of the Bank Tax within the Bank Tax chapter itself, the South Carolina Legislature explicitly adopted provisions of the CIT into the Bank Tax:

> 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 [*i.e.*, the CIT chapter] that may be appropriate or applicable are adopted and made a part of [the Bank Tax] chapter for the enforcement and administration of [the Bank Tax] chapter, including the requirement to make declarations of estimated tax and make estimated tax payments.

[4] In accordance with S.C. Info. Bulletin 15-8 (July 2, 2015) and 16-1 (Jan. 4, 2016), no interest was paid on these refunds; instead, the Legislature has dictated that the 3% interest rate be reduced to zero for overpayments, and that the amounts must instead be used (1) by the Senate for operating expenses of the Joint Citizens and Legislative Committee on Children; (2) by the Department of Juvenile Justice for programs for mentoring or other alternatives to incarceration; and (3) for operations of the state's Guardian ad Litem Program. *See* S.C. Info. Letter No. 14-12 (Sept. 2, 2014).

S.C. Code Ann. § 12-11-40. Accordingly, the statutes and regulations governing the Bank Tax cannot—and do not—operate in isolation, but rather look to the CIT for definition.

B. The Bank Tax adopts the definition of the phrase "entire net income" from the CIT.

No tax can function without an adequate definition of its base, and the Bank Tax does not include *any* definition of "entire net income." But given the explicit statutory connection between the two taxes, the Bank Tax appropriately and necessarily finds the meaning of that phrase in the CIT.

When the Bank Tax was originally enacted, both the CIT and the Bank Tax used "entire net income" as their base. *Compare* 1932 S.C. Code § 2440 (imposing the CIT on the "entire net income" of a corporation) *with id.* 1937 (40) 565, § 2 (imposing the Bank Tax on the "entire net income" of a bank engaged in business in the state). When it originally enacted the Bank Tax, the Legislature did not provide any definition or means of computing "entire net income"; instead the Legislature referred to—and explicitly adopted—the provisions of the CIT for purposes of defining the Bank Tax base. *See id.* 1937 (40) 565, § 4 (stating that all of the provisions of the CIT "are hereby adopted and made a part of this Section for the enforcement and administration of this Act"). Thus, the only way that a bank has ever determined the starting point of its liability under the Bank Tax is through application of the adopted provisions of the CIT, which long defined "net income" as "the gross income of a taxpayer less the deductions allowed by this [CIT] chapter." *See* 1932 S.C. Code § 2443; 1942 S.C. Code § 2443; S.C. Code Ann. § 65-255 (1962); S.C. Code Ann. § 12-7-600 (1976).

Later amendments to the CIT did not change this situation. In 1985, the Legislature revised the CIT to refer to a "taxable income" base, but it did not amend the Bank Tax's adoption of—and reliance on—the CIT provisions for its definition of "entire net income" and for the other provisions under which a bank should compute its Bank Tax liability. *See* 1985 S.C. Laws Act No. 101 (revising CIT to a tax based on "taxable income" but making no changes to the Bank Tax). Moreover, the CIT continues to use the phrases "entire net income" and "net income" today, demonstrating the continuing link between the Bank Tax's base and the provisions of the CIT. *See, e.g.*, S.C. Code Ann. § 12-6-2210(A) (stating that if the entire business of a taxpayer is conducted in South Carolina, the CIT is measured by the "entire net income" of the taxpayer); *see also id.* § 12-6-2210(B) (stating that a taxpayer is conducting business in another state—and is therefore entitled to allocate and apportion its income—"if the other taxing jurisdiction adopted the net income tax laws of this State"). Accordingly, it is clear that the definition and computation of "entire net income" in the Bank Tax relies on the provisions of the CIT. This reliance has been true since the inception of the Bank Tax, and it continues to be true today.

C. The Department has recognized in formal guidance that the Bank Tax and the CIT must be interpreted and applied in harmony.

Not only has the Legislature explicitly tied the administration of the Bank Tax to the provisions of the CIT, but the Department itself has a history of referring to the CIT to interpret and apply the Bank Tax. *See, e.g.*, S.C. Dep't of Rev. Comm'n Decisions, No. I-D-200 (Aug. 4, 1975) (referring to the Corporate Income Tax adoption of IRC § 368 for purposes of interpreting a Bank Tax issue); *see also* S.C. Private Letter Ruling No. 95-10 (Aug. 28, 1995) (again applying IRC Section 368 principles to the Bank Tax, noting that "the same policy reasons that encouraged the adoption by South Carolina of the Internal Revenue Code . . . to corporations [subject to the Corporate Income Tax] encourage the extension of these provisions to . . . taxpayers subject to [the Bank Tax]."). Thus, as the Department itself has recognized, the provisions of the CIT apply for purposes of interpreting and applying the Bank Tax.

II. Because the CIT Defines the Base and Computation of the Bank Tax, the CIT's Allowance for NOLs Must Apply to the Bank Tax.

As demonstrated in Section I of this Exhibit, under South Carolina law a taxpayer's "entire net income" for purposes of the Bank Tax is computed using the provisions of the CIT, all of which are explicitly adopted into the Bank Tax through Section 12-11-40. Section II of this Exhibit further demonstrates that because the CIT chapter provides an NOL deduction to corporations that are subject to tax under that chapter, the Bank Tax chapter likewise provides an NOL deduction to banks that are subject to tax under the Bank Tax chapter, because banks must compute their tax under the provisions of the CIT, on which the Bank Tax chapter explicitly relies.

Since 1955, the South Carolina CIT has included a provision permitting taxpayers to deduct NOLs. The original NOL provision allowed a deduction for taxpayers that "established a new business or industry" in the state during the tax year. *See* 1955 (49) 437, § 6 (adding S.C. Code § 65-259(13)). In 1979, the Legislature extended the NOL deduction to "all taxpayers." *See* 1976 S.C. Code Ann. § 12-7-700(12A) (Supp. 1979) (providing that the state's NOL deduction "shall be allowed to all taxpayers").

When those NOL provisions were adopted, the CIT and the Bank Tax shared the same base: "entire net income." Furthermore, to the extent that any additions or deductions to that base were required or permitted, they were found in the CIT. There were also no provisions in the Bank Tax or the CIT that "carved out" any of the deductions available under the CIT—including NOL deductions—from the Bank Tax; rather, ever since its initial enactment, the Bank Tax has always adopted the provisions of the CIT in full. Because the Bank Tax has always explicitly relied on the CIT to compute its tax base (as well as any relevant additions or deductions to that base), the deductions permitted with respect to the CIT—including NOL deductions—must apply equally to the Bank Tax.

The conclusion that taxpayers are permitted to deduct NOLs in computing their Bank Tax liability is also justified under South Carolina law on other grounds. First, the Legislature implicitly recognized that the Bank Tax allows an NOL deduction when it revised Section 12-6-50 in 2005. That section had historically provided the list of IRC provisions that do *not* apply to the CIT. In 2005, the Legislature amended that statute to apply not only to the CIT but also to all "taxes administered by the department"—including the Bank Tax. *See* 2005 Act No. 145, § 8 (H.B. 3768). One specific IRC provision that the Legislature left unadopted is the federal tax provision allowing NOL carrybacks. *See* S.C. Code Ann. § 12-6-50(6). It would make no sense to extend to the Bank Tax a provision which prohibits NOL *carrybacks* if banks were already prohibited from taking *all* NOLs against the Bank Tax, and the rules of statutory construction require that statutes be construed so as to give force to each part of a statute. *See, e.g., State v. Sweat*, 379 S.C. 367, 377 (S.C. Ct. App. 2008) ("A statute should be so construed that no word, clause, sentence, provision or part shall be rendered surplusage, or superfluous . . . .") (citation omitted).[5]

Moreover, the Bank Tax is, and always has been, expressly labeled as South Carolina's "*income tax* on banks," and banks operating in South Carolina *must* pay the Bank Tax instead of the CIT. *Compare* 1937 (40) 565 (Preamble to act imposing Bank Tax, which states that it was creating "a tax upon the income of banks") *with* S.C. Code Ann. § 12-11-10 *et seq.* (labeling the current Bank Tax as an "Income Tax on Banks"). It is undeniable that in South Carolina, a non-bank corporate taxpayer has an unambiguous right to employ NOLs to reduce its South Carolina income tax liability. *See* S.C. Code Ann. § 12-6-1130(4). Furthermore, the Bank Tax's tax base has always been defined by the provisions of the CIT—which the Bank Tax has always explicitly adopted. As this Section II has demonstrated, there is no statutory or regulatory basis anywhere in the South Carolina Code or Administrative Code for denying banks a benefit that is available to all other South Carolina businesses, especially where that benefit is provided for in the CIT chapter that is expressly incorporated into the Bank Tax and to which banks must turn to compute their Bank Tax liability. Accordingly, permitting banks the use of NOLs for purposes of the Bank Tax is compelled by South Carolina law.

III. Allowing the Use of NOLs for Purposes of the Bank Tax Promotes Sound Banking Policy and Conforms to Common Income Tax Practices.

Allowing NOLs for purposes of the Bank Tax also promotes sound banking and income tax policy. Public policy in the United States recognizes that, in particular among business corporations, banking institutions in a functioning economy must remain adequately capitalized. To this end, federal regulators such as the Office of the Comptroller of the Currency ("OCC") and the Federal Deposit Insurance Corporation have established elaborate minimum capital requirements for national banks, pursuant to

[5] Note also that the CIT has its own specific provision prohibiting NOL carrybacks. *See* S.C. Code Ann. § 12-6-1130(4)(b). Accordingly, the extension of Section 12-6-50 to the Bank Tax would have little impact if NOLs are not permitted under that tax.

federal law. *See, e.g.*, 12 C.F.R. §§ 3.1–3.701 (providing capital requirements and capital calculation methodologies for national banks and federal savings associations regulated by the OCC). In addition, South Carolina law establishes minimum capital requirements for state-chartered banks. *See* S.C. Code Ann. §§ 34-9-40, 34-9-60.

By contrast, the Department's refusal to allow banks to use NOLs *impairs* banking capital. Under the Department's position, banks—unlike all other corporate taxpayers in South Carolina—are taxed in relationship to their profitability in good years but receive no corresponding relief from taxation in years of losses. This phenomenon imprudently shifts bank assets away from working capital, diminishing the viability and safety of banks that operate in South Carolina. The Department's disallowance of NOLs for purposes of the Bank Tax is confounding in light of the clear policy of federal and South Carolina banking regulations that bank capital should be preserved.

Other states that impose a specific income tax on banks have recognized the imperative to promote banking capital and, consequently, allow the use of NOLs. For example, California allows NOLs for purposes of its tax on banks and financial corporations. *See* Cal. Rev. & Tax. Code § 23181 (imposing a tax on the "net income" of banks); *id.* § 24416 (defining "net income" to include a provision for NOLs). Likewise, until its recent repeal, New York allowed a deduction of NOLs from its franchise tax on banking corporations, which like the Bank Tax was levied on "entire net income." *See* N.Y. Tax Law § 1453(k-1) (repealed 2015).

In fact, almost *all* taxes on net income allow for the use of NOLs. The federal government and most states impose taxes on net income, and in virtually every case the tax base allows for a deduction for NOLs. *See, e.g.*, 30 Del. Code § 1903; N.Y. Tax Law § 1503; R.I. Reg. CT 94-06. Courts have recognized that NOLs provide reasonable equitable relief from the potentially harsh consequences of levying an income tax based on a yearly accounting period. *See, e.g., Richard's Auto City, Inc. v. Dir., Div. of Taxation*, 12 N.J. Tax 619, 626 (1992), *rev'd on other grounds* ("The [New Jersey] Legislature recognized that [] not permitting a net operating loss to be carried over to a subsequent tax accounting period [] would produce harsh results for many businesses whose yearly income may fluctuate from a loss in one year to a profit the next."); *United Technologies Corp. v. Groppo*, 600 A.2d 1350, 1358 (Conn. 1991) ("An inequitable tax burden would result if companies were taxed during profitable periods without receiving any relief during periods of net operating losses.") (citation omitted). It is unlikely that the South Carolina Legislature departed from widely accepted income tax norms in order to enact a levy on banks that is contrary to such a well-established and commonly accepted income tax policy.

IV. The Department Has Proposed an Assessment to Recoup a Refund Amount for Tax Year 2012 That the Department Never Paid to Synovus.

As explained in note 2, Synovus never received the $566,543 refund that it claimed for tax year 2012. The Department issued a notice dated Aug. 27, 2015 stating that such refund was being held for "refund verification," but such refund was never issued.

Accordingly, the Department has overstated the amount of the proposed assessment by $566,543.00, and to impose such taxes against Synovus would be tax Synovus twice for amounts that were paid to the Department and never refunded to Synovus, in violation of South Carolina law and the Constitutions of the United States and the State of South Carolina. Accordingly, either the amount should be refunded to Synovus or the assessment should be canceled to the extent that it has included amounts that were never refunded. Any interest charges associated with such taxes should also be canceled (as described in more detail in the following section).

V. The Department's Computation of Interest Has No Basis in South Carolina Law and Violates the Takings Clause of the United States and South Carolina Constitutions.

As explained *supra*, the Department issued a proposed assessment against Synovus in which it computed interest on the proposed assessments from the original due date of Synovus's returns. In an informal meeting, the Department explained that it computed interest in this manner because it had "booked" interest as having been paid to Synovus, even though pursuant to state law, interest on refund claims is reduced to zero and must be directed to various state agencies rather than the taxpayer. *See supra* note 4. The Department's use of the original due date to compute interest on the proposed assessment serves, incredibly, to charge interest to Synovus for periods when the Department held Synovus's money. The use of that date is improper because it (1) finds no basis in South Carolina law; and (2) constitutes a taking under the Takings Clause of the Constitutions of the United States and the State of South Carolina.

First, there is no basis under South Carolina law to impose *any* interest against Synovus. The South Carolina Code includes only one provision governing the imposition of interest in connection with an assessment against a taxpayer for underpayment of tax. It reads: "If any tax is not paid when due, interest is due on the unpaid portion from the time the tax was due until paid in its entirety." S.C. Code § 12-54-25(A). Subsection (B) of that code section adds that for purposes of the interest statute, "a tax is due on the last day provided for its payment, without regard for any extension of time for payment and without regard for or to any" jeopardy assessment. Here, Synovus's Bank Tax liability for each year of the Assessment Period was due no later than the deadline for filing Synovus's Bank Tax return, and Synovus timely paid its tax for each year of the Assessment Period. Because the taxes were "paid when due," Section 12-54-25 provides no authority for the imposition of interest. Furthermore, there is no other statute in the

Code that provides authority to impose interest against Synovus; accordingly, there is no basis under South Carolina law to impose interest against Synovus for an "underpayment" of tax for those years. Synovus's tax was timely paid; the bell was rung. The Department cannot un-ring the bell by refunding a portion of the taxes paid by Synovus and then issuing an assessment to reverse the refund. However, if Section 12-54-25 provides authority for the Department to impose any interest in connection with the PNOAs, it would only be from the date when the taxes became "unpaid"—that is, the date that the PNOAs were issued.

Second, even if the South Carolina Code authorizes the Department's imposition of interest against Synovus on these facts, the Department's method for computing interest constitutes a "taking" of Synovus's property under the Fifth Amendment to the United States Constitution and Section 13 of the Constitution of the State of South Carolina. The state's practice of withholding interest from taxpayers in connection with paid refunds and directing such interest for public use is constitutionally suspect. *See Brown v. Legal Foundation of Washington*, 538 U.S. 216, 235-36 (2003) (holding that Washington's court rules requiring that interest generated by IOLTA accounts be used for public purposes was a taking, but holding in that case that no compensation was required); *see id.* at 240 ("A law that requires that the interest on those funds be transferred to a different owner for a legitimate public use, however, could be a *per se* taking requiring the payment of 'just compensation' to the client."). For the state to go one step further than the *per se* taking in *Brown* and charge interest to Synovus on amounts that Synovus never received is a blatant constitutional violation. *See id.* at 236-37 (discussing measure of property owner's loss as the basis for computing just compensation).

Accordingly, even if the assessment of tax against Synovus is upheld, the Department's computation of interest on that assessment is both statutorily and constitutionally invalid and must be revised.

CONCLUSION

Though the Department has issued prior guidance denying the use of NOLs for purposes of the Bank Tax, that guidance is nonbinding under South Carolina law. In fact, as this Exhibit demonstrates, exactly the opposite conclusion is required by South Carolina law and sound public policy. The Bank Tax functions only in coordination with the CIT, which clearly allows for NOLs, and the use of NOLs by bank taxpayers promotes adequate bank capital and conforms to commonly accepted income tax policy. Accordingly, Synovus requests that the Department recognize Synovus's right to utilize NOL carryforwards and withdraw the proposed assessments for the Assessment Period. Synovus further requests that the Department cancel the imposition of interest in connection with the proposed assessments.

Synovus requests a conference with the South Carolina Department of Revenue in connection with this protest, and it reserves the right to supplement this protest with additional argumentation or authorities.

Exhibit C

Acts and Joint Resolutions
OF THE
GENERAL ASSEMBLY
OF THE
State of South Carolina

JOHN G. RICHARDS, Governor; T. BOTHWELL BUTLER, Lieutenant Governor and *ex officio* President of the Senate; JOHN K. HAMBLIN, Speaker of the House of Representatives; JAS. H. FOWLES, Clerk of the Senate; J. WILSON GIBBES, Clerk of the House of Representatives.

Passed at the Regular Session, which was begun and held at the City of Columbia on the 11th day of January, A. D. 1927, and was adjourned without day on the 23rd day of April, A. D. 1927.

PART I

GENERAL AND PERMANENT LAWS

No. 1

AN ACT to Raise Revenue for the Support of the State Government by the Levy and Collection of a Tax upon Income.

Section 1. Article 1—Short Title and Definitions.—Be it enacted by the General Assembly of the State of South Carolina: This Act shall be known and may be cited as the Income Tax Act of 1926.

§ **2. Definitions.**—For the purposes of this Act and unless otherwise required by the context:

(1) The words "tax commission" mean the South Carolina Tax Commission.

(2) The word "taxpayer" means any individual, fiduciary, or corporation subject to the tax imposed by this Act.

(3) The word "fiduciary" means a guardian, trustee, executor, administrator, receiver, conserver, or any person, whether individual or corporate, acting in any fiduciary capacity for any person, estate or trust.

(4) The word "person" includes individuals, fiduciaries, partnerships or corporations.

(5) The word "corporation" includes joint-stock companies or associations and insurance companies.

(6) The word "business" includes trade, profession, occupation or employment.

(7) The words "tangible property" mean real property and corporeal personal property and do not mean money, bank deposits, shares of stocks, bonds, credits, evidences of debt, choses in action evidences of an interest in property.

(8) The words "intangible property" mean all property other than tangible property.

(9) The words "income year" mean the calendar year or the fiscal year, upon the basis of which the net income is computed under this Act; if no fiscal year has been established they mean the calendar year.

(10) The words "fiscal year" mean an income year ending on the last day of any month other than December.

(11) The word "paid" for the purpose of the deductions under this Act, means "paid or accrued" or "paid or incurred," and the words "paid or accrued," "paid or incurred" and "incurred" shall be construed according to the method of accounting upon the basis of which the net income is computed under this Act. The word "received" for the purpose of the computation of the net income under this Act means "received or accrued," and the words "received and accrued" shall be construed according to method of accounting upon the basis of which the net income is computed under this Act.

(12) The words "foreign corporation" mean any corporation other than a domestic corporation.

§ 3. Article II—Imposition of the Tax—Tax on Individuals.—A tax is hereby imposed upon every individual residing in the State of South Carolina, which tax shall be levied, collected, and paid annually, with respect, to the entire net income of the taxpayer, as hereinafter defined, and upon income earned within the jurisdiction of this State of every non-resident having a business of agency in the State, or from the sale or rentals of property within this State, computed at the following rates, after deducting the exemptions provided by this Act:

On the excess over the amount legally exempted up to twenty-five hundred dollars, one per cent.

On the excess above twenty-five hundred dollars and up to five thousand dollars, one and one-half per cent.

On the excess above five thousand dollars and up to seven thousand five hundred dollars, two and one-half per cent.

On the excess above seven thousand five hundred dollars and up to ten thousand dollars, three and one-half per cent.

On the excess above ten thousand dollars and up to fifteen thousand dollars, four and one-half per cent.

On the excess over fifteen thousand dollars, five per cent.

§ 4. (a) Tax on corporations.—Every corporation organized under the laws of this State shall pay annually an income tax, with respect to carrying on or doing business equivalent to four per cent of the entire net income of such corporation, as herein defined, received by such corporation during the income year; and every foreign corporation doing business within the jurisdiction of this State shall pay annually an income tax equivalent to four per cent. of a proportion of its entire net income, to be determined as hereinafter provided in this Act.

Sleeping car
Power
Nav.
W W
L+G
Companies added by 1930 Act

(b) Railroads and public service corporations; basis of ascertaining net income.—The basis of ascertaining the net income of every corporation engaged in the business of operating a steam or electric railroad, express service, telephone or telegraph business, or other form of public service, when such company is required to keep records according to the standard classification of accounting of the Interstate Commerce Commission, shall be the "net operating income" of such corporation as shown by their

Amended 1930 to provide "whether or not"
" 1943 " " " and/or FCC

records kept in accordance with that standard classification of accounts, when their business is wholly within the jurisdiction of this State, and when their business is in part within and in part without the State their net income within the jurisdiction of this State shall be ascertained by taking their gross "operating revenues" within this State, including in this gross "operating revenues" within the jurisdiction of this State the equal mileage proportion within the jurisdiction of this State of their interstate business and deducting from their gross "operating revenues" the proportionate average of "operating expenses," or "operating ratio," for their whole business, as shown by the Interstate Commerce Commission standard classification of accounts. From the net operating income thus ascertained shall be deducted "uncollectible revenue," and taxes paid in this State for the income year, other than income taxes, and the balance shall be deemed to be their net income taxable under this Act: *Provided*, That interest paid or accrued and rentals may be deducted from gross operating revenues in the event that they have not been deducted by the above provisions.

(c) Car hire considered.—In determining the taxable income of a corporation engaged in the business of operating a railroad under the preceding section (Section (b)), in the case of a railroad located entirely within the jurisdiction of this State, the net income shall be increased or decreased to the extent of any credit balance received or paid, as the case may be, on account of car hire; and when a railroad is located partly within and partly without the jurisdiction of this State, then said net operating income shall be increased or decreased to the extent of an equal mileage proportion within the jurisdiction of this State of any credit or debit balance received or paid, as the case may be, on account of car hire.

(d) Tax on fiduciaries.—The tax imposed by this Act shall be imposed upon resident fiduciaries and upon non-resident fiduciaries having in charge funds or property for the benefit of a resident of this State, which tax shall be levied, collected, and paid annually with respect to:

(1) That part of the net income of estates or trusts which has not been distributed. (2) The net income received during the income year by deceased individuals who, at the time of death were residents and who have died during the tax year or income year without having made a return. (3) The entire net income of resi-

dent insolvent or incompetent individuals whether or not any portion thereof is held for the future use of the beneficiaries, where the fiduciary has complete charge of such net income. (4) The tax imposed upon a fiduciary by this Act shall be a charge against the estate or trust.

§ 5. **Exemptions.**—There shall be deducted from net income the following exemptions:

(a) In the case of a single individual, a personal exemption of fifteen hundred ($1,500.00) dollars.

(b) In the case of a married individual, living with husband or wife or the head of a household, twenty-five hundred ($2,500.00) dollars.

(c) Four hundred ($400.00) dollars for each individual other than husband or wife dependent upon and receiving his chief support from the taxpayer if such dependent individual is under twenty-one years of age or is incapable of self support because mentally or physically defective.

(d) In the case of a fiduciary if taxable under clause (a) supra, a personal exemption of one thousand ($1,000.00) dollars; if taxable under clause (b) supra, the same exemption as would be allowed the deceased if living; if taxable under clause (c) supra, the same exemptions to which the beneficiary would be entitled.

§ 6. **Organizations that are exempt.**—The following organizations shall be exempt from taxation under this Act:

(1) Fraternal beneficiary societies, orders or associations, (a) operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system and, (b) providing for the payment of life, sick, accident or other benefits to the members of such society, order or association or their dependents.

(2) Building and loan associations and co-operative banks without capital stock, organized and operated for mutual purposes and without profits, and insurance companies.

(3) Cemetery corporations and corporations organized for religious, charitable, scientific, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earn-

ings of which inures to the benefit of any private stockholder or individual.

(4) Business leagues, chambers of commerce, or boards of trade, not organized for profit and no part of the net earnings of which inures to the benefit of any private stockholder or individual.

(5) Civic leagues or organizations not organized for profit, but operated exclusively for the promotion of social welfare.

(6) Farmers' or other mutual hail, cyclone, or fire insurance companies, mutual ditch or irrigation companies, mutual or co-operative telephone companies or like organizations of a purely local character, the income of which consists solely of assessments, dues, and fees collected from members for the sole purpose of meeting expenses.

(7) Farmers', fruit growers' or like organizations, organized and operated as sales agent for the purpose of marketing the products of members and turning back to them the proceeds of sales, less the necessary selling expenses, on the basis of the quantity of produce furnished by them.

(8) Labor, agricultural or horticultural organizations, no part of the net earnings of which inures to the benefit of any private stockholder or member.

§ 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.

§ 8. (1) The words "gross income" mean the income of a taxpayer derived from salaries, wages or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, business, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property, also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains, or profits, and income derived from any source whatever. The amount of all such items shall be included in the gross income of the income year in which received by the taxpayer, unless, under the methods of accounting permitted under this Act, any such amounts are to be properly accounted for as of a different period.

(2) The words "gross income" do not include the following items which shall be exempt from taxation under this Act:

(a) The proceeds of life insurance policies and contracts paid upon the death of the insured to individual beneficiaries or to the estate of the insured.

(b) The amount received by the insured as a return of premium or premiums paid by him under life insurance, endowment or annuity contracts, either during the term or at the maturity of the term mentioned in the contract or upon surrender of the contract.

(c) The value of property acquired by gift, bequest, devise or descent (but the income from such property shall be included in gross income).

(d) Interest upon the obligations of the United States or its possessions, or of the State of South Carolina, or any political subdivision thereof.

(e) Salaries, wages, or other compensation received from the United States by officials or employees thereof, including persons in the military or naval forces of the United States.

(f) Any amounts received through accident or health insurance or under workmen's compensation acts, as compensation for personal injuries or sickness, plus the amount of any damages received whether by suit or agreement, on account of such injuries or sickness.

§ 9. Basis of return of net income.—(1) The net income of a taxpayer shall be computed in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if such method does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Tax Commission does clearly reflect the income. Taxpayers whose accounting period of twelve months ends as of the last day of some month other than December and the books of such taxpayer are kept accordingly, may, with the approval of the Tax Commission, and subject to such rules and regulations as it may establish, return their net income under this Act on the basis of such fiscal year in lieu of that of the calendar year.

(2) A taxpayer may, with the approval of the Tax Commission and under such regulations as it may prescribe change the income

year from fiscal year to calendar year or otherwise, in which case his net income shall be computed upon the basis of such new income year: *Provided,* That such approval must be obtained from the Commission at least thirty days prior to the end of such income year.

(3) An individual carrying on business in partnership shall be liable for income tax only in his individual capacity, and shall include in his gross income his distributive share of the net income of the partnership for each income year, whether distributed or not.

(4) Every individual taxable under this Act who is a beneficiary of an estate or trust shall include in his gross income the distributive share of the net income of the estate or trust, received by him or distributable to him during the income year. Unless otherwise provided in the law, the will, the deed, or other instrument creating the estate, trust or fiduciary relation, the net income shall be deemed to be distributed to the beneficiaries (including the fiduciary as a beneficiary, in the case of income accumulated for future distribution) ratably in proportion to their respective interests.

§ 10. **Determination of gain or loss.**—For the purpose of ascertaining the gain or loss from the sale or other disposition of property, real, personal or mixed, the basis shall be in the case of property acquired before January first, one thousand nine hundred and twenty-one, the fair market price or the value of such property as of that date, and in all other cases, the cost thereof: *Provided,* That in the case of property which was included in the last preceding annual inventory used in determining net income in a return under this Act, such inventory value shall be taken in lieu of costs or market value.

The final distribution to the taxpayer of the assets of a corporation shall be treated as a sale of the stock or securities of the corporation owned by him, and the gain or loss shall be computed accordingly.

§ 11. **Exchanges of Property.**—(1) When property is exchanged, whether or not of a like nature, the gain or loss shall be the difference between the cost or value January 1st, 1921, if acquired prior to that date, of the property exchanged and the value of the property received, whether the same be bonds, stocks, securities, or other tangible or intangible property.

(2) In the case of the organization of a corporation, the stock or securities received shall be considered to take the place of property transferred thereto, and no gain or loss shall be deemed to arise therefrom.

(3) When in connection with the organization, merger, or consolidation of a corporation, a stockholder receives, in place of stock or securities owned by him, new stock or securities, the basis of computing the gain or loss, if any, shall be, in case the stock or securities owned were acquired before January first, one thousand nine hundred and twenty-one, the fair market price or value thereof as of that date, and in all other cases the cost thereof.

§ 12. **Inventory.**—Whenever in the opinion of the Tax Commission it is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Tax Commission may prescribe, conforming as nearly as may be to the best accounting practice in the trade or business and most clearly reflecting the income.

§ 13. **Deductions.**—In computing net income there shall be allowed as deductions:

(1) All the ordinary and necessary expenses paid or accrued (in case the books are kept on the accrual basis) during the income year in carrying on any trade or business, including:

(a) As to individuals, reasonable wages of employees for services actually rendered in producing such income.

(b) As to partnerships, reasonable wages of employees and a reasonable allowance for copartners or members of a firm, for services actually rendered in producing such income, the amount of such salary allowance to be included in the personal return of the copartner receiving same.

(c) As to corporations, wages of employees and salaries of officers, if reasonable in amount, for services actually rendered in producing such income.

(2) Rentals or other payments required to be made as a condition of the continued use or possession, for the purpose of the trade, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

(3) All interest paid during the income year on indebtedness except interest on obligations contracted for the purchase of non-taxable securities or stock. Dividends on preferred stock shall not be deducted as interest.

(4) Taxes for the income year, except taxes on income, inheritance taxes, and taxes assessed for local benefit of a kind tending to increase the value of the property assessed.

(5) Dividends from stock in any corporation the income of which shall have been assessed and the tax on such income paid by the corporation under the provisions of this Act.

(6) Losses sustained during the income year on property used in trade or business, or of property not connected with trade or business, if arising from fire, storms, shipwrecks or other casualties, or theft and if not compensated for by insurance or otherwise.

(7) Debts ascertained to be worthless and actually charged off the books of the taxpayer within the income year.

(8) A reasonable allowance for the depreciation and obsolescence of property used in the trade or business; and in the case of mines, other natural deposits, and timber, a reasonable allowance for depletion, for brick buildings more than three years old a deduction of five per cent of the value thereof; wooden buildings more than three years old a deduction of ten per cent of the value thereof shall be allowed: *Provided,* That in computing the deductions allowed under this paragraph, the basis shall be the cost plus any additions and improvements (including in the case of mines, and other natural deposits, the cost of development not otherwise deducted).

In the case of leases the deductions allowed may be equitably apportioned between the lessor and the lessee.

(9) Resident individuals and corporations having an established business in another State, or investment in property in another State, may deduct the next income from such business or investment. The deduction authorized in this subsection shall in no case extend to any part of the income of resident individuals and corporations from personal services, or mortgages, stocks, bonds, securities, and deposits.

(10) In the case of a non-resident individual, the deductions allowed in this Section shall be allowed only if, and to the extent that,

they are connected with income arising from sources within the State; and the proper apportionment and allocation of the deductions with respect to sources of income within and without this State shall be determined under rules and regulations prescribed by the Tax Commission.

§ 14. Items not deductible.—In computing net income no deduction shall in any case be allowed in respect of:

(a) Personal, living, or family expenses.

(b) Any amount paid out for new buildings or for permanent improvements or betterments, made to increase the value of any property or estate.

(c) Any amount of expenses in restoring property for which an allowance is or has been made.

(d) Premiums paid on any life insurance policy.

§ 15. (1) Non-residents and foreign corporations.—If the entire trade or business of a non-resident individual or a foreign corporation is carried on in the jurisdiction of this State the tax imposed by this Act shall be computed upon the entire income of such non-resident individual or foreign corporation: *Provided, further,* Except as herein provided, each and every foreign corporation, non-resident individual engaged in the business of manufacturing within the jurisdiction of the State of South Carolina shall make returns and pay annually an income tax from business done and transacted within the State, computed on a proportion of its entire net income to be determined according to the following rules: The proportion shall be such a proportion of the entire net income derived from all sources as the fair cash value of the real estate and tangible personal property located, and actually used in the conduct of the business, in the State of South Carolina (no deductions on account of encumbrances) is to the cash value of the entire real estate and tangible personal property actually used in the conduct of the trade or business wheresoever located (no deduction on account of encumbrances). Such property shall be taken at its actual value, which in the case of property valued or appraised for purposes of inventory, depreciation, depletion, or other purposes shall be the highest amount at which so valued or appraised, and which in other cases shall be deemed to be its book value in the absence of affirmative evidence showing such value to be greater or less than the actual

value. The average value during the taxable year or period shall be employed. The average value of property as above prescribed at the beginning and end of the taxable year or period ordinarily may be used, unless by reason of material changes during the taxable year or period, such average does not fairly represent the average for such year or period, in which event the average shall be determined upon a monthly or daily basis: *Provided, further,* That when a foreign corporation or non-resident individual shows to the satisfaction of the Tax Commission that their books of account are kept in such a manner as to reflect the true net income accruing or arising from business transacted within the State, the return may, with the approval of the Tax Commission, be based upon such books of account and the tax paid upon the net income so determined.

(2) Gross income derived from the sale of personal property by non-resident individuals of foreign corporations produced (in whole or in part) by the taxpayer without and sold within the State shall be treated as derived partly from sources within and partly from sources without the State, computed as follows:

The net income shall first be computed by deducting from the gross income derived from sources partly within and partly without the State the expenses, losses, or other deductions properly apportioned or allocated thereto and a ratable part of any expenses, losses, or other deductions which cannot definitely be allocated to some item or class of gross income. Of the amount of net income so determined one-half shall be apportioned in accordance with the value of the taxpayer's tangible property within and without the State the portion attributable to sources, within the State, being determined by multiplying such one-half by a fraction the numerator of which consists of the values of the taxpayer's tangible property within the State and the denominator of which consists of the value of the taxpayer's tangible property both within and without the State. The remaining one-half of such net income shall be apportioned in accordance with the gross sales of the taxpayer within and without the State, the portion attributable to sources within the State being determined by multiplying such one-half by a fraction, the numerator of which consists of the taxpayer's gross sales for the taxable year or period within the State, and the denominator of which consists of the taxpayer's gross sales for the taxable year or period both within and without the State. "Gross sales within the

State" means the aggregate amount of all the sales made during the taxable year which were principally secured, negotiated or effected by employees, agents, offices, or branches of the taxpayer's business resident or located in the State.

(3) The term "tangible property" as used in this Article includes only the property held or used to produce income which is derived from sources partly within and partly without the State (including all property held or used to produce income which is allocated or apportioned to other classes of income). Such property should be taken at its actual value, which in the case of property valued or appraised for purpose of inventory, depreciation, depletion, or other purposes shall be the highest amount at which so valued or appraised and which in other cases shall be deemed to be its book value in the absence of affirmative evidence showing such value to be greater or less than the actual value. The average value during the taxable year or period shall be employed. The average value of property as above prescribed at the beginning and end of the taxable year or period ordinarily may be used, unless by reason of material changes during the taxable year or period such average does not fairly represent the average for such year or period, in which event the average shall be determined upon a monthly or daily basis.

(4) In a case where there is no real estate or tangible personal property, or a non-resident individual or foreign corporation is engaged in buying and selling, the net income attributable to the State shall be arrived at by taking such a proportion of the total net income as the gross sales within the State bear to the total gross sales.

(5) A rule shall not be deemed to be inapplicable merely because all of the real estate and tangible personal property is found to be situated outside the State, or because all of the gross receipts are found to have been received outside the State.

§ 16. **Article IV—Information returns.**—That all individuals, corporations and partnerships in whatever capacity acting, including lessees or mortgagees of real or personal property, fiduciaries, and employers making payment to another individual, corporation or partnership of interest, rent, dividends, salaries, wages, emoluments, or other fixed or determinable gains; profits and income of $1,000 or more in any taxable year, or in the case of such

payments made by South Carolina, the officers or employees of South Carolina having information as to such payments and required to make returns in regard thereto, shall render a true and accurate return to the Tax Commission under such regulations as the Tax Commission may prescribe, setting forth the amounts of such gains, profits and income and the name and address of the recipient of same.

§ 17. Persons and corporations required to make returns.—(1) Details of returns. Every resident or non-resident having a net income during the income year taxable in this State of $1,500.00 and over, if single, or if married and not living with husband or wife or having a net income for the income year of $2,500.00 or over, if married and living with husband or wife, and every corporation except those specifically exempted, shall make a return under oath, stating specifically the items of gross income and the deductions and exemptions allowed by this Act, and such other facts as the Tax Commission may require for the purpose of making any computation required by this Act. When the Tax Commission has reason to believe any person or corporation is liable for tax under this Act, it may require any such person or corporation to make a return. If a husband and wife living together have an aggregate net income of $2,500.00 or over, each shall make such a return, unless the income of each is included in a single joint return.

(2) If an individual taxpayer is unable to make his own return, the return shall be made by a duly authorized agent or by a guardian or other person charged with the conduct of the business of the taxpayer.

(3) The return by a partnership shall be made by any one of the partners and shall show the net income of the partnership and the amount of such income allocated to each partner.

(4) The return of the net income of a trade or business carried on by an estate or trust shall be made by the fiduciary and, under such regulations as the Tax Commission may prescribe, may be made by one of two or more joint fiduciaries, and such return shall show the net income of such estate or trust, and the distribution of such income to the beneficiaries.

(5) The return by a corporation shall be sworn to by the president or other principal officer and by the treasurer or assistant treasurer.

(6) The return of an individual who, while living, was carrying on trade or business in the State, during the income year and who has died before making the return, shall be made in his name and behalf by the administrator or executor of the estate and the tax shall be levied upon and collected from his estate.

§ 18. **Consolidated returns.**—(1) Any taxpayer capable of exercising either directly or indirectly substantially the entire control of the business of another taxpayer, either by ownership or control of substantially the entire capital stock (if a corporation) of such other taxpayer or otherwise, may, under regulations to be prescribed by the Tax Commission, be permitted to make a consolidated return, showing the consolidated net income and such other information as the Tax Commission may require in order to compute the net income properly attributable to the State and to impose the tax upon the taxpayers concerned.

(2) The Tax Commission may permit the filing of a consolidated return where substantially the entire control of two or more taxpayers liable to taxation under this Act is exercised by the same interests.

(3) Where the Tax Commission has reason to believe that any taxpayer so conducts the trade or business as either directly or indirectly to distort his true net income and the net income properly attributable to the State, whether by the arbitrary shifting of income, through price fixing, charges for service or otherwise, whereby the net income is arbitrarily assigned to one or another unit in a group of taxpayers carrying on business under a substantial common control, it may require such facts as it deems necessary for the proper computation of the entire net income and the net income properly attributable to the State and in determining the same the Tax Commission shall have regard to the fair profits which would normally arise from the conduct of the trade or business.

§ 19. **Returns when income year changed.**—If a taxpayer, with the approval of the Tax Commission, changes the income year on the basis of which his net income is computed, he shall, at such time and in such manner as the Tax Commission may prescribe, make a separate return of his net income received during the period intervening between the end of his former income year and the beginning of the new income year in which return the specific deduction allowed in this Act shall be reduced to an amount which

bears the same ratio to the full deduction thus allowed as the number of months in such period bears to twelve months.

§ 20. **Time and place of filing returns.**—Returns shall be in such form as the Tax Commission may from time to time prescribe and shall be filed with the Tax Commission on or before the fifteenth day of the third month next after the preceding income year. In case of sickness, absence or other disability, or whenever in its judgment good cause exists, the Tax Commission may allow further time for filing returns. There shall be annexed to the return the affidavit or affirmation of the taxpayer making the return, to the effect that the statements contained therein are true. The Tax Commission shall cause to be prepared blank forms for the said returns to be furnished upon application, but failure to receive or secure the form shall not relieve any taxpayer from the obligation of making the return.

§ 21. **Failure to file returns—Supplementary returns.**—If the Tax Commission shall be of the opinion that any taxpayer has failed to file a return, or to include in a return filed, either intentionally or through error, items of taxable income, it may require from such taxpayer a return, or a supplementary return, under oath, in such form as it shall prescribe, of all items of income which the taxpayer received during the year for which the return is made, whether or not taxable under the provisions of this Act. If from a supplementary return or otherwise, the Tax Commission finds that any items of income taxable under this Act have been omitted from the original return, it may require the items so omitted to be disclosed to it, under oath of the taxpayer, and to be added to the original return. Such supplementary return and the correction of the original return shall not relieve the taxpayer from any of the penalties to which he may be liable under any provision of this Act. The Tax Commission may proceed under the provisions of Section 502 of this Act whether or not it requires a return or a supplementary return under this Section.

§ 22. **Article V—Collection and enforcement of tax—Time and place of payment of tax.**—(1) The full amount of the tax payable, as the same shall appear from the face of the return, shall be paid to the Tax Commission at the office where the return is filed, at the time fixed by law for filing the return. If the time for filing the return shall be extended, interest at the rate of six per

cent per annum, from the time when the return was originally required to be filed, to the time of payment, shall be added and paid.

(2) The Tax may be paid with uncertified check, during such time and under such regulations as the Tax Commission shall prescribe, but if a check so received is not paid by the bank on which it is drawn, the taxpayer by whom such check is tendered shall remain liable for the payment of the tax and for all legal penalties, the same as if such check had not been tendered.

§ 23. Examination of returns.—(1) As soon as practicable after the return is filed, the Tax Commission shall examine it and compute the tax, and the amount so computed by the Tax Commission shall be the tax. If the tax found due shall be greater than the amount heretofore paid, the excess shall be paid to the Tax Commission within ten days after notice of the amount shall be mailed by the Tax Commission.

(2) If the return is made in good faith and the understatement of the tax is not due to any fault of the taxpayer, there shall be no penalty or additional tax added because of such understatement, but interest shall be added to the amount of the deficiency at the rate of one per cent for each month or fraction of a month.

(3) If the understatement is due to negligence on the part of the taxpayer, but without intent to defraud, there shall be added to the amount of the deficiency five per cent thereof, and in addition interest at the rate of one per cent per month or fraction of a month.

(4) If the understatement is false or fraudulent, with intent to evade the tax, the tax on the additional income discovered to be taxable shall be doubled and one per cent per month or fraction of a month on such doubled shall be added.

(5) The interest provided for in this section shall in all cases be computed from the date the tax was orignally due to the date of payment.

(6) If the amount of tax found due as computed shall be less than the amount theretofore paid, the excess shall be ordered refunded by the Tax Commission.

§ 24. Additional Taxes.—If the Tax Commission discovers from the examination of the return or otherwise that the income of any taxpayer, or any portion thereof, has been assessed, it may, at

any time within five years after the time when the return was due, assess the same and give notice to the taxpayer of such assessment, and such taxpayer shall thereupon have an opportunity, within thirty days, to confer with the Tax Commission as to the proposed assessment. The limitation of five years to the assessment of such tax or additional tax shall not apply to the assessment of additional taxes upon fraudulent returns. After the expiration of thirty days from such notification the Tax Commission shall assess the income of such taxpayer or any portion thereof which it believes has not heretofore been assessed and shall give notice to the taxpayer so assessed, of the amount of the tax and interest and penalties if any, and the amount thereof shall be due and payable within ten days from the date of such notice. The provisions of this Act with respect to revision and appeal shall apply to a tax assessed. No additional tax amounting to less than fifty cents shall be assessed, and no refunds for less than fifty cents shall be made.

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§ 25. **Warrant for the collection of taxes.**—If any tax imposed by this Act or any portion of such tax be not paid within sixty days after the same becomes due, the Tax Commission shall issue a warrant under its hand and official seal directed to the Sheriff of any county of the State, commanding him to levy upon and sell the real and personal property of the taxpayer found within his county for the payment of the amount thereof, with the added penalties, interest and the cost of executing the warrant, and to return such warrant to the Tax Commission and to pay to it the money collected by virtue thereof by a time to be therein specified, not more than sixty days after the receipt of the warrant, and to file with the Clerk of Court of his county a copy thereof, and thereupon the clerk of the court shall enter in the judgment docket, in the column for judgment debtors, the name of the taxpayer mentioned in the warrant, and in appropriate columns the amount of the tax or portion thereof and penalties for which the warrant is issued and the date when such copy is filed, and thereupon the amount of such warrant so docketed shall become a lien upon the title to an interest in real property or chattels real of the taxpayer against whom it is issued in the same manner as a judgment duly docketed in the office of said clerk. The said Sheriff shall thereupon proceed upon the same in all respects with like effect, and in the same manner prescribed by law in respect to executions issued against property upon judgments of a court of record, and shall be entitled to

the same fees for his services in executing the warrant, to be collected in the same manner. If a warrant be returned not satisfied in full, the Tax Commission shall have the same remedies to enforce the claim for taxes against the taxpayer as if the people of the State had recovered judgment against the taxpayer for the amount of the tax.

§ 26. **Tax a debt.**—Every tax imposed by this Act, and all increases, interest, and penalties thereon, shall become from the time it is due and payable, a personal debt, from the person or persons liable to pay the same, to the State of South Carolina.

§ 27. **Action for recovery of taxes.**—Action may be brought at any time by the Attorney-General of the State, in the name of the State, to recover the amount of any taxes, penalties, and interest due under this Act.

§ 28. **Tax upon settlement of fiduciary's account.**—(1) No final account of a fiduciary shall be allowed by the probate court unless such account shows, and the judge of said court finds, that all taxes imposed by the provisions of this Act upon said fiduciary, which have become payable, have been paid, and that all taxes which may become due are secured by bond, deposit or otherwise. The certificate of the Tax Commission and the receipt for the amount of the tax therein certified shall be conclusive as to the payment of the tax, to the extent of said certificate.

(2) For the purpose of facilitating the settlement and distribution of estates held by fiduciaries, the Tax Commission, with the approval of the Attorney-General, may, on behalf of the State agree upon the amount of taxes at any time due or to become due from such fiduciaries under the provisions of this Act, and payment in accorance with such agreement shall be full satisfaction of the taxes to which the agreement relates.

§ 29. **Article VI—Penalties.**—1. If any taxpayer, without intent to evade any tax imposed by this Act, shall fail to file a return of income or to pay a tax, if one is due, at the time required by or under the provisions of this Act, but shall voluntarily file a correct return of income and pay the tax due, there shall be added to the tax an additional amount equal to five per cent thereof, and an additional one per cent for each month or fraction of a month during which the tax remains unpaid.

(2) If any taxpayer fails voluntarily to file a return of income or to pay a tax, if one is due, within sixty days of the time required by or under the provisions of this Act, the tax shall be increased by twenty-five per cent.

(3) The Tax Commission shall have power, upon making a record of its reason therefor, to waive or reduce any of the additional taxes or interest provided in subdivisions (1) and (2), (5) and (6) of this section, or in subdivisions (2), (3) and (4) of Section 23.

(4) If any taxpayer fails to file a return within sixty days of the time prescribed by this Act, or judge of the Circuit Court, upon petition of the Tax Commission, shall issue a writ of mandamus requiring such person to file a return. The order of notice upon the petition shall be returnable not later than ten days after the filing of the petition. The petition shall be heard and determined on the return day or on such day thereafter as the court shall fix, having regard to the speediest possible determination of the case, consistent with the rights of the parties. The judgment shall include costs in favor of the prevailing party. All writs and processes may be issued from the clerk's office in any county, and except as aforesaid, shall be returnable as the court shall order.

(5) Any person who, without fraudulent intent, fails to pay any tax or to make, render, sign or verify any return, or to supply any information, within the time required by or under the provisions of this Act, shall be liable to a penalty of not more than $1,000.00, to be recovered by the Attorney-General, in the name of the people, by action in any court of competent jurisdiction.

(6) Any person or any officer or employee of any corporation or member or employee of any partnership, who, with intent to evade any requirement of this Act, or any lawful requirements of the Tax Commission thereunder, shall fail to pay any tax or to make, sign or verify any return or to supply any information required by or under the provisions of this Act, or who, with like intent, shall make, render, sign or verify any false or fraudulent return or statement, or shall supply any false or fraudulent information, shall be liable to a penalty of not less than $500.00 or more than $500.00 to be recovered by the Attorney-General in the name of the people, by action of any court of competent jurisdiction, and shall also be guilty of a misdemeanor and shall upon conviction, be fined not to exceed

$5,000.00 or be imprisoned not to exceed five years or both, at the discretion of the court.

(7) The Tax Commission may compromise any civil or criminal case arising under the provisions of this Act instead of commencing suit thereon, and may compromise any such case with the consent of the Attorney-General after suit thereon has been commenced. Where any case is compromised the Tax Commission shall keep on file in the office of the Tax Commission reasons for settlement of any case by compromise, together with a statement of the amount of tax assessed, the amount of additional tax or penalty or interest imposed by law in consequence of the neglect or delinquency of the person against whom the tax is assessed, and the amount actually paid in accordance with the terms of the compromise.

(8) The failure to do any act required by or under the provisions of this Act shall be deemed an act committed in part at the office of the Tax Commission in Columbia, South Carolina. The certificate of the Tax Commission to the effect that a tax has not been paid, that a return has not been filed, or that information has not been supplied as required by or under the provisions of this Act, shall be *prima facie* evidence that such tax has not been paid, that such return has not been filed and that such information has not been supplied.

(9) If any taxpayer who has failed to file a return or has filed an incorrect or insufficient return, and has been notified by the Tax Commission of his delinquency, refuses or neglects within twenty days after such notice to file a proper return, or files a fraudulent return, the Tax Commission shall determine the income of such taxpayer according to its best information and belief and assess the same at not more than double the amount so determined. The Tax Commission may in its discretion allow further time for the filing of a return in such case.

§ 30. Article VII—Revision remedies and proceedings for relief of taxpayers—Revision by Tax Commission.—A taxpayer may apply to the Tax Commission for revision of the tax assessed against him, at any time within one year from the time of the filing of the return, or from the date of the notice of the assessment of any additional tax. The Tax Commission shall grant a hearing thereon and if upon such hearing, it shall determine that the tax is excessive or incorrect, it shall re-settle the same accordingly.

The Tax Commission shall notify the taxpayer of its determination and shall refund to the taxpayer the amount, if any, paid in excess of the tax found by it to be due.

§ **31.** The collection of income taxes as provided in this Act or in prior Acts, shall not be stayed or prevented by any injunction, writ or order issued by any court or judge thereon; and no writ, order or process of any kind whatsoever staying or preventing the South Carolina Tax Commission from taking any step or proceeding in the assessment or collection of any income tax whether such tax is legally due or not in any case be granted by any court or the judge of any court; but in all cases whatsoever the person against whom any income tax shall stand charged by the South Carolina Tax Commission shall be required to pay the same in such funds and moneys as the said South Carolina Tax Commission shall be authorized to receive by any Act of the General Assembly, and thereupon shall have his remedy as is hereinafter provided.

§ **32.** In all cases in which any income taxes are now or shall be hereafter charged by the South Carolina Tax Commission against any person, and the South Carolina Tax Commission shall claim the payment of the taxes so charged, or shall take any step or proceeding to collect the same, the person against whom such taxes are charged, or against whom such steps or proceedings shall be taken, shall, if he conceives the same to be unjust or illegal for any cause, pay the said taxes, which shall include the penalties, notwithstanding, under protest in writing in such funds and moneys as the said South Carolina Tax Commission shall be authorized to receive; and upon such payment being made the South Carolina Tax Commission shall pay the taxes, and penalties, if any, so collected into the State Treasury as now provided by law giving notice at the time to the State Treasurer that the payment was made under protest; and the person so paying said taxes may at any time within thirty days after making such payment, but not afterwards, bring an action against the South Carolina Tax Commission for the recovery thereof in the Court of Common Pleas for any county having jurisdiction; and if it be determined in said action that such taxes, and penalties if any, were wrongfully or illegally collected, for any reason going to the merits, then the court before whom the case is tried shall certify of record that the same were wrongfully collected and ought to be refunded, and thereupon the South Carolina Tax Commission shall issue its order to the State Treasurer to refund the said taxes, and

penalties if any, so paid in conformity with the order of the court, which shall be paid in preference to other claims against the State Treasury; there shall be no other remedy in any case of the illegal or wrongful collection of income taxes or attempt to collect such taxes than that provided in this Act.

§ 33. Article VIII—Administration—Tax Commission to Administer this Act.—The Tax Commission shall administer and enforce the tax herein imposed.

§ 34. Power of Tax Commission.—The Tax Commission for the purpose of ascertaining the correctness of any return or for the purpose of making an estimate of the taxable income of any taxpayer, shall have power to examine or cause to be examined by any agent or representative designated by it for that purpose, any books, papers, records or memoranda, bearing upon the matters required to be included in the return. Where any person who is required to make a return under this Act fails so to do at the time required, or delivers any return which, in the opinion of the Tax Commission is erroneous or refuses to allow any regularly authorized agent of the Tax Commission to examine his books and records, it shall be lawful for the Tax Commission to summons such person or any other person having possession, care or custody of books of account containing entries relating to the business of such person, or any other person it may deem proper to appear before the Tax Commission and to produce such books at a time and place named in the summons and to give testimony and answer questions under oath, respecting any object of income liable to tax on the return thereof; such summons shall in all cases be served by an authorized agent of the Tax Commission by an attested copy delivered to such person in hand, or left at his last or usual place of abode allowing such person one day for each twenty-five miles he may be required to travel computed from the place of service to the place of examination; when the summons requires the production of books and returns, it shall be sufficient if such books are described with reasonable certainty; and whenever any person summoned under the provisions of this section, neglects or refuses to obey such summons as required, the Tax Commission may apply to any Circuit Judge of the South Carolina Circuit Court for an attachment against him for contempt. It shall be the duty of such Judge to hear the application and if satisfactory proof is made, to issue an attachment directed to the Sheriff of the county in which the person resides for the arrest of

such person and upon his being brought before him to proceed to a hearing of the case, and upon such hearing the Judge shall have power to make such order as he shall deem proper not inconsistent with existing laws for the punishment of contempt to enforce obedience to the requirements of the summons and to punish such person for his default or disobedience.

§ 35. **Officers, Agents and Employees.**—(1) The Tax Commission may appoint and remove a person to be known as the Income Tax Director who, under its direction, shall have the supervision and control of the assessment and collection of the income taxes provided in this Act; the Tax Commission may also appoint such other officers, agents, deputies, clerks and employees as it may deem necessary, such persons to have such duties and powers as the Tax Commission may from time to time prescribe.

(2) The salaries of all officers, agents and employees employed by the Tax Commission shall be such as it may prescribe, not to exceed such amounts as may be appropriated therefor by the Legislature, and the members of the Tax Commission and such officers, agents and employees shall be allowed such reasonable and necessary traveling and other expenses as may be incurred in the performance of their duties, not to exceed the amount appropriated therefor by the Legislature.

(3) The Tax Commission may require such of the officers, agents and employees as it may designate, to give bond for the faithful performance of their duties in such sum and with such sureties as it may determine, and all premiums on such bonds shall be paid by the Tax Commission out of monies appropriated for the purpose of this Act.

§ 36. **Oaths and acknowledgment.**—The members of the Tax Commission and such officers as it may designate, shall have the power to administer an oath to any person or to take the acknowledgment of any person in respect of any return or report required by this Act, or the rules and regulations of the Tax Commission.

§ 37. **Publication of statistics.**—The Tax Commission shall prepare and publish annually statistics reasonably available with respect to the operation of this Act, including amounts collected, classifications of taxpayers, and such other facts as are deemed pertinent and valuable.

§ 38. Secrecy required of officials, penalty for violation.—(1) Except in accordance with proper judicial order or as otherwise provided by law, it shall be unlawful for the members of the Tax Commission, any deputy, agent, clerk or other officer or employee, to divulge or make known in any manner the amount of income or any particulars set forth or disclosed in any report or return required under this Act. Nothing herein shall be construed to prohibit the publication of statistics, so classified as to prevent the identification of particular reports or returns and the items thereof, or the inspection by the Attorney-General or other legal representative of the State, of the report or return of any taxpayer who shall bring action to set aside or review the tax based thereon, or against whom an action or proceeding has been instituted to recover any tax or any penalty imposed by this Act. Reports and returns shall be preserved for five years and thereafter, until the Tax Commission orders them to be destroyed.

(2) Any offense against subdivision one of this section shall be punished by a fine of not exceeding One Thousand ($1,000.00) Dollars or by imprisonment not exceeding one year, or both, at the discretion of the Court, and if the offender be an officer or employee of the State, he shall be dismissed from office and be incapable of holding any public office in this State for a period of five years thereafter.

(3) Notwithstanding the provisions of this section, the Tax Commission may permit the Commissioner of Internal Revenue of the United States, or the proper officer of any State imposing an income tax similar to that imposed by this Act, or the authorized representative of either such officer, to inspect the income tax returns of any taxpayer, or may furnish to such officer or his authorized representative an abstract of the return of income of any taxpayer or supply him with information concerning any item of income contained in any return, or disclosed by the report of any investigation of the income or return of income of any taxpayer; but such permission shall be granted or such information furnished to such officer or his representative, only if the statutes of the United States or of such other State, as the case may be, grant substantially similar privileges to the proper officer of this State charged with the administration of this Act.

§ 39. Regulations.—The Tax Commission may, from time to time, make such rules and regulations, not inconsistent with this

Act, as it may deem necessary to enforce its provisions, and the same shall have full force and effect of law.

§ 40. **Article IX—Miscellaneous—Distribution of the Tax.**—The Tax Commission shall pay to the State Treasurer on or before the twenty-fifth day of each month, to the credit of the general fund, all taxes, interest, and penalties collected under this Act during the preceding calendar month as appears from lists made and returns filed. Said payment shall be made by check drawn in favor of the State Treasurer, and signed by the Director of the Income Tax Division and countersigned by the Chairman of the Tax Commission or by the two other members of the Tax Commission.

§ 41. **Unconstitutionality or invalidity.**—If any clause, sentence, paragraph or part of this Act shall, for any reason, be adjudged by any court of competent jurisdiction to be invalid, such judgment shall not affect, impair, or invalidate the remainder of this Act, but shall be confirmed in its operation to the clause, sentence, paragraph or part thereof directly involved in the controversy in which such judgment shall have been rendered. No caption of any section or set of sections shall in any way affect the interpretation of this Act or any part thereof.

§ 42. That on the passage of this Act, the Income Tax Act approved the 13th day of March, 1922, as amended, is repealed to take effect January 1st, 1925.

§ 43. That the Income Tax Act of 1922, and amendments thereto, which is repealed by this Act shall remain in force for the assessment and collection of all taxes which have accrued or may accrue under the Income Tax Act of 1922, and amendments thereto, and for the imposition of all penalties and interests which have accrued or may accrue in relation to said Act.

§ 43-A. That the South Carolina Tax Commission shall use as far as possible and practicable for filing returns for income tax, blanks as used by the United States down to the net income part of said blanks.

§ 44. **Taking effect of the Act.**—This Act shall take effect on January 1st, 1926.

Approved the 12th day of October, A. D. 1926.

Exhibit D

Acts and Joint Resolutions

OF THE

GENERAL ASSEMBLY

OF THE

State of South Carolina

REGULAR SESSION OF 1937

First Part of Fortieth Volume of Statutes at Large

PRINTED UNDER DIRECTION OF
JOINT COMMITTEE ON PRINTING
GENERAL ASSEMBLY OF SOUTH CAROLINA

(619)

No. 349.

AN ACT to Raise Revenue for the Support of the State Government by the Levy and Collection of a Tax Upon the Income of Banks in Lieu of All Other Taxes Except Taxes on Real Property.

Section 1. "Banks and taxpayers" defined.—Be it enacted by the General Assembly of the State of South Carolina: For the purpose of this Act and unless otherwise required by the context, the words "banks and taxpayers," wherever used in this Act, shall mean any person, firm or corporation, engaged in a banking business whether incorporated under the laws of this State, any other State, or the United States, or whether unincorporated except cash depositories.

§ 2. Tax on banks.—A tax is hereby imposed upon every bank engaged in business in the State of South Carolina, which tax shall be levied, collected and paid annually, with respect to the entire net income of the taxpayer doing a banking business within this State, or from the sales or rentals of property within this State, computed at the following rate:

Four and one-half (4½%) per centum of the entire net income of such bank or taxpayer.

§ 3. In lieu of other taxes except taxes on real property.—The income taxes herein provided shall be in lieu of all other taxes, except taxes on real property. The real property of any such bank, or banking association, shall be taxed in the place where the same may be located, the same as the real property of individuals.

§ 4. Enforcement—administration.—That for the purpose of administration, enforcement, collection, liens, penalties, and other provisions of enforcement, all of the provisions of Sections 2435-2479, inclusive, Code of Laws of South Carolina, 1932, that may be appropriate or applicable are hereby adopted and made a part of this Section for the enforcement and administration of this Act.

§ 5. Invalidity.—In case the first provision (contained in the first sentence) of Section 3 hereof should for any reason be declared to be invalid by a Court of competent jurisdiction, then and in that event, the taxes provided in Section 2663-2667, inclusive, Code of Laws of South Carolina, shall be and remain in full force and effect, and the income tax provided herein shall not be effective.

§ 6. **Payment of tax—distribution.**—The taxes herein provided for shall be paid to South Carolina Tax Commission as is provided in Section Four (4) of this Act and the income taxes paid under the provisions of this Act shall be distributed between the general fund of the State, the County and Municipality in which the bank is located as follows:

Ten (10) per cent to the general fund of the State

Sixty (60) per cent to the County

Thirty (30) per cent to the Municipality in which the Bank is located.

The Tax Commission is authorized and directed to draw warrants on the State Treasurer for such distribution on or before May 15 of each year and the State Treasurer is authorized and directed to honor said warrants.

For the purpose of and in the distribution of the taxes paid under this Act by a bank having one or more branches, each branch of the bank shall be deemed to have paid such portion of the entire tax as its deposits on January 1st of each taxable year bear to the total of the deposits of all branches and the tax distributed accordingly.

§ 7. **Repeal.**—All Acts or parts of Acts inconsistent with this Act are hereby repealed except as hereinabove provided.

§ 8. **Time effective.**—This Act shall take effect immediately upon its approval by the Governor and shall be retroactive so as to apply during the year 1937.

Approved the 19th day of May, 1937.

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(623) No. 350.

AN ACT Abolishing the Governing Board (Advisory Board) and Devolving All the Powers, Duties, Responsibilities and Functions Thereof on the Supervisor of Union County, Abolishing the Salaries of Members of Governing Board (Advisory Board) of Union County, and Making It Unlawful for the Supervisor to Issue Vouchers in Payment of the Same After July 1st, 1937, and Making It Unlawful for the Treasurer of Union County to Honor and/or Pay the Same After July 1st, 1937, with the Exception of Salaries Aforesaid Members of Governing Board (Advisory Board) Earned Prior to July 1st, 1937.

Exhibit E

CHAPTER 5.

INCOME TAX ACT OF 1926.*

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ARTICLE 1.

General Provisions.

§ 65-201. Short title.

This chapter shall be known and may be cited as the "Income Tax Act of 1926."

1942 Code § 2435; 1932 Code § 2435; 1927 (35) 1.

Editor's note.—The first Income Tax Law of South Carolina was approved March 13th, 1922. It appeared in 32 Statutes at Large, p. 896, and was known and referred to as the Income Tax Act of 1922. It did not appear in the Code of 1922 for the reason that the Act of the Legislature under which that publication was published,

provided that the Code should contain only the general statutory laws in force up to and inclusive of the year 1921.

The present chapter, known as the Income Tax Act, is in many respects materially different from the Act of 1922. The cases decided under the 1922 Act were, in many instances based upon provisions which are no longer found in the Code. These cases have, however, been placed under those sections of this chapter which appear to resemble closely the section of the 1922 Act, but which were omitted.

Constitutionality of Income Tax Act.—Santee Mills v. Query, 122 S. C. 158, 115 S. E. 202 (1922); Southern Ry. Co. v. Query, 21 F. (2d) 333 (1927).

§ 65-202. Definitions.

For the purposes of this chapter, unless otherwise required by the context:

(1) The word *"taxpayer"* means any individual, fiduciary or corporation subject to the tax imposed by this chapter;

(2) The word *"fiduciary"* means a guardian, trustee, executor, administrator, receiver, conservator, or any person, whether individual or corporate, acting in any fiduciary capacity for any person, estate or trust;

(3) The word *"person"* includes individuals, fiduciaries, partnerships and corporations;

(4) The word *"corporation"* includes joint-stock companies or associations and insurance companies;

(5) The word *"business"* includes trade, profession, occupation or employment;

(6) The words *"tangible property"* mean real property and corporeal personal property and do not mean money, bank deposits, shares of stock, bonds, credits, evidences of debt, choses in action or evidences of an interest in property;

(7) The words *"intangible property"* mean all property other than tangible property;

(8) The words *"income year"* means the calendar year or the fiscal year upon the basis of which the net income is computed under this chapter; if no fiscal year has been established they mean the calendar year;

(9) The words *"fiscal year"* mean an income year ending on the last day of any month other than December;

(10) The word *"paid"* for the purpose of the deductions under this chapter means *"paid or accrued"* or *"paid or incurred"* and the words *"paid or accrued," "paid or incurred"* and *"incurred"* shall be construed according to the method of accounting upon the basis of which the net income is computed under this chapter;

(11) The word *"received"* for the purpose of the computation of net income under this chapter means *"received or accrued"* and the words *"received and accrued"* shall be construed according to the method of accounting upon the basis of which the net income is computed under this chapter; and

(12) The words *"foreign corporation"* mean any corporation other than a domestic corporation.

1942 Code § 2436; 1932 Code § 2436; 1927 (35) 1.

Income is to be taken in its ordinary sense of gain or profit. Southern Weaving Co. v. Query, 206 S. C. 307, 34 S. E. (2d) 51 (1945).

Applied in Read Phosphate Co. v. South Carolina Tax Comm., 169 S. C. 314, 168 S. E. 722 (1933); Gable v. South Carolina Tax Comm., 189 S. C. 346, 1 S. E. (2d) 244 (1939); Hadden v. South Carolina Tax Comm., 183 S. C. 38, 190 S. E. 249 (1937).

§ 65-203. Tax Commission to administer chapter.

The Commission shall administer and enforce the taxes imposed by this chapter.

1942 Code § 2470; 1932 Code § 2470; 1927 (35) 1.

§ 65-204. Income Tax Director and other employees.

The Commission may appoint and remove a person to be known as the Income Tax Director who, under its direction, shall have the supervision and control of the assessment and collection of the income taxes provided in this chapter. The Commission may also appoint such other officers, agents, deputies, clerks and employees as it may deem necessary to carry out the provisions of this chapter, such persons to have such duties and powers as the Commission may from time to time prescribe.

1942 Code § 2472; 1932 Code § 2472; 1927 (35) 1.

§ 65-205. Salaries of employees.

The salaries of all officers, agents and employees employed by the Commission to carry out the provisions of this chapter shall be such as it may prescribe, not to exceed such amounts as may be appropriated therefor by the General Assembly, and the members of the Commission and such officers, agents and employees shall be allowed such reasonable and necessary travelling and other expenses as may be incurred in the performance of their duties under this chapter, not to exceed the amount appropriated therefor by the General Assembly.

1942 Code § 2472; 1932 Code § 2472; 1927 (35) 1.

§ 65-206. Bonds of employees.

The Commission may require such of its officers, agents and employees employed to carry out the provisions of this chapter as it may designate to give bond for the faithful performance of their duties in such sum and with such sureties as it may determine and all premiums on such bonds shall be paid by the Commission out of moneys appropriated for the purpose of this chapter.

1942 Code § 2472; 1932 Code § 2472; 1927 (35) 1.

§ 65-207. Regulations.

The Commission may, from time to time, make such rules and regulations, not inconsistent with this chapter, as it may deem necessary to enforce its provisions and such rules and regulations shall have full force and effect of law.

1942 Code § 2476; 1932 Code § 2476; 1927 (35) 1.

§ 65-208. Publication of statistics.

The Commission shall prepare and publish annually statistics reasonably available with respect to the operation of this chapter, including amounts col-

lected, classifications of taxpayers and such other facts as are deemed pertinent and valuable.

1942 Code § 2474; 1932 Code § 2474; 1927 (35) 1.

ARTICLE 2.

Imposition of Tax; Exemptions and Exempt Organizations.

§ 65-221. Imposition of the tax on individuals.

A tax is imposed upon every individual residing in the State, including officers and employees of the State and all subdivisions thereof, which shall be levied, collected and paid annually with respect to the entire net income of the taxpayer, and upon income earned within the jurisdiction of this State of every nonresident having a business or agency in the State or from the sale or rental of or income from property within this State, computed at the following rates, after deducting the exemptions provided by this chapter:

On the excess over the amount legally exempted up to two thousand dollars, two per cent;

On the excess above two thousand dollars and up to four thousand dollars, three per cent;

On the excess above four thousand dollars and up to six thousand dollars, four per cent;

On the excess above six thousand dollars, five per cent.

1942 Code §§ 2437, 2438; 1932 Code §§ 2437, 2438; 1926 (34) 1050; 1927 (35) 1; 1930 (36) 1339; 1933 (38) 572; 1946 (44) 1491.

The word "residing" refers to legal residence in this State, which is equivalent to domicile. Phillips v. South Carolina Tax Comm., 195 S. C. 472, 12 S. E. (2d) 13 (1940).

Double taxation.—The provisions of this section indicate the legislative intent against the principle of double taxation, that is, taxation on the same income by more than one state. Phillips v. South Carolina Tax Comm., 195 S. C. 472, 12 S. E. (2d) 13 (1940).

For additional related case, see Alderman v. Wells, 85 S. C. 507, 67 SE 781 (1910).

Cited in Cooley v. South Carolina Tax Comm., 204 S. C. 10, 28 S. E. (2d) 445 (1943).

§ 65-222. Tax on corporations.

Every corporation organized under the laws of this State shall make a return and shall pay annually an income tax equivalent to four and one-half per cent of the entire net income of such corporation received by such corporation during the income tax year and, except as otherwise provided, every foreign corporation doing business or having an income within the jurisdiction of this State shall make a return and shall pay annually an income tax equivalent to four and one-half per cent of a proportion of its entire net income to be determined as provided in this chapter; *provided*, that the amount of such tax shall not be less than would be produced by applying a rate of three per cent to a base consisting of the entire net income plus salaries and other compensation paid to all elective and appointed officers and to any stockholder owning in excess of five per cent of the issued capital stock of the corporation,

after deducting from the base six thousand dollars and any deficit reported for the year.

1946 (44) 1491.

§ 65-223. Tax on fiduciaries.

The tax imposed by this chapter shall be imposed upon resident fiduciaries and upon nonresident fiduciaries having in charge funds or property for the benefit of a resident of this State and shall be levied, collected and paid annually with respect to:

(1) That part of the net income of estates or trusts which has not been distributed;

(2) The net income received during the income year by deceased individuals who at the time of death were residents and who have died during the tax year or income year without having made a return; and

(3) The entire net income of resident insolvent or incompetent individuals, whether or not any portion thereof is held for the future use of the beneficiaries, when the fiduciary has complete charge of such net income.

The tax imposed upon a fiduciary by this chapter shall be a charge against the estate or trust.

1942 Code § 2440; 1932 Code § 2440; 1927 (35) 1, 362; 1930 (36) 1339, 1393.

Cross reference.—As to nonresidents, see §§ 65-231 to 65-241.

Income tax is a personal liability.—The State income tax is in the nature of a subjective tax imposing personal liability on the recipient of income. Crescent Mfg. Co. v. South Carolina Tax Comm., 129 S. C. 480, 124 S. E. 761 (1924).

The fundamental theory underlying the income tax laws is that all residents and citizens of the State should contribute to the public treasury in proportion to ability to pay, measured by the amount of net income from all sources. Crescent Mfg. Co. v. South Carolina Tax Comm., 129 S. C. 480, 124 S. E. 761 (1924).

§ 65-224. Liability of partners.

An individual carrying on business in partnership shall be liable for income tax only in his individual capacity and shall include in his gross income his distributive share of the net income of the partnership for each income year, whether distributed or not.

1942 Code § 2445; 1932 Code § 2445; 1927 (35) 1.

§ 65-225. Exemptions.

There shall be deducted from net income the following exemptions:

(1) In the case of a single individual, a personal exemption of one thousand dollars;

(2) In the case of a married individual living with husband or wife or the head of a household, two thousand dollars;

(3) If a husband and wife living together make separate income tax returns, the personal exemption of two thousand dollars may be taken by either or divided between them, but in no case shall a husband and wife living together receive more than one personal exemption;

(4) If a husband and wife are legally separated each shall be entitled to the exemption allowed a single person;

(5) Four hundred dollars for each individual other than husband or wife dependent upon and receiving his chief support from the taxpayer if such dependent individual is under twenty-one years of age or is incapable of self support because mentally or physical defective;

(6) In the case of a fiduciary (a) if taxable under item (1) of § 65-223, a personal exemption of one thousand dollars, (b) if taxable under item (2) of said section, the same exemption as would be allowed the deceased if living and (c) if taxable under item (3) of said section, the same exemptions to which the beneficiary would be entitled; *provided,* that if the income is held in the estate undistributed the exemption shall be one thousand dollars.

1942 Code § 2441; 1932 Code § 2441; 1927 (35) 1, 217; 1930 (36) 1339; 1933 (38) 572; 1951 (47) 546.

§ 65-225.1. Exemptions for persons in military service.

In computing the income tax of persons who are engaged in the military service of the United States, the Commission shall allow the same exemptions as are allowed by the Federal Government in computing Federal income taxes.

1945 (44) 502.

§ 65-226. Organizations that are exempt.

The following organizations shall be exempt from taxation under this chapter:

(1) Fraternal beneficiary societies, orders or associations (a) operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system and (b) providing for the payment of life, sick, accident or other benefits to the members of such society, order or association or their dependents;

(2) Building and loan associations and cooperative banks without capital stock, organized and operated for mutual purposes and without profits, and insurance companies;

(3) Cemetery corporations and corporations organized for religious, charitable, scientific or educational purposes or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual;

(4) Business leagues, chambers of commerce or boards of trade, not organized for profit and no part of the net earnings of which inures to the benefit of any private stockholder or individual;

(5) Civic leagues or organizations not organized for profit, but operated exclusively for the promotion of social welfare;

(6) Farmers' or other mutual hail, cyclone or fire insurance companies, mutual ditch or irrigation companies, mutual or cooperative telephone companies or like organizations of a purely local character, the income of which consists solely of assessments, dues and fees collected from members for the sole purpose of meeting expenses;

(7) Farmers', fruit growers' or like organizations, organized and operated as sales agents for the purpose of marketing the products of members and

turning back to them the proceeds of sales, less the necessary selling expenses, on the basis of the quantity of produce furnished by them; and

(8) Labor, agricultural or horticultural organizations no part of the net earnings of which inures to the benefit of any private stockholder or member.

1942 Code § 2442; 1932 Code § 2442; 1927 (35) 1.

ARTICLE 3.

Nonresidents.

§ 65-231. Nonresidents carrying on entire business in State.

If the entire trade or business of a nonresident individual or foreign corporation is carried on in the jurisdiction of this State the tax imposed by this chapter shall be computed upon the entire net income of such nonresident individual or foreign corporation.

1942 Code § 2451; 1932 Code § 2451; 1927 (35) 1; 1932 (37) 1306; 1946 (44) 1491.

Applied in United States Rubber Products v. South Carolina Tax Comm., 189 S. C. 386, 1 S. E. (2d) 153 (1939).

§ 65-232. Nonresident manufacturing, etc., within State.

If the principal business of a nonresident individual or a foreign corporation in this State is manufacturing or if it is any form of collecting, buying, assembling or processing goods and materials within this State, such nonresident individual or foreign corporation shall make returns and pay annually an income tax upon a proportion of its entire net income computed on the basis of the arithmetical average of the following two ratios: (a) the ratio of the value of the real estate and tangible personal property in this State to the value of the entire real estate and tangible personal property, with no deductions on account of encumbrances thereon and (b) the ratio of the total cost of manufacturing, collecting, buying, assembling or processing within this State during the income year to the total cost of manufacturing, collecting, buying, assembling or processing within and without the State during such income year. The phrase "cost of manufacturing, collecting, buying, assembling or processing" as used in this section shall be interpreted in a manner to conform as nearly as may be to the best accounting practice in the trade or business and, unless in the opinion of the Commission the peculiar circumstances in any case justify a different basis, this phrase shall be generally interpreted to include as elements of cost within and without this State (a) the total cost of all goods, materials and supplies used in manufacturing, assembling or processing, regardless of where purchased; (b) the total wages and salaries paid or accrued during the income year in such manufacturing, assembling or processing activities and (c) the total overhead or manufacturing burden properly assignable according to good accounting practice to such manufacturing, assembling or processing activities but shall not include property, privilege, stamp or other taxes.

1942 Code § 2451; 1932 Code § 2451; 1927 (35) 1; 1932 (37) 1306; 1946 (44) 1491.

§ 65-233. Nonresident distributors, etc.

If the principal business of a nonresident individual or a foreign corporation in this State is selling, distributing or dealing in tangible personal property within this State such nonresident individual or foreign corporation shall make returns and pay annually an income tax upon a proportion of its entire net income computed upon the basis of the arithmetical average of (a) the ratio of the value of the real estate and tangible personal property in this State during the income year to the value of the total real estate and tangible property during the income year with no deductions on account of encumbrances thereon and (b) the ratio of the total sales made within this State during the income year which were principally secured, negotiated or effected by employees, agents, consignees, officers or branches of the taxpayer resident or located in the State to the total sales made everywhere during such income year.

1942 Code § 2451; 1932 Code § 2451; 1927 (35) 1; 1932 (37) 1306; 1946 (44) 1491.

§ 65-234. Other nonresidents.

If the principal profits or income of a nonresident individual or foreign corporation are derived from sources other than manufacturing, collecting, buying, assembling or processing or selling, distributing or dealing in tangible personal property such nonresident individual or foreign corporation shall make returns and pay annually an income tax upon a proportion of its entire net income computed on the basis of the ratio of gross receipts in this State during the income year to the total gross receipts for such year within and without the State.

1942 Code § 2451; 1932 Code § 2451; 1927 (35) 1; 1932 (37) 1306; 1946 (44) 1491.

§ 65-235. Sale of real estate by nonresident.

When a nonresident individual or foreign corporation has a gain or loss from the sale of real estate located within this State, the gain or loss arising from such sale shall be determined in accordance with the provisions of § 65-271 and the tax thereon shall be paid at the rate provided by this chapter.

1942 Code § 2451; 1932 Code § 2451; 1927 (35) 1; 1932 (37) 1306; 1946 (44) 1491.

§ 65-236. Definition of tangible property.

The term *"tangible property"* as used in this article includes only the property held or used to produce income which is derived from sources partly within and partly without the State.

1942 Code § 2451; 1932 Code § 2451; 1927 (35) 1; 1932 (37) 1306; 1946 (44) 1491.

§ 65-237. Valuation of tangible property.

Tangible property shall be taken at its actual value which, in the case of property valued or appraised for purpose of inventory, depreciation, depletion or other purposes, shall be the highest amount at which it has been so valued or appraised and which in other cases shall be deemed to be its book value without any deduction for depreciation, depletion or obsolescence in the absence of affirmative evidence showing such value to be greater or less than

the actual value. The average value during the taxable year or period shall be employed. The average value of property as above described at the beginning and end of the taxable year or period ordinarily may be used, unless by reason of material changes during the taxable year or period such average does not fairly represent the average for such year or period, in which event the average shall be determined upon a monthly or daily basis.

1942 Code § 2451; 1932 Code § 2451; 1927 (35) 1; 1932 (37) 1306; 1946 (44) 1491.

§ 65-238. Meaning of "entire net income" in case of apportionment.

When the property ratio provided by this article is involved, the phrase *"entire net income"* shall include only the entire net income from property held or used to produce income which is derived from sources partly within and partly without this State and for the purposes of apportionment under the provisions of this article no gain or loss from the sale of real property shall be included in the "entire net income" to be apportioned.

1942 Code § 2451; 1932 Code § 2451; 1927 (35) 1; 1932 (37) 1306; 1946 (44) 1491.

§ 65-239. Determining income on basis of nonresident's books.

When a nonresident individual or a foreign corporation maintains books of account and records in such manner as to clearly reflect the true net income accruing or arising from sources within this State the return may, with the approval of the Commission, be based upon such books of account or records and the tax paid upon the net income so determined. When the Commission finds the books of account and records sufficiently clear, in its opinion, to show the true net income arising from sources within this State it may require the return to be filed upon such basis and calculate the tax due upon the net income so determined.

1942 Code § 2451; 1932 Code § 2451; 1927 (35) 1; 1932 (37) 1306; 1946 (44) 1491.

§ 65-240. Limitations of deductions allowed nonresidents.

In the case of a nonresident individual the deductions allowed in §§ 65-259 and 65-264 shall be allowed only if, and to the extent that, they are connected with income arising from sources within the State and the proper apportionment and allocation of the deductions with respect to sources of income within and without this State shall be determined under rules and regulations prescribed by the Commission.

1942 Code § 2449; 1932 Code § 2449; 1927 (35) 1, 217; 1933 (38) 574; 1934 (38) 1413; 1936 (39) 1681.

§ 65-241. Credit to nonresidents for tax paid in home state.

Whenever a taxpayer other than a resident of the state has become liable to income tax to the state in which he resides upon his net income for the taxable year derived from sources within this State and subject to taxation under this chapter, the Commission shall credit the amount of income tax payable by him under this chapter with such proportion of the tax so payable by him to the state in which he resides as his income subject to taxation under this chapter bears to his entire income upon which the tax so payable

to such other state was imposed. But such credit shall be allowed only if the laws of such other state (a) grant a substantially similar credit to residents of this State subject to income tax under such laws or (b) impose a tax upon the personal income of its residents derived from sources in this State and exempt from taxation the personal income of residents of this State. No credit shall be allowed against the amount of the tax on any income taxable under this chapter which is exempt from taxation under the laws of such other state.

1942 Code § 2439; 1932 Code § 2439; 1930 (36) 1339.

ARTICLE 4.

Gross and Net Income; Deductions.

§ 65-251. Gross income defined.

The words *"gross income"* mean the income of a taxpayer derived from salaries, wages or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, business, commerce, sales or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property, and also from interest, rent, dividends, securities or the transaction of any business carried on for gain or profit and income derived from any source whatsoever. The amount of all such items shall be included in the gross income of the income year in which received by the taxpayer unless, under the methods of accounting permitted under this chapter, any such amounts are to be properly accounted for as of a different period.

1942 Code § 2444; 1932 Code § 2444; 1927 (35) 1.

§ 65-252. Income of beneficiaries of trusts.

Every individual taxable under this chapter who is a beneficiary of an estate or trust shall include in his gross income the distributive share of the net income of the estate or trust received by him or distributable to him during the income year. Unless otherwise provided in the law, will, deed or other instrument creating the estate, trust or fiduciary relation, the net income shall be deemed to be distributed to the beneficiaries (including the fiduciary as a beneficiary, in the case of income accumulated for future distribution) ratably in proportion to their respective interests.

1942 Code § 2445; 1932 Code § 2445; 1927 (35) 1.

§ 65-253. Items not included in gross income.

The words *"gross income"* do not include the following items which shall be exempt from taxation under this chapter:

(1) The proceeds of life insurance policies and contracts paid upon the death of the insured to individual beneficiaries or to the estate of the insurer;

(2) The amount received by the insured as a return of premium or premiums paid by him under life insurance, endowment or annuity contracts, either during the term or at the maturity of the term mentioned in the contract or upon surrender of the contract;

(3) The value of property acquired by gift, bequest, devise or descent (but the income from such property shall be included in gross income);

(4) Interest upon obligations of the United States or its possessions or of this State or any political subdivision thereof;

(5) The rental value of a dwelling house and appurtenances thereof furnished a minister of the Gospel as part of his compensation; and

(6) Any amounts received through accident or health insurance or under workmen's compensation acts, as compensation for personal injuries or sickness, plus the amount of any damage received whether by suit or agreement on account of such injuries or sickness.

1942 Code § 2444; 1932 Code § 2444; 1927 (35) 1; 1942 (42) 1855; 1943 (43) 88.

§ 65-254. Compensation for certain military service not included.

No part of the compensation received by the members of the South Carolina National Guard from the State or from the Federal Government or by members of the reserve components of the armed forces of the United States who are residents of this State from the Federal Government for services in performing their duties shall be considered as any part of the income, gross or net, of the respective members in computing income taxes payable to the State of South Carolina. But the provisions of this section shall not be applicable to income derived from tours of active military duty extending beyond the customary training periods established for national guard and reserve units.

1950 (46) 2499.

§ 65-255. Net income defined.

The words *"net income"* as used in this chapter mean the gross income of a taxpayer less the deductions allowed by this chapter.

1942 Code § 2443; 1932 Code § 2443; 1927 (35) 1.

§ 65-256. Net income of public service corporations.

The basis of ascertaining the net taxable income of every corporation engaged in the business of operating a steam or electric railroad, navigation company, waterworks company, light or gas company, power company, express service, telephone or telegraph business, sleeping car company or other form of public service, whether or not such company is required to keep records according to the standard classification of accounting of the Interstate Commerce Commission or the Federal Communications Commission, shall be the net operating income of such corporation computed in accordance with the present standard classification of accounts when their business is wholly within the jurisdiction of this State and, when their business is in part within and in part without the State, their net income within the jurisdiction of this State shall be ascertained by taking their gross operating revenues within this State, including in this gross operating revenues within the jurisdiction of this State the equal mileage proportion within the jurisdiction of this State of their interstate business, and deducting from their gross operating revenues the proportionate average of operating expenses or operating ratio for their whole business computed in accordance with

the present Interstate Commerce Commission or the Federal Communications Commission standard classification of accounts. From the net operating income thus ascertained shall be deducted uncollectible revenue and taxes paid in this State for the income year, other than income taxes, and the balance shall be deemed to be their net income taxable under this chapter.

1942 Code § 2440; 1932 Code § 2440; 1927 (35) 1, 362; 1930 (36) 1339, 1393; 1943 (43) 272.

The words "other form of public service" as used in this section must be construed to relate to and embrace only such corporations as are of a similar nature or perform services of a similar kind to the companies expressly enumerated in the statute. Cooper River Bridge v. South Carolina Tax Comm., 182 S. C. 72, 188 S. E. 508 (1936).

Bridge companies and tollgate companies are not public service corporations within the meaning of this section.—Cooper River Bridge v. South Carolina Tax Comm., 182 S. C. 72, 188 S. E. 508 (1936).

Income from interstate transactions.—Crescent Mfg. Co. v. South Carolina Tax Comm., 129 S. C. 480, 124 S. E. 761 (1924); Western Union Tel. Co. v. Query, 144 S. C. 234, 142 S. E. 509 (1927).

Net income.—Where all the stock and bonds of a South Carolina corporation were owned by a Virginia corporation and all the properties of both were leased to a third corporation at an annual rental, the lessee being obligated to make any interest payment which might be required, the South Carolina corporation's allotment of rental was actual net income within the meaning of this section and such corporation was not entitled to deduct therefrom interest on its bonded indebtedness which it had accrued on its books. Carolina, C. & O. Ry. v. South Carolina Tax Comm., 197 S. C. 529, 15 S. E. (2) 764 (1941).

A corporation may not escape its liabilities for income tax merely because it is subsidiary to a parent corporation of another state, which is hence the ultimate beneficiary of its income. Carolina, C. & O. Ry. v. South Carolina Tax Comm., 197 S. C. 529, 15 S. E. (2d) 764 (1941).

§ 65-257. Same; car hire of railroads considered.

In determining the taxable income of a corporation engaged in the business of operating a steam or electric railroad located entirely within the jurisdiction of this State the net income shall be increased or decreased to the extent of any credit balance received or paid, as the case may be, on account of car hire and when any such railroad is located partly within and partly without the jurisdiction of this State such net operating income shall be increased or decreased to the extent of an equal mileage proportion within the jurisdiction of this State of any credit or debit balance received or paid, as the case may be, on account of car hire.

1942 Code § 2440; 1932 Code § 2440; 1927 (35) 1, 362; 1930 (36) 1339, 1393.

Application of mileage proportion basis as to railroad.—Piedmont & N. Ry. Co. v. Query, 56 F. (2d) 172 (1932).

§ 65-258. Adjusted gross income defined for § 65-260.

For the purpose of § 65-260 *"adjusted gross income"* means gross income minus:

(1) Expenses attributable to a trade or business carried on by the taxpayer, except when the trade or business is the performance of services as an employee;

(2) Travel expenses incurred by the taxpayer in performing services as an employee if the amount reimbursed is included in gross income;

(3) Expenses attributable to rents and royalties;
(4) Expenses incurred in the sale or exchange of property; and
(5) Losses arising from the sale or exchange of property.
1951 (47) 546.

§ 65-259. Deductions.

In computing net income there shall be allowed as deductions:

(1) All the ordinary and necessary expenses paid or accrued (in case the books are kept on the accrual basis) during the income year in carrying on any trade or business, including:

(a) As to individuals, reasonable wages of employees for services actually rendered in producing such income;

(b) As to partnerships, reasonable wages of employees and a reasonable allowance for copartners or members of a firm, for services actually rendered in producing such income, the amount of any such salary allowance to be included in the personal return of the copartner receiving it; and

(c) As to corporations, wages of employees and salaries of officers, if reasonable in amount, for services actually rendered in producing such income;

(2) Rentals or other payments required to be made as a condition to the continued use or possession, for the purpose of the trade, of property to which the taxpayer has not taken or is not taking title or in which he has no equity;

(3) All interest paid during the income year on indebtedness except interest on obligations contracted for the purchase of non-taxable securities or stock; but dividends on preferred stock shall not be deducted as interest;

(4) Taxes for the income year, except taxes on income (other than taxes imposed by the United States on income of individuals to an amount not exceeding five hundred dollars), inheritance taxes and taxes assessed for a local benefit of a kind tending to increase the value of the property assessed;

(5) All contributions made by corporations to or for the use of:

(a) The State of South Carolina or any political subdivision thereof, for exclusive public purposes;

(b) Any institution owned, operated, controlled or supported by the State or any of its political subdivisions;

(c) The American Red Cross; or

(d) Any charitable or eleemosynary corporation, trust, community chest or foundation organized and operated exclusively for doing religious, charitable, scientific, literary or educational work within South Carolina if no part of the earnings or income of the same inures to the benefit of any private shareholder or individual and if no part of the activities of the same consist of carrying on propaganda or otherwise attempting to influence legislation or are activities usually engaged in by chambers of commerce, boards of trade or the like;

But the total deduction to be allowed any corporation by reason of contributions to the foregoing in any one year shall not exceed five per cent of the corporation's net income, as computed without the benefit of the deductions allowed by this item (5);

(6) Losses sustained during the income year on property used in trade or business or of property not connected with trade or business if arising from fire, storms, shipwrecks or other casualties or theft and if not compensated for by insurance or otherwise;

(7) Debts ascertained to be worthless and actually charged off the books of the taxpayer within the income year;

(8) A reasonable allowance for the depreciation and obsolescence of property used in the trade or business and, in the case of mines and other natural deposits, a reasonable allowance for depletion, the basis for computing such allowances to be the cost plus any additions and improvements (including, in the case of mines and other natural deposits, the cost of development not otherwise deducted) and in the case of leases the allowances to be equitably apportioned between the lessor and the lessee;

(9) A reasonable allowance for depletion of timber, the basis for such allowance to be in the case of timber acquired before January 1 1921 the fair market price or value thereof as of that date and in all other cases the cost thereof;

(10) The net income of resident individuals and corporations having an established business in another state or an investment in property in another state from such business or investment, this deduction in no case to extend to any part of the income of resident individuals and corporations from personal services or mortgages, stocks, bonds, securities or deposits;

(11) Contributions or gifts made by individuals within the taxable year to corporations or associations operated exclusively for religious, charitable, scientific or educational purposes or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual, to an amount not in excess of fifteen per cent of the taxpayer's net income as computed without the benefit of this item (11);

(12) All expenses paid during the taxable year, not compensated for by insurance or otherwise, for medical care of the taxpayer and any dependent of the taxpayer as defined by § 65-225 to the extent that such expenses exceed five per cent of the adjusted gross income. The term *"medical care,"* as used in this item (12) of this section, shall include amounts paid for the diagnosis, cure, mitigation, treatment or prevention of diseases or for the purpose of affecting any structure or function of the body, including amounts paid for accident or health insurance.

1942 Code § 2449; 1932 Code § 2449; 1927 (35) 1, 217; 1933 (38) 574; 1934 (38) 1413; 1936 (39) 1681; 1943 (43) 170; 1945 (44) 278; 1951 (47) 546.

Deductions from gross income are not a matter of right. They are a matter of legislative grace, and a taxpayer claiming a deduction must bring himself squarely within the terms of a statute expressly authorizing it. Southern Weaving Co. v. Query, 206 S. C. 307, 34 S. E. (2d) 51 (1945).

In computing the cost of timber, it is not proper to allow the interest paid on the purchase price, the cost of incorporating the company, the real estate taxes and the premium on a bond executed in lieu of mortgage. Georgia Cypress Co. v. South Carolina Tax Comm., 201 S. C. 213, 22 S. E. (2d) 419 (1942).

Legal and other expense in connection with investigating and perfecting title to property is a proper item to be included in computing cost. Georgia Cypress Co. v. South Carolina Tax Comm., 201 S. C. 213, 22 S. E. (2d) 419 (1942).

Applied, as to subsec. (8), in Read Phosphate Co. v. South Carolina Tax Comm., 169 S. C. 314, 168 S. E. 722 (1933).

§ 65-260. Optional standard deduction.

In lieu of all other deductions from adjusted gross income, an individual may, at the option of the taxpayer, deduct an amount not exceeding ten per cent of his adjusted gross income or the sum of five hundred dollars, whichever is the lesser; *provided*, that when a husband and wife make a joint return the amount deductible may be an amount not exceeding ten per cent of their combined adjusted gross income or the sum of one thousand dollars, whichever is the lesser. When a husband and wife make separate returns, both must exercise the same option.

1951 (47) 546.

Cross reference.—For definition of adjusted gross income, see § 65-258.

§ 65-261. Same; option must be exercised when return filed and is irrevocable.

The deduction provided for in § 65-260 shall be allowed only if the taxpayer elects in his original return to use this deduction in lieu of all other deductions and so signifies on his return. The option exercised by the taxpayer in the original return shall be irrevocable for the period covered by the return.

1951 (47) 546.

§ 65-262. Deduction of United States income tax must be of amount actually paid in year.

The deduction of United States taxes on income of an individual to the extent authorized as a deduction by item (4) of § 65-259 shall be claimed on the basis of the amount actually paid during the income year, regardless of the method of accounting employed by the taxpayer.

1951 (47) 546.

§ 65-263. Contributions of public service corporations.

In the case of corporations as to which the basis for ascertaining net income is prescribed by § 65-256, net operating income, operating expenses and operating ratio shall be revised and adjusted for income tax purposes to the extent necessary to reflect the deductions allowed by item (5) of § 65-259.

1945 (44) 278.

§ 65-264. Amortization of defense facilities.

Every taxpayer to which has been or may be issued a certificate of necessity in connection with national defense as contemplated by Section 124 of the Internal Revenue Code of the United States (Second Revenue Act 1940, Section 302, as amended by Public No. 3, January 31 1941) may, for the purpose of computing its liability under the income tax law of this State, avail itself of an amortization deduction in respect to the property covered by such

certificate to the same extent that such deduction is permitted and availed of under the Federal Income Tax Laws. In the case of railroad and other public service corporations as to which the basis for ascertaining net income is prescribed by § 65-256, net operating income, operating expenses and operating ratio arrived at as otherwise provided by law shall be revised and adjusted for income tax purposes to the extent necessary to reflect the amortization deduction granted in this section.

1942 Code § 2444; 1941 (42) 152; 1943 (43) 88.

§ 65-265. Items not deductible.

In computing net income no deduction shall in any case be allowed in respect of:

(1) Personal, living, or family expenses;

(2) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate;

(3) Any amount of expenses of restoring property for which an allowance is or has been made; or

(4) Premiums paid on any life insurance policy.

1942 Code § 2450; 1932 Code § 2450; 1927 (35) 1.

ARTICLE 5.

Gain or Loss and Basis Therefor.

§ 65-271. Basis for determination of gain or loss.

For the purpose of ascertaining the gain or loss from the sale or other disposition of property, real, personal or mixed, the basis shall be, in the case of property acquired before January 1 1921, the fair market price or value of such property as of that date and in all other cases the cost thereof except that in the case of property which was included in the last preceding annual inventory used in determining net income in a return under this chapter such inventory value shall be taken in lieu of cost or market value.

1942 Code § 2446; 1932 Code § 2446; 1927 (35) 1.

§ 65-272. No gain or loss in 1951 or 1952 on certain property sold to or condemned by United States.

No gain or loss shall be recognized under the provisions of § 65-271 upon the sale under condemnation or threat of condemnation of property when such property was or is purchased or seized by the United States during the period commencing January 1 1951 and ending December 31 1952 for use as a part of the site of the Savannah River Plant of the Atomic Energy Commission.

1951 (47) 546.

§ 65-273. Gain or loss on exchanges generally.

When property is exchanged, whether or not of a like nature, the gain or loss shall be the difference between the cost, or the value on January 1 1921 if acquired prior to that date, of the property exchanged and the value of the

property received, whether bonds, stocks, securities or other tangible or intangible property.

1942 Code § 2447; 1932 Code § 2447; 1927 (35) 1; 1928 (35) 1159.

§ 65-274. No gain or loss on corporate organizations generally.

In the case of an organization of a corporation, the stock or securities received shall be considered to take the place of property transferred thereto and no gain or loss shall be deemed to arise therefrom.

1942 Code § 2447; 1932 Code § 2447; 1927 (35) 1; 1928 (35) 1159.

§ 65-275. No gain or loss on corporate reorganizations generally.

In a reorganization, consolidation or merger the exchange of stock or property for stock of a corporation a party to the reorganization, consolidation or merger shall not be deemed to result in gain or loss.

1942 Code § 2447; 1932 Code § 2447; 1927 (35) 1; 1928 (35) 1159.

§ 65-276. Basis for gain or loss on certain corporate organizations, mergers, etc.

When in connection with the organization, merger or consolidation of a corporation a stockholder receives, in place of stock or securities owned by him, new stock or securities, the basis for computing the gain or loss, if any, shall be, in case the stock or securities owned were acquired before January 1 1921, the fair market price or value thereof as of that date and in all other cases the cost thereof.

1942 Code § 2447; 1932 Code § 2447; 1927 (35) 1; 1928 (35) 1159.

§ 65-277. Gain or loss on corporate liquidations.

The final distribution to the taxpayer of the assets of a corporation shall be treated as a sale of the stock or securities of the corporation owned by him and the gain or loss shall be computed accordingly.

1942 Code § 2446; 1932 Code § 2446; 1927 (35) 1.

ARTICLE 6.

Accounting Methods and Periods.

§ 65-281. Methods.

The net income of a taxpayer shall be computed in accordance with the method of accounting regularly employed in keeping the books of such taxpayer. But if such method does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commission does clearly reflect the income.

1942 Code § 2445; 1932 Code § 2445; 1927 (35) 1.

Income, as used in a tax statute, is to be taken in its ordinary sense of gain or profit. Southern Weaving Co. v. Query, 206 S. C. 307, 34 S. E. (2d) 51 (1945).

The law does not contemplate that that is income of the taxpayer which belongs to another. Southern Weaving Co. v. Query, 206 S. C. 307, 34 S. E. (2d) 51 (1945).

War contract profits.—Where a company, operating under a war contract, had a tentative net profit of over $500,000 but after renegotiation with the government returned

$350,000, sought to have its taxes reduced accordingly, the Tax Commission holding that it could not reduce the amount, it was held that such income returned was not taxable as net income and was not a deduction from gross income as it related to the amount of gross income where the Commission contended that it couldn't be deducted and must be taxed. Southern Weaving Co. v. Query, 206 S. C. 307, 34 S. E. (2d) 51 (1945).

§ 65-282. Fiscal year.

Taxpayers whose accounting period of twelve months ends as of the last day of some month other than December and whose books are kept accordingly may, with the approval of the Commission and subject to such rules and regulations as it may establish, return their net income under this chapter on the basis of such fiscal year in lieu of that of the calendar year.

1942 Code § 2445; 1932 Code § 2445; 1927 (35) 1.

§ 65-283. Change from fiscal to calendar year and vice versa.

A taxpayer may, with the approval of the Commission and under such regulations as it may prescribe, change his income year from a fiscal year to a calendar year or vice versa, in which case his net income shall be computed upon the basis of such new income year. Such approval must be obtained from the Commission at least thirty days prior to the end of such income year.

1942 Code § 2445; 1932 Code § 2445; 1927 (35) 1.

§ 65-284. When inventories must be taken.

Whenever in the opinion of the Commission it is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commission may prescribe, conforming as nearly as may be to the best accounting practice in the trade or business and most clearly reflecting the income.

1942 Code § 2448; 1932 Code § 2448; 1927 (35) 1.

§ 65-285. Determination of income in case of arbitrary shifting.

When the Commission has reason to believe that any taxpayer so conducts the trade or business as, directly or indirectly, to distort his true net income and the net income properly attributable to the State by the arbitrary shifting of income, through price fixing, charges for service or otherwise, whereby the net income is arbitrarily assigned to one or another unit in a group of taxpayers carrying on business under a substantially common control, it may require such facts as it deems necessary for the proper computation of the entire net income and the net income properly attributable to the State and in determining the same the Commission shall have regard to the fair profits which would normally arise from the conduct of the trade or business.

1942 Code § 2454; 1932 Code § 2454; 1927 (35) 1.

ARTICLE 7.

Returns.

§ 65-291. Who required to make returns.

Every resident or nonresident having a net income during the income year taxable in this State of one thousand dollars and over, if single or if married and not living with husband or wife, or having a net income for the income year of one thousand eight hundred dollars or over, if married and living with husband or wife, and every corporation except those specifically exempted shall make a return stating specifically the items of gross income and the deductions and exemptions allowed by this chapter and such other facts as the Commission may require for the purpose of making any computation required by this chapter. When the Commission has reason to believe that any person or corporation is liable for tax under this chapter it may require any such person or corporation to make a return. If a husband or wife living together have an aggregate net income of one thousand eight hundred dollars or over each shall make a return, unless the income of each is included in a single joint return.

1942 Code § 2453; 1932 Code § 2453; 1927 (35) 1; 1930 (36) 1338; 1933 (38) 573; 1943 (43) 52.

§ 65-292. Return when individual unable to make it.

If an individual taxpayer is unable to make his own return the return shall be made by a duly authorized agent or by a guardian or other person charged with the conduct of the business of the taxpayer.

1942 Code § 2453; 1932 Code § 2453; 1927 (35) 1; 1930 (36) 1338; 1933 (38) 573.

§ 65-293. Return of deceased individual.

The return of an individual who, while living, was carrying on a trade or business in the State during the income year and who has died before making the return shall be made in his name and behalf by the administrator or executor of his estate and the tax shall be levied upon and collected from his estate.

1942 Code § 2453; 1932 Code § 2453; 1927 (35) 1; 1930 (36) 1338; 1933 (38) 573.

§ 65-294. Execution of corporate return.

The return of a corporation shall be signed by the president or other principal officer and by the treasurer or assistant treasurer.

1942 Code § 2453; 1932 Code § 2453; 1927 (35) 1; 1930 (36) 1338; 1933 (38) 573; 1943 (43) 52.

§ 65-295. Return of partnership.

The return of a partnership shall be made by any one of the partners and shall show the net income of the partnership and the amount of such income allocated to each partner.

1942 Code § 2453; 1932 Code § 2453; 1927 (35) 1; 1930 (36) 1338; 1933 (38) 573.

§ 65-296. Return of estate or trust.

The return of the net income of a trade or business carried on by an estate or trust shall be made by the fiduciary and, under such regulations as the Commission may prescribe, may be made by one of two or more joint fiduciaries. Such return shall show the net income of such estate or trust and the distribution of such income to the beneficiaries.

1942 Code § 2453; 1932 Code § 2453; 1927 (35) 1; 1930 (36) 1338; 1933 (38) 573.

§ 65-297. When consolidated returns permitted.

Any taxpayer capable of exercising, directly or indirectly, substantially the entire control of the business of another taxpayer, either by ownership or control of substantially the entire capital stock (if a corporation) of such other taxpayer or otherwise, may, under regulations prescribed by the Commission, be permitted to make a consolidated return, showing the consolidated net income and such other information as the Commission may require in order to compute the net income properly attributable to the State and to impose the tax upon the taxpayers concerned.

The Commission may also permit the filing of a consolidated return when substantially the entire control of two or more taxpayers liable to taxation under this chapter is exercised by the same interest.

1942 Code § 2454; 1932 Code § 2454; 1927 (35) 1.

§ 65-298. Returns of less than year when income year changed.

If a taxpayer, with the approval of the Commission, changes the income year on the basis of which his net income is computed, he shall, at such time and in such manner as the Commission may prescribe, make a separate return of his net income received during the period intervening between the end of his former income year and the beginning of the new income year, in which return the specific deduction allowed in this chapter shall be reduced to an amount which bears the same ratio to the full deduction thus allowed as the number of months in such period bears to twelve months.

1942 Code § 2455; 1932 Code § 2455; 1927 (35) 1.

§ 65-299. Information returns.

All individuals, corporations and partnerships, in whatever capacity acting, including lessees and mortgagors of real or personal property, fiduciaries and employers making payment to another individual, corporation or partnership of interest, rent, dividends, salaries, wages, emoluments or other fixed or determined gains, profits or income of one thousand dollars or more in any taxable year and, in the case of such payments made by this State or any subdivision thereof, the officers or employees of this State or any subdivision thereof having information as to such payments and required to make returns in regard thereto shall make a true and accurate return to the Commission under such regulations as the Commission may prescribe, setting forth the amount of such gains, profits and income and the name and address of the recipient thereof.

1942 Code § 2452; 1932 Code § 2452; 1927 (35) 1; 1934 (38) 1572; 1940 (41) 1729.

§ 65-300. Commission to furnish blank returns.

The Commission shall cause to be prepared blank forms for the returns to be furnished upon application, but failure to receive or secure the form shall not relieve any taxpayer from the obligation of making a return.

1942 Code § 2456; 1932 Code § 2456; 1927 (35) 1.

§ 65-301. Use of form of Federal returns.

The Commission shall use as far as possible and practicable for filing returns for income tax blanks as used by the United States down to the net income part of such blanks.

1942 Code § 2479; 1932 Code § 2479; 1927 (35) 1.

It is the duty of the Tax Commission to furnish the taxpayers with blank forms on which to make their returns. Hadden v. South Carolina Tax Comm., 183 S. C. 38, 190 S. E. 249 (1937).

§ 65-302. Returns need not be sworn to but are subject to penalties of perjury.

It shall not be necessary that such returns be sworn to but any person who shall knowingly make any false statement in a return signed by him shall be guilty of a felony and punished as provided for perjury.

1943 (43) 52.

§ 65-303. Time and place of filing returns.

Returns shall be in such form as the Commission may from time to time prescribe and shall be filed with the Commission on or before the fifteenth day of the third month next after the preceding income year. In case of sickness, absence or other disability or whenever in its judgment good cause exists the Commission may allow further time for filing returns.

1942 Code § 2456; 1932 Code § 2456; 1927 (35) 1.

§ 65-304. Failure to file returns; supplementary returns.

If the Commission shall be of the opinion that any taxpayer has failed to file a return or to include in a return filed, either intentionally or through error, items of taxable income, it may require from such taxpayer a return or a supplementary return, in such form as it shall prescribe, of all items of income which the taxpayer received during the year for which the return is made, whether or not taxable under the provisions of this chapter. If from a supplementary return or otherwise the Commission finds that any item of income taxable under this chapter has been omitted from the original return, it may require the item so omitted to be disclosed to it, under oath of the taxpayer, and to be added to the original return. Such supplementary return and the correction of the original return shall not relieve the taxpayer from any of the penalties to which he may be liable under any provisions of this chapter. The Commission may proceed under the provisions of § 65-322 whether or not it requires a return or a supplementary return under this section.

1942 Code § 2457; 1932 Code § 2457; 1927 (35) 1.

§ 65-305. Mandamus to require filing of return.

If any taxpayer fails to file a return within sixty days of the time prescribed by this chapter, any judge of the circuit court, upon petition of the Commission, shall issue a writ of mandamus requiring such person to file a return. The order of notice upon the petition shall be returnable not later than ten days after the filing of the petition. The petition shall be heard and determined on the return day or on such day thereafter as the court shall fix, having regard to the speediest possible determination of the case consistent with the rights of the parties. The judgment shall include costs in favor of the prevailing party. All writs and processes may be issued from the clerk's office in any county and, except as above provided, shall be returnable as the court shall order.

1942 Code § 2466; 1932 Code § 2466; 1927 (35) 1.

§ 65-306. Determination of income by Commission.

If any taxpayer who has failed to file a return or has filed an incorrect or insufficient return and has been notified by the Commission of his delinquency refuses or neglects within twenty days after such notice to file a proper return or files a fraudulent return, the Commission shall determine the income of such taxpayer according to its best information and belief and assess it at not more than double the amount so determined. The Commission may in its discretion allow further time for the filing of a return in such case.

1942 Code § 2466; 1932 Code § 2466; 1927 (35) 1.

§ 65-307. Secrecy of reports and returns.

Except in accordance with proper judicial order or as otherwise provided by law it shall be unlawful for the members of the Commission or any deputy, agent, clerk or other officer or employee thereof to divulge or make known in any manner the amount of income or any particulars set forth or disclosed in any report or return required under this chapter. Nothing in this section shall be construed to prohibit the publication of statistics so classified as to prevent the identification of particular reports or returns and the items thereof or the inspection by the Attorney General or other legal representative of the State of the report or return of any taxpayer who shall bring action to set aside or review the tax based thereon or against whom an action or proceeding has been instituted to recover any tax or any penalty imposed by this chapter. Reports and returns shall be preserved for five years and thereafter until the Commission orders them to be destroyed.

Any offense against this section shall be punished by a fine of not exceeding one thousand dollars or by imprisonment not exceeding one year or both, at the discretion of the court, and if the offender be an officer or employee of the State he shall be dismissed from office and be incapable of holding any public office in this State for a period of five years thereafter.

1942 Code § 2475; 1932 Code § 2475; 1927 (35) 1.

§ 65-308. Same; exceptions.

Notwithstanding the provisions of § 65-307, the Commission may permit

the Commissioner of Internal Revenue of the United States, the proper officer of any state imposing an income tax similar to that imposed by this chapter or the authorized representative of either such officer to inspect the income tax returns of any taxpayer or may furnish to such officer or his authorized representative an abstract of the return of income of any taxpayer or supply him with information concerning any item of income contained in any return or disclosed by the report of any investigation of the income or return of income of any taxpayer. But such permission shall be granted or such information furnished to such officer or his representative only if the statutes of the United States or of such other state, as the case may be, grant substantially similar privileges to the proper officer of this State charged with the administration of this chapter.

1942 Code § 2475; 1932 Code § 2475; 1927 (35) 1.

§ 65-309. Oaths and acknowledgments.

The members of the Commission and such officers as it may designate may administer oaths to any person or take acknowledgments of any person in respect of any return or report required by this chapter or the rules and regulations of the Commission.

1942 Code § 2473; 1932 Code § 2473; 1927 (35) 1.

ARTICLE 8.

Examinations, Deficiencies and Illegal or Excessive Assessments.

§ 65-321. Examination of returns; interest and penalties on deficiencies.

As soon as practicable after each return is filed, the Commission shall examine it and compute the tax and the amount so computed by the Commission shall be the tax. If the tax found due shall be greater than the amount theretofore paid, the excess shall be paid to the Commission within ten days after notice of the amount shall be mailed by the Commission.

If additional tax is found to be due upon the examination of an income tax return and the return has been made in good faith and the understatement of the tax was not due to any fault of the taxpayer there shall be no penalty added because of such understatement, but interest shall be added to the amount of the deficiency at the rate of one-half of one per cent for each month or fraction of a month from the date the tax was originally due until the date the deficiency is paid.

If the understatement is due to negligence on the part of the taxpayer, but without intent to defraud, there shall be added to the amount of the deficiency five per cent thereof and in addition interest at the rate of one per cent per month or fraction of a month.

If the understatement is false or fraudulent, with intent to evade the tax, the tax on the additional income discovered to be taxable shall be doubled and one per cent per month or fraction of a month on such doubled tax shall be added.

The interest provided for in this section shall in all cases be computed from the date the tax was originally due to the date of payment.

If the amount of tax found due as computed shall be less than the amount theretofore paid, the excess shall be ordered refunded by the Commission.

1942 Code § 2459; 1932 Code § 2459; 1927 (35) 1, 217.

§ 65-322. Assessment of additional taxes.

If the Commission discovers from the examination of the return or otherwise that the income of any taxpayer, or any portion thereof, has not been assessed, it may, at any time within five years after the time when the return was due, assess such income and give notice to the taxpayer of such assessment and such taxpayer shall thereupon have an opportunity within thirty days to confer with the Commission as to the proposed assessment. The limitation of five years to the assessment of such tax or additional tax shall not apply to the assessment of additional taxes upon fraudulent returns. After the expiration of thirty days from such notification the Commission shall assess the income of such taxpayer or any portion thereof which it believes has not theretofore been assessed and shall give notice to the taxpayer so assessed of the amount of the tax and interest and penalties, if any, and the amount thereof shall be due and payable within ten days from the date of such notice. The provisions of this chapter with respect to revision and appeal shall apply to a tax so assessed. No additional tax amounting to less than fifty cents shall be assessed.

1942 Code § 2460; 1932 Code § 2460; 1927 (35) 1; 1932 (37) 1311.

§ 65-323. Refund of taxes illegally collected.

If the Commission discovers from the examination of the return or otherwise that the income tax, penalty or interest paid by any taxpayer is in excess of the amount legally due, the Commission may issue to the taxpayer its voucher to the Comptroller General for the refund of such illegally collected income tax, penalty or interest together with the interest provided for in § 65-330. Upon receipt of such voucher, properly executed and endorsed, the Comptroller General shall issue his warrant to the State Treasurer for the payment to the taxpayer of such refund, out of any income tax funds in his possession or out of any such funds that may come into his possession.

The Commission shall keep in its files a duplicate of each such voucher and also a statement which shall set forth the reasons why such refund shall have been ordered.

This section shall be in addition to any remedies for the abatement or refund of taxes that may otherwise be provided by law.

1942 Code § 2461; 1932 Code § 2461; 1929 (36) 1048.

Cross reference.—As to State's right to sue and be sued, see § 14-1.

This section does not create a plain ministerial duty on the part of the Tax Commission to refund any and all overpaid income taxes assessed and collected against taxpayers prior to the passage of this law, without regard to the legality or equity of such claims. Argent Lbr. Co. v. Query, 178 S. C. 1, 182 S. E. 93 (1935).

The Tax Commission's authority to order a refund is limited by the terms of this section in its scope, and it confers the power and authority upon the Tax Commission to refund illegally collected income tax, penalty or interest, when it discovers from the examination of the return or otherwise that the amount paid by any taxpayer is in excess of the amount legally due; this allowance of such a refund is not made obliga-

tory, and no provision for its enforcement by the taxpayer by suit against the State, without its consent, is contained in this section. Argent Lbr. Co. v. Query, 178 S. C. 1, 182 S. E. 93 (1935).

Section does not authorize taxpayer's suit for refund.—Under the terms of this section the Tax Commission is clothed with the power and authority to make such refunds for valid reasons, but no corresponding right is conferred upon the taxpayer to compel by suit the exercise of this authority. Argent Lbr. Co. v. Query, 178 S. C. 1, 182 S. E. 93 (1935).

State must consent to suit against commissions.—A suit by a taxpayer against the Tax Commission for the recovery of interest on refunded taxes, is a suit against the State, and may not be instituted without the consent of the State. Monarch Mills v. South Carolina Tax Comm., 149 S. C. 219, 146 S. E. 870 (1929).

For additional related case, see Southern Ry. Co. v. Query, 21 F. (2d) 333 (1927).

§ 65-324. Examination of books, etc.

The Commission, for the purpose of ascertaining the correctness of any return or for the purpose of making an estimate of the taxable income of any taxpayer, may examine or cause to be examined by any agent or representative designated by it for that purpose any books, papers, records or memoranda bearing upon the matters required to be included in the return.

1942 Code § 2471; 1932 Code § 2471; 1927 (35) 1.

§ 65-325. Summons to produce books, etc.

When any person who is required to make a return under this chapter (a) fails so to do at the time required, (b) delivers any return which, in the opinion of the Commission is erroneous or (c) refuses to allow any regularly authorized agent of the Commission to examine his books and records, the Commission may summons (a) such person, (b) any other person having possession, care or custody of books of account containing entries relating to the business of such person or (c) any other person it may deem proper, to appear before the Commission and produce such books at a time and place named in the summons and to give testimony and answer questions under oath respecting any item of income liable to tax on the return thereof. Such summons shall in all cases be served by an authorized agent of the Commission by delivering an attested copy to such person in hand or leaving such copy at such person's last or usual place of abode, allowing such person one day for each twenty-five miles he may be required to travel computed from the place of service to the place of examination. When the summons requires the production of books and returns it shall be sufficient if such books are described with reasonable certainty.

1942 Code § 2471; 1932 Code § 2471; 1927 (35) 1.

§ 65-326. Enforcement of summons by court.

Whenever any person summoned under the provisions of § 65-325 neglects or refuses to obey such summons the Commission may apply to any circuit judge for an attachment against him for contempt. Any such judge shall hear such application and, if satisfactory proof is made, shall issue an attachment directed to the sheriff of the county in which the person resides for the arrest of such person. Upon such person being brought before him such judge shall proceed to a hearing of the case and upon such hearing the judge may make such order as he shall deem proper, not inconsistent with existing laws for

the punishment of contempt, to enforce obedience to the requirements of the summons and to punish such person for his default or disobedience.

1942 Code § 2471; 1932 Code § 2471; 1927 (35) 1.

§ 65-327. Revision by Commission on application of taxpayer.

A taxpayer may apply to the Commission for revision of the tax assessed against him, at any time within one year from the time of the filing of the return or from the date of the notice of the assessment of any additional tax. The Commission shall grant a hearing thereon and if, upon such hearing, it shall determine that the tax is excessive or incorrect it shall re-settle it accordingly. The Commission shall notify the taxpayer of its determination and shall refund to the taxpayer the amount, if any, paid in excess of the tax found by it to be due.

1942 Code § 2467; 1932 Code § 2467; 1927 (35) 1.

Quoted in Argent Lbr. Co. v. Query, 178 S. C. 1, 182 S. E. 93 (1935).

Cited in Southern Ry. Co. v. Query, 21 F. (2d) 333 (1927).

§ 65-328. Blank.

§ 65-329. Blank.

§ 65-330. Interest on refunds or credits.

Upon the allowance of a credit or refund of any tax, penalty or interest erroneously, improperly or illegally paid, interest shall be allowed and paid on the amount of such credit or refund at the rate of one-half of one per cent per month from the date such tax, penalty or interest was paid to the date the order for refund or credit is issued.

1942 Code § 2461; 1932 Code § 2461; 1929 (36) 1048.

Collection of interest.—See Western Union Tel. Co. v. Query, 144 S. C. 234, 142 S. E. 509 (1927); Monarch Mills v. South Carolina Tax Comm., 149 S. C. 219, 146 S. E. 870 (1929).

ARTICLE 9.

Payment, Collection and Use of Tax.

§ 65-341. When tax payable; installment payments.

The full amount of the tax payable as shown on the face of the return shall be paid to the Commission at the office where the return is filed, at the time fixed by law for filing the return. If the taxpayer so elects he may pay the tax in four equal installments, in which case the first installment shall be paid on the date prescribed for the payment of the tax by the taxpayer, the second installment shall be paid on the fifteenth day of the third month, the third installment on the fifteenth day of the sixth month and the fourth installment on the fifteenth day of the ninth month after such date. If any installment is not paid on or before the date fixed for its payment, the entire amount of unpaid tax, interest and penalty shall become due and payable. If the taxpayer is granted an extension of time in which to file his income tax return,

the interest on deferred payments shall in no instance exceed six per cent per annum on such deferred payments from the time the return is due to be filed until the tax due thereon is paid.

The provisions of this section shall not apply to the payment of additional taxes assessed by the Commission, such additional taxes to be paid as otherwise required by law.

1942 Code § 2458; 1932 Code § 2458; 1927 (35) 1; 1946 (44) 1491.

§ 65-342. Payment by uncertified check.

The tax may be paid with an uncertified check, during such time and under such regulations as the Commission shall prescribe, but if a check so received is not paid by the bank on which it is drawn the taxpayer by whom such check is tendered shall remain liable for the payment of the tax and for all legal penalties as if such check had not been tendered.

1942 Code § 2458; 1932 Code § 2458; 1927 (35) 1; 1946 (44) 1491.

§ 65-343. Jeopardy assessments and collections.

If the Commission finds that the assessment or collection of a tax or a deficiency for any year, current or past, will be jeopardized in whole or in part by delay, the Commission may mail or issue a notice of such finding to the taxpayer together with a demand for immediate payment of the tax or the deficiency declared to be in jeopardy, including interest, penalties and additions thereto. In the case of the tax for a current period, the Commission may declare the taxable period of the taxpayer immediately terminated and shall cause notice of such finding and declaration to be mailed or issued to the taxpayer, together with a demand for immediate payment of the tax based on the period declared terminated and such tax shall be immediately due and payable whether or not the time otherwise allowed by law for filing the return and paying the tax has expired. Any such assessment provided for in this section shall be immediately due and payable and proceedings for collection shall commence at once and, if such tax is not paid upon demand of the Commission, the Commission shall forthwith issue a warrant of distraint against the property of the taxpayer or, in its discretion, may require the taxpayer to file such indemnity bond as in the judgment of the Commission may be sufficient to protect the interest of the State.

1942 Code § 2458; 1932 Code § 2458; 1927 (35) 1; 1946 (44) 1491.

§ 65-344. Issue of warrant for collection.

If any tax, interest or penalty imposed by this chapter remain due and unpaid for a period of ten days, the Commission shall issue a warrant under its hand and official seal directed to the sheriff or tax collector of any county commanding him to levy upon and sell the real and personal property of the taxpayer found within his county for the payment of the amount thereof with added penalties, interest and the cost of executing the warrant and to return such warrant to the Commission and pay to it the money collected by virtue

thereof by a time to be therein specified, not more than sixty days after the receipt of the warrant.

1942 Code § 2462; 1932 Code § 2462; 1927 (35) 1; 1946 (44) 1491.

Cited in State v. Wilder, 198 S. C. 390, 18 S. E. (2d) 324 (1941).

§ 65-345. Docketing of warrant and lien thereof.

Immediately upon receipt of the warrant, the sheriff or tax collector shall file with the clerk of court of his county a copy thereof and thereupon the clerk of court shall enter in the judgment docket, in the column for judgment debtors, the name of the taxpayer mentioned in the warrant and in appropriate columns the amount of the tax or portion thereof and penalties for which the warrant is issued and the date when such copy is filed, and shall index the warrant upon the index of judgments. Thereupon the amount of such warrant so docketed shall become a lien upon the title to and interest in real property or chattels real of the taxpayer against whom it is issued in the same manner as a judgment duly docketed in the office of said clerk.

1942 Code § 2462; 1932 Code § 2462; 1927 (35) 1; 1946 (44) 1491.

§ 65-346. Collection of warrant; fees of officers.

The sheriff or tax collector shall proceed upon the warrant in all respects with like effect and in the same manner prescribed by law in respect to executions issued against property upon judgments of a court of record. The sheriff or tax collector and the clerk of court shall be entitled to the same fees for service in executing and recording the warrant as prescribed by law in respect to the executions issued against property upon judgments of a court of record, to be collected in the same manner.

1942 Code § 2462; 1932 Code § 2462; 1927 (35) 1; 1946 (44) 1491.

§ 65-347. Collection when warrant not satisfied.

If a warrant be returned not satisfied in full, the Commission shall have the same remedies to enforce the claim for taxes against the taxpayer as if the people of the State had recovered judgment against the taxpayer for the amount of the tax.

1942 Code § 2462; 1932 Code § 2462; 1927 (35) 1; 1946 (44) 1491.

§ 65-348. Tax a debt.

Every tax imposed by this chapter and all increases, interest and penalties thereon shall become, from the time it is due and payable, a personal debt from the person liable to pay it to the State.

1942 Code § 2463; 1932 Code § 2463; 1927 (35) 1.

§ 65-349. Action for recovery of taxes.

Action may be brought at any time by the Attorney General, in the name of the State, to recover the amount of any taxes, penalties and interest due under this chapter.

1942 Code § 2464; 1932 Code § 2464; 1927 (35) 1.

§ 65-350. Compromises by Commission.

The Commission may compromise any civil or criminal case arising under the provisions of this chapter instead of commencing suit thereon and may compromise any such case with the consent of the Attorney General after suit thereon has been commenced. When any case is compromised the Commission shall keep on file in its office the reasons for such settlement, together with a statement of the amount of tax assessed, the amount of additional tax or penalty or interest imposed by law in consequence of the neglect or delinquency of the person against whom the tax is assessed and the amount actually paid in accordance with the terms of the compromise.

1942 Code § 2466; 1932 Code § 2466; 1927 (35) 1.

§ 65-351. Blank.

§ 65-352. Allocation of income tax revenue.

All revenue from the income tax shall be allocable to the revenues and appropriations for the fiscal year in which the first installment thereof comes due and the State Treasurer may borrow in anticipation of all deferred installments if such revenues be necessary to pay appropriations.

1942 Code § 2458; 1932 Code § 2458; 1927 (35) 1; 1946 (44) 1491.

§ 65-353. Expenses incurred under certain sections.

Out of the revenue and interest derived under the provisions of this chapter the Commission may expend so much as is necessary to defray the additional expenses incurred in the administration and enforcement of §§ 65-341 to 65-343 and 65-352. All such expenditures shall be made upon the approval of the State Budget and Control Board.

1942 Code § 2458; 1932 Code § 2458; 1927 (35) 1; 1946 (44) 1491.

ARTICLE 10.

Penalties.

§ 65-361. Increase of tax for failure to file return or pay tax generally.

If any taxpayer, without intent to evade any tax imposed by this article, shall fail to file a return of income or to pay a tax, if one is due, at the time required by or under the provisions of this chapter, but shall later voluntarily file a correct return of income and pay the tax due, there shall be added to the tax an additional amount equal to five per cent thereof and an additional one per cent for each month or fraction of a month during which the tax remains unpaid.

1942 Code § 2466; 1932 Code § 2466; 1927 (35) 1.

§ 65-362. Increase of tax for intentional failure to file or pay.

If any taxpayer fails voluntarily to file a return of income or to pay a tax, if one is due, within sixty days of the time required by or under the provisions of this chapter, the tax shall be increased by twenty-five per cent.

1942 Code § 2466; 1932 Code § 2466; 1927 (35) 1.

§ 65-363. Additional penalty for nonfraudulent failure to file, pay, etc.

Any person who, without fraudulent intent, fails to pay any tax, to make, render, sign or verify any return or to supply any information within the time required by or under the provisions of this chapter shall be liable to a penalty of not more than one thousand dollars, to be recovered by the Attorney General, in the name of the people, by action in any court of competent jurisdiction.

1942 Code § 2466; 1932 Code § 2466; 1927 (35) 1.

§ 65-364. Additional penalty for fraudulent failure to file, pay, etc.

Any person or any officer or employee of any corporation or member or employee of any partnership who, with intent to evade any requirement of this chapter or any lawful requirement of the Commission under this chapter, shall fail to pay any tax, to make, sign or verify any return or to supply any information required by or under the provisions of this chapter or who, with like intent, shall make, render, sign or verify any false or fraudulent return or statement or shall supply any false or fraudulent information shall be liable to a penalty of five hundred dollars to be recovered by the Attorney General, in the name of the people, by action in any court of competent jurisdiction and shall also be guilty of a misdemeanor and shall, upon conviction, be fined not to exceed five thousand dollars or be imprisoned not to exceed five years or both, at the discretion of the court.

1942 Code § 2466; 1932 Code § 2466; 1927 (35) 1.

§ 65-365. Commission may waive or reduce penalties or interest.

The Commission may, upon making a record of its reason therefor, waive or reduce any of the additional taxes or interest provided in §§ 65-361 to 65-364 or § 65-321.

1942 Code § 2466; 1932 Code § 2466; 1927 (35) 1.

§ 65-366. All failures deemed to take place in Columbia.

The failure to do any act required by or under the provisions of this chapter shall be deemed an act committed in part at the office of the Commission in *Columbia.*

1942 Code § 2466; 1932 Code § 2466; 1927 (35) 1.

§ 65-367. Certificate of Commission as prima facie evidence.

The certificate of the Commission to the effect that a tax has not been paid, that a return has not been filed or that information has not been supplied as required by or under the provisions of this chapter shall be prima facie evidence that such tax has not been paid, that such return has not been filed or that such information has not been supplied.

1942 Code § 2466; 1932 Code § 2466; 1927 (35) 1.

Exhibit F

CHAPTER 6.

INCOME TAX ON BANKS.

Sec.
65-401. "Banks" and "taxpayers" defined.
65-402. Tax on income of banks.
65-403. Tax in lieu of other taxes except on real property.
65-404. Enforcement; administration.
65-405. Payment of tax; distribution.
65-406. Invalidity.

§ 65-401. "Banks" and "taxpayers" defined.

For the purpose of this chapter and unless otherwise required by the context, the words "banks" and "taxpayers," whenever used in this chapter, shall mean any person engaged in a banking business, whether incorporated under the laws of this State, any other state or the United States or whether unincorporated, except cash depositories.

1942 Code § 2676; 1937 (40) 565; 1938 (40) 1762.

§ 65-402. Tax on income of banks.

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

1942 Code § 2676; 1937 (40) 565; 1938 (40) 1762.

Cross reference.—As to bank notes and stock exempt from taxes, see § 65-1522.

§ 65-403. Tax in lieu of other taxes except on real property.

The income tax provided in this chapter shall be in lieu of all other taxes on banks, except taxes on real property. The real property of any such bank shall be taxed in the place where it may be located, the same as the real property of individuals.

1942 Code § 2676; 1937 (40) 565; 1938 (40) 1762.

§ 65-404. Enforcement; administration.

For the purpose of administration, enforcement, collection, liens, penalties and other similar provisions, all of the provisions of chapter 5 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.

1942 Code § 2676; 1937 (40) 565; 1938 (40) 1762.

§ 65-405. Payment of tax; distribution.

The taxes provided for in this chapter shall be paid to the Commission as is provided in § 65-404 and the income tax paid under the provisions of this chapter shall be distributed among the general fund of the State the county and municipality which the bank is located as follows:

(1) Ten per cent to the general fund of the State;

(2) Sixty per cent to the county; and

(3) Thirty per cent to the municipality in which the bank is located.

The revenue received from banks located outside of incorporated cities or towns shall be distributed as follows:

(1) Forty per cent to the general fund of the State; and

(2) Sixty per cent to the county.

The Commission shall draw warrants on the State Treasurer for such distribution on or before May 15th of each year and the State Treasurer shall honor such warrants.

For the purpose of and in the distribution of the taxes paid under this chapter by a bank having one or more branches, each branch of the bank shall be deemed to have paid such portion of the entire tax as its deposits on January 1st of each taxable year bear to the total of the deposits of all branches and the tax shall be distributed accordingly.

1942 Code § 2676; 1937 (40) 565; 1938 (40) 1762.

§ 65-406. Invalidity.

In case the first sentence of § 65-403 should for any reason be declared to be invalid by a court of competent jurisdiction, the provisions of §§ 2663 through 2675, 2677 and paragraphs (33), (34) and (53) of § 2578 of the Code of 1942 shall be and remain in full force and effect and the income tax provided in this chapter shall not be effective.

1942 Code § 2676; 1937 (40) 565; 1938 (40) 1762.

CHAPTER 7.

INHERITANCE TAX.*

Article 1.

General Provisions.

Sec.

65-451. Definitions.
65-452. Territories of the United States.
65-453. States having no inheritance tax laws.
65-454. Blanks and forms; penalty for refusal to use.
65-455. Effect of chapter on accrued penalties; remission thereof.

Article 2.

Imposition of Tax; Valuations, etc.

65-461. Transfers subject to tax.
65-462. Powers of appointment.
65-463. Joint ownership passing to survivor.
65-464. Certain transfers deemed in contemplation of death.
65-465. Bequest or legacy to an executor or trustee.
65-466. Debts due at or after death.
65-467. Tax rates on transfer to close relative.
65-468. Exemptions in such cases.
65-469. Tax rates on transfers to other relatives.
65-470. Exemptions in such cases.
65-471. Tax rate on other transfers.
65-472. Exemptions in such cases.
65-473. Educational, charitable, etc., exemptions.
65-474. Valuation of interest in property less than an estate in fee.
65-475. Same; when value of such estate dependent upon contingency.
65-476. Same; when identity of remainderman uncertain.
65-477. Legacies, etc., not diminished by claim of legatees, etc.

* As to inheritance tax fee, see § 27-303.

Exhibit G

C. Section 1359, of Article 1, of Chapter 15, of Title 65, Code of Laws of South Carolina for 1952, as amended, is hereby amended by adding thereto Sub-division (5), which shall read as follows:

"(5). Every person engaged in the business of renting or leasing or otherwise furnishing any tangible personal property for a consideration, either by lease or rental or other form of agreement."

Notwithstanding any other provision of law, the license and the sales and/or use tax imposed by Chapter 15, of Title 65, Code of Laws for 1952, as amended, is hereby imposed upon the fair market value of tangible personal property manufactured within South Carolina or imported into South Carolina by the manufacturer thereof for the purpose of renting or leasing the same or for storage, use or consumption within South Carolina by said manufacturer.

This section shall become effective on the first day of the first month following the approval of this Act by the Governor.

SECTION 5

Section 65-222, 1952 Code, amended—tax on corporations increased:

That Section 65-222, Code of Laws of South Carolina for 1952, be and the same is hereby amended by striking out all of said Section 65-222 and inserting in lieu thereof the following which shall be Section 65-222:

"Section 65-222. Every corporation organized under the laws of this State shall make a return and shall pay annually an income tax equivalent to five percent of the entire net income of such corporation received by such corporation during the income tax year and, except as otherwise provided, every foreign corporation doing business or having an income within the jurisdiction of this State shall make a return and shall pay annually an income tax equivalent to five percent of a proportion of its entire net income to be determined as provided in this chapter; provided, that the amount of such tax shall not be less than would be produced by applying a rate of three per cent to a base consisting of the entire net income plus salaries and other compensation paid to all elective and appointed officers and to any stockholder owning in excess of five per cent of the issued capital stock of the corporation, after deducting from the base six thousand dollars and any deficit reported for the year."

This section shall be effective as to income tax accounting periods ending after June 30, 1955.

Section 65-259, 1952 C additional deduction f industry:

Section 259 of Chapt amended, is hereby ame be known as Subsection

"(13) With respect o business or industry in S and thereafter, in add Chapter, there shall be a net operating loss carr

(A). The net operati on or after December 3 succeeding taxable year three years next succeed such net operating loss able income of a succe herein allowed shall be the operation of the said

(B) As used herein shall be deemed to be t tion of income taxes, pe The net income of the ta deduction as adjusted is deduction of income ta pendents, and such inco used to increase the net other taxable period.

(C). As used in this hereby defined as the e come for the taxable y business or industry. In tion, deductions, includi pendents and income ta trade or business shall allowable for the taxabl income not derived fron

(D). Notwithstandin Commission discovers fr

SECTION 6

Section 65-259, 1952 Code, amended—subsection (13) added—additional deduction for persons establishing a new business or industry:

Section 259 of Chapter 5 of Title 65, Code of Laws for 1952, as amended, is hereby amended by adding thereto a new Subsection to be known as Subsection 13.

"(13) With respect only to taxpayers who have established a new business or industry in South Carolina during the calendar year 1955 and thereafter, in addition to other deductions allowed by this Chapter, there shall be allowed as a deduction from gross income a net operating loss carry over under the following rules:

(A). The net operating loss as herein defined for any year ending on or after December 31, 1955, may be carried forward to the next succeeding taxable year and annually thereafter for a total period of three years next succeeding the year of such operating loss, or until such net operating loss has been exhausted or absorbed by the taxable income of a succeeding year. The net operating loss deduction herein allowed shall be allowable only for the first three years of the operation of the said new business or industry in South Carolina.

(B) As used herein the term "taxable income" or "net income" shall be deemed to be the net income computed without the deduction of income taxes, personal exemption, and credit for dependents. The net income of the taxable period to which the net operating loss deduction as adjusted is carried shall be the net income before the deduction of income taxes, personal exemption, and credit for dependents, and such income taxes, exemption, and credits shall not be used to increase the net operating loss which may be carried to any other taxable period.

(C). As used in this Subsection the term "net operating loss" is hereby defined as the excess of allowable deductions over gross income for the taxable year arising from the operation of such new business or industry. In the case of a taxpayer other than a corporation, deductions, including personal exemptions and credit for dependents and income taxes, not attributable to the operation of a trade or business shall be eliminated from the deductions otherwise allowable for the taxable year to the extent that they exceed gross income not derived from such trade or business.

(D). Notwithstanding any other provision of Law, if the Tax Commission discovers from the examination of the return or other-

wise that the income of any taxpayer or any portion thereof has not been assessed with respect to any return in which a net operating loss is sustained or is claimed as a deduction, in whole or in part, it may at any time within five years from the date of the return which finally absorbs the net operating loss deduction is filed, assess such income and give notice to the taxpayer of such assessment and the taxpayer shall thereupon have an opportunity within thirty days to confer with the Commission as to the proposed assessment. After the expiration of thirty days from such notification the Commission shall assess the income of such taxpayer or any portion thereof which it believes has not theretofore been assessed and shall give notice to the taxpayer so assessed of the amount of the tax and interest and penalty, if any, and the amount thereof shall be due and payable within ten days from the date of such notice. The provisions of this Chapter with respect to revision and appeal shall apply to a tax so assessed. The limitation herein provided for shall not apply to the assessment of additional taxes upon fraudulent returns, nor shall it apply to the assessment of taxes with respect to returns not filed in accordance with requirements of Law."

SECTION 7

Delinquent taxpayers—employers to withhold compensation upon notice from Tax Commission:

Notwithstanding any other provision of law, South Carolina Tax Commission may give notice to any employer doing business or having an income within this State or having an employee rendering a service within this State, to the effect that a taxpayer employed by said employer is delinquent with respect to income taxes or has failed to pay income taxes, penalties or interest with respect to income taxes. Notice may be served either by mail or by delivery by any duly authorized representative of the Tax Commission. Upon receipt of the notice of the delinquency or failure to make payment, the employer and the person having control of compensation of the taxpayer shall withhold from compensation due or to become due to the taxpayer the total amount shown by the notice, provided that the Tax Commission or its duly authorized representative in their discretion may arrange between employer and employee for a deduction of an amount not less than twenty (20%) percent of the total amount due the employee each pay period until the total amount as shown by the notice has been withheld. In the event that the taxpayer leaves the employ of employer or gives notice of his intention so to do, employer

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STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

Synovus Bank, Petitioner, v. South Carolina Department of Revenue, Respondent.	)	Docket No. 17-ALJ-17-0418-CC

Synovus Bank's Motion to Reconsider the Findings of Fact, Conclusions of Law and Order

Petitioner Synovus Bank's respectfully ask the Court to reconsider its Findings of Fact and Conclusions of Law relative to multiple areas: (1) that a Net Operating Loss carryforward is not allowed to be taken by a bank in South Carolina; (2) that the bank tax is based on financial, not taxable income; (3) that "entire net income" for publicly traded banks is based on the GAAP definition of "net income" and that no unconstitutional delegation of powers has occurred as a result thereof; (4) that neither ASC 740 nor GAAP allows a publicly traded bank to utilize a NOL carryforward in calculating the bank tax; (5) that the Petitioner was not entitled to utilize all income and all expenses/losses in its calculation of entire net income in each year during the audit period; (6) in determining a net operating loss ("NOL") carryforward is not an appropriate method to calculate and include all expenses and losses; (7) that deference is owed to the South Carolina Department of Revenue ("Department") on the issue of the calculation of entire net income and application of conformity to the bank tax; (8) that conformity did not apply to the bank tax contained in Title 12, Chapter 11 of the South Carolina Code; (9) that the bank tax is not a tax on income and thus not an income tax; and (10) that equitable standards do not apply to the issue of how banks must account for expenses and losses because the accounting method to do so is through a deduction. In addition, the Court has failed to rule on several issues raised during the trial on

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this matter. Finally, the Order of the Court creates an issue of equal protection and substantive due process that cannot be resolved in any manner other than a reconsideration of the Order in this case and a reversal of the ultimate determination.

Dated this 8th day of May, 2020.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on the 8th day of May 2020, the foregoing Synovus Bank's Motion to Reconsider the Findings of Fact, Conclusions of Law and Order has been served upon the following persons via U.S. Mail, First Class thereto:

Jason P. Luther, Esq.
Andrew W. Saleeby, Esq.
South Carolina Department of Revenue
PO Box 12265
Columbia, SC 29211-9979



42785370.1

STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

Synovus Bank, Petitioner, v. South Carolina Department of Revenue, Respondent.	)	Docket No. 17-ALJ-17-0418-CC

Memorandum in Support of Motion to Reconsider the Findings of Fact, Conclusions of Law and Order

This Memorandum of Law is submitted in support of Petitioner Synovus Bank's (herein after referred to as "Petitioner") Motion to Reconsider the Findings of Fact, Conclusions of Law and Order entered in this matter.

Petitioners respectfully ask the Court to reconsider its Findings of Fact and Conclusions of Law relative to multiple areas: (1) that a Net Operating Loss carryforward is not allowed to be taken by a bank in South Carolina; (2) that the bank tax is based on financial, not taxable income; (3) that "entire net income" for publicly traded banks is based on the GAAP definition of "net income" and that no unconstitutional delegation of powers has occurred as a result thereof; (4) that neither ASC 740 nor GAAP allows a publicly traded bank to utilize a NOL carryforward in calculating the bank tax; (5) that the Petitioner was not entitled to utilize all income and all expenses/losses in its calculation of entire net income in each year during the audit period; (6) in determining a net operating loss ("NOL") carryforward is not an appropriate method to calculate and include all expenses and losses; (7) that deference is owed to the South Carolina Department of Revenue ("Department") on the issue of the calculation of entire net income and application of conformity to the bank tax; (8) that conformity did not apply to the bank tax contained in Title 12, Chapter 11 of the South Carolina Code; (9) that the bank tax is not a tax on income and thus not

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an income tax; and (10) that equitable standards do not apply to the issue of how banks must account for expenses and losses because the accounting method to do so is through a deduction. In addition, the Court has failed to rule on several issues raised during the trial on this matter. Finally, the Order of the Court creates an issue of equal protection and substantive due process that cannot be resolved in any manner other than a reconsideration of the Order in this case and a reversal of the ultimate determination.

A. INTRODUCTION

I. Argument of Petitioner

Petitioner has proven its burden that a net operating loss carryforward is allowed for a bank in South Carolina. First, the bank tax is based on taxable income. The language of the bank tax statute makes clear the bank tax is a "tax on income of banks." The basis of the bank tax is "entire net income." "Entire net income" is term that has been used in relation to income taxes since 1918. As an income tax, located in Title 12 of the South Carolina tax code, it is clear that conformity applies, I.R.C. rules govern the calculation of the bank tax and an NOL carryforward is allowed.

"Entire net income" cannot mean financial (or book) income because to reach this conclusion requires the Department and Court to rely on the definition of "net income" as determined by the Generally Accepted Accounting Principles (GAAP). Reliance on GAAP is the only manner in which the Court can reach a conclusion with a definable calculation metric under financial accounting because the Department has failed in its duty to promulgate a regulation that defines the term "entire net income" or provide a calculation metric for "entire net income" in the 83 years since the passages of the bank tax. This level of reliance on the promulgations of a third party is an unconstitutional delegation of powers. Further, it creates a disparity in how different bank taxpayers using different accounting methods (cash v accrual) are treated.

In the alternative, if the bank tax is, in fact, based on financial accounting, the use of the term "entire" must be given meaning. "Entire" means income minus expenses. The NOL carryforwards at issue in the case are based on expenses in excess of income that are carried over into subsequent financial accounting years based on GAAP accounting rules. When such excess expenses occur on taxes based on income, ASC 740 requires the excess expenses be moved from the income statement to a balance sheet. Multiple financial statements make up GAAP accounting and all must be viewed together to obtain the financial status of the organization. The use of the word "entire" creates the statutory authority for a bank to utilize all expenses in the calculation of its taxes. The only manner in which all expenses can be deducted by a publicly traded bank operating on accrual based accounting, versus a cash accounting basis, is through the use of a NOL carryforward. If GAAP accounting is used, then GAAP requires NOL deductions to be reflected on the financial statement and, therefore, to be incorporated into the calculation of "entire net income."

II. Order of the Court

The Court agreed with the Petitioner that it must determine how "entire net income" is to be calculated under the bank tax to resolve the issues in this case. Order p, 36. The Court agreed with Petitioner and found the Department failed to establish a long-standing statutory interpretation of how to calculate "entire net income." Order, page 26. The Court further found that GAAP should not be used as a wholesale proxy for "entire net income." or "book income." Order, page 24. In doing so, the Court acknowledged that this type of reliance on GAAP was an unconstitutional delegation of power. Order, page 24. The Court then further agreed with Petitioner in its determination that "entire net income" means "gross income minus gross expenses." Order, p. 7. The Court acknowledged neither "gross income" nor "gross expense" have been defined by

the Department. Order, p. 24. At trial, evidence was put forward by the Petitioner that the amount of the "net operating losses" at issue before the Court were, in fact, expenses attributable to the Petitioner in a prior year that were subsequently carried over due to the lack of gross income available in a certain 12 month period. Tr. Trans. Doug Branch at p. 83. Despite this evidence, and none presented to the contrary by the Department, the Court improperly held that "net operating loss" is not an expense under its own "minus gross expense" definitional holding. Order, p. 7. The Court also agreed with Petitioner that ASC 740/GAAP does not allow an NOL carryforward. Order, pp. 5, 7. Despite this conclusion, the Court ultimately determined that a bank is not eligible to utilize the NOL in South Carolina despite its clear allowance under GAAP.

The Court reached this improper conclusion based on deference to the Department and the historical reference to the bank tax as a "franchise tax," which included an assumption that a "franchise tax" is calculated on financial versus taxable income. Financial income, according to the Court, is commonly referred to as "book income," a term which very generally refers to the revenues and expenses listed on the general ledger of an organization. How a company "keeps the books" may vary depending upon accounting methods. Order, p 36. Based on these conclusions, the Court improperly determined that it is reasonable to conclude that a company's "book income" is the same as "net income" under GAAP accounting because both subtract expenses from revenue. Order, page 36. The Court ignored the impact of the evidence that neither "book income" nor "entire net income" are terms used in GAAP and that "net income" is a specific term of art in accounting and under GAAP with defined parameters. The Court also disregarding the evidence that all financial forms mandated by GAAP must be used in conjunction with each other and that the income statement alone, where "net income" is located, does not provide the full financial position of the Company.

As a result of the Court's incorrect conclusion that the bank tax is based on financial income, not taxable income, the Court improperly disregarded the clear intent of the Legislature to conform all taxes found in Title 12 of the South Carolina Tax code, including the bank tax located in Title 12, Chapter 6, to the I.R.C., where there is no question that NOL carryforwards are allowed.

B. ARGUMENT

I. The Court Failed to Affirmatively Rule on the Department's Reliance on Financial Accounting to Define "Entire Net Income" and the Unconstitutional Delegation of Power than Results from Such Reliance

Petitioner Synovus raised and presented at trial that the Department's reliance on financial accounting to define entire net income creates an unconstitutional delegation of authority to a private entity. The Court has failed to rule on that issue.

At its base, Synovus argues it is required by statute to pay tax on its South Carolina apportioned share of entire net income. *See* S.C. Code § 12-11-20 ("A tax is imposed upon every bank . . . which shall be levied, collected and paid annually with respect to the entire net income."); *see* S.C. Code § 12-11-40 ("For the purpose of . . . allocation and apportionment . . . the provisions of Chapter 6 of this title . . . are adopted."). As to these two elements, no dispute exists on Petitioner's apportionment computation. Rather, the dispute was—and continues to be—the computation of entire net income.

At trial, Synovus asserted entire net income means taxable income. The Department, to the contrary, asserted entire net income means financial income. Order p. 6 ("The Department's longstanding practice is to use financial accounting to calculate the basis of the bank tax.").

The Court held "Petitioner is a publicly traded company . . . required to use GAAP to prepare its financial statements." Order p. 4. Thus, under the Department's requirement of financial

accounting, Synovus, along with all publicly traded banks in South Carolina, must conform to GAAP in computing entire net income.

However, despite finding GAAP is mandatory for Synovus and all publicly traded banks and despite further finding "[t]he FASB is an independent non-profit corporation" (*see* Order p. 24), the Court fails to rule on the unconstitutional delegation of authority issue raised by Synovus. Instead, the Court merely states "any delegation of taxing power to the FASB **could** constitute a violation of the South Carolina Constitution." (emphasis added)*See* Order p. 24.

Accordingly, to ensure all issues raised and presented are preserved for appeal, the Court is asked to rule on Synovus' claim the Department's use of financial accounting is an unconstitutional delegation of authority to FASB. *Cowburn v. Leventis*, 366 S.C. 20, 41, 619 S.E.2d 437, 449 (Ct. App. 2005) ("When a trial court makes a general ruling on an issue, but does not address the specific argument raised by a party, that party must make a Rule 59(e) motion asking the trial court to rule on the issue in order to preserve it for appeal.").

In ruling on this issue, the Court should find the Department's use of financial accounting for publicly traded banks such as Synovus mandates the use of GAAP in an unconstitutional delegation of legislative authority to the FASB, a private entity. *See E. Fed. Corp. v. Wasson*, 281 S.C. 450, 452, 316 S.E.2d 373, 374 (1984) (there the determination of the tax due was dependent "solely [on] the discretion of the MPAA . . . which . . . of necessity, determines which films will be taxed at twenty percent [and thus causes a] . . . clear [unconstitutional] delegation of legislative power.")

II. The Court Reached an Incorrect Conclusion by Determining the Bank Tax is Based on Financial Accounting and Has Created an Equal Protection Issue.

Synovus has consistently asserted entire net income is a concept that encompasses all sources of income and all expense of the taxpayer in determining taxable income while the

Department consistently asserts entire net income means financial income. Having the burden of proof, Synovus, in its case-in-chief, established sufficient evidence supporting taxable income as the base for the bank tax. The Court, after Synovus met its initial burden at trial, required the Department to present its case-in-chief.

The Department's case-in-chief established evidence of financial income as the base for the bank tax. The Court, after weighing the evidence and analyzing the law, found, as a GAAP filer, "Petitioner's 'book income' is equivalent to its 'net income.'" Order p. 39. But, in doing so, the Court made a broad finding in footnote 33 by holding "'book income' represents the revenues minus losses **based upon whatever accounting method is used**, which may be GAAP." (emphasis added). Order p. 39.

Accordingly, the Court's Order *sua sponte* creates a new, first-time position not addressed by either side in their cases-in-chief. The case before the Court in *Synovus* (the dispute to be addressed) is what are the ramifications of the Department's mandating Synovus use GAAP for setting the rules defining "entire net income" for a publicly traded bank. The issues the Court now raises by its Order are the ramifications of the Department's imposing "whatever accounting method is used" as the rules defining "entire net income."

As was presented at trial, the bank tax regulations allow a bank taxpayer to use cash based or accrual based accounting. Tri. Tran. Von Lehe at p. 40. *See also* Tri. Tran. Beckwith at p. 190-191. There are multiple accrual based accounting methods. One such method is GAAP. Cash based accounting does not and cannot use GAAP accounting. Tri. Tran. Branch at p. 77. The difference in the accounting methods is substantial. An accrual based publicly traded bank operating under GAAP accounting should not see a different result from a non-GAAP filer who

has the ability to adjust high earning volatility resulting from temporary conditions, such as losses in one year reflected in a subsequent year just as in an NOL carryforward.

At a minimum, the Department's ability to impose such obligations raises equal protection concerns not previously examined by the parties. For example, experts and perhaps bank witnesses will likely need to show that virtually identical banks with similar incomes and expenses but employing different accounting methods produce different bank tax liabilities. *Joseph v. S.C. Dep't of Labor, Licensing & Regulation*, 417 S.C. 436, 451, 790 S.E.2d 763, 771 (2016) ("Under the rational basis test, the Court must determine: (1) whether the law treats similarly situated entities differently; (2) if so, whether the legislative body has a rational basis for the disparate treatment; and (3) whether the disparate treatment bears a rational relationship to a legitimate government purpose.").

Likewise as to due process. *Worsley Co., Inc. v. Town of Mount Pleasant*, 339 S.C. 51, 56, 528 S.E.2d 657, 660 (2000) ("Substantive due process protects a person from being deprived of life, liberty or property for arbitrary reasons."). The law and facts of similar banks with different accounting methods for entire net income could now need to be shown by applying a rule of "whatever accounting method is used" and deciding if arbitrary differences result in bank tax.

Accordingly, here the issue raised *sua sponte* should be a basis for either reopening the hearing or removing the issue and a rewriting of the Order consistent with deciding the ramifications of the Department mandating Synovus use GAAP for setting the rules defining "entire net income" for a publicly traded bank.

III. The Order of the Court Creates a Due Process Issue by Creating a Binding Norm Without an Applicable Regulation Having Been Issued by the Department of Revenue

Due process requires definiteness to meet the minimum standard of due process. *Huber v. S.C. State Bd. of Physical Therapy Examiners*, 316 S.C. 24, 26–27, 446 S.E.2d 433, 435 (1994)

("[w]hen the persons affected by the law constitute a select group with a specialized understanding of the subject being regulated, the degree of definiteness required to satisfy due process is measured by the common understanding and knowledge of the group.").

Here, the Court failed to enter a conclusion of law required by its findings of fact. The Court in its Order, p 25 – 26 factually found:

> While the testimony of these experts indicates that the actions of the Department's staff have led some practitioners to perceive the Department's interpretation of the bank tax as based on book income or financial net income, the fact remains that the Department has not issued any formal guidance on how it calculates or interprets "entire net income" beyond S.C. Regulation 117-1500.1.

Further, the Court factually found "the Department has no formal ruling or publication interpreting the meaning or calculation of 'entire net income'." Order p. 26. Here, after 83 years of bank taxation, the Department has articulated no published standard for compliance by the public and the banking industry despite the creation and changes in the FASB and GAAP.

Accordingly, the Court's factual findings fail to produce a required conclusion of law. A failure to act for 83 years violates Synovus' due process rights of definiteness when a state agency with authority to issue regulations fails to issue regulations on the most fundamental issue of taxation: what income and expenses constitute the taxable base upon which the bank tax is imposed.

Not all agency positions must be promulgated as a regulation. A regulation is required if an agency applies a position announcing a rule having "general public applicability." S.C. Code Ann. § 1-23-10(4); *Home Health Serv. Inc. v. South Carolina Tax Comm'n*, 312. S.C. 324, 328, 440 S.E.2d 375, 378 (1994). However, a regulation is not required if the agency is simply making a policy statement. *Id.* The line of demarcation is whether the agency action establishes a "binding

norm." *Home Health* at 328; 440 S.E.2d at 378. If yes, a regulation is required; if no, a regulation is not required.

A binding norm is found based on "the extent to which the challenged policy leaves the agency free to exercise its discretion to follow or not to follow that general policy in an individual case, or on the other hand, whether the policy so fills out the statutory scheme that upon application one need only determine whether a given case is within the rule's criterion." *Ryder Truck Lines, Inc. v. United States*, 716 F.2d 1369, 1377 (11th Cir. 1983).

Here, the Court as a factual finding stated the Department's policy as "[t]he Department's longstanding practice is to use financial accounting to calculate the basis of the bank tax." Order p. 6. The agency has no ability "to exercise its discretion to follow or not to follow" the use of financial accounting. *Id.* Synovus is a bank; financial income is required. That's the binding rule. Then, having set a binding norm, the agency must promulgate regulations telling the taxpaying public what "entire net income" is. *Joseph v. S.C. Dep't of Labor, Licensing & Regulation*, 417 S.C. 436, 451, 790 S.E.2d 763, 771 (2016)

This Court should amend its Order to issue a conclusion that Synovus' due process rights require the Department to issue a regulation with the definiteness to meet the minimum standard of due process. And, further, the Order should state that because the Department has not issued the required regulations, the use of taxable income is more persuasive than application of an illegal position advanced without authority under the Administrative Procedures Act.

IV. The Intent of the Legislature has been Disregarded and Should Be Reconsidered by the Court

The intent of the Legislature and statutory authority, which afforded banks the ability to calculate "entire net income" on all profit and all expense, has been available since 1922 when banks were first taxed and continues to the present. Regardless of how the accounting method is

viewed, both under historical legislative interpretation and under accounting methods, expenses in excess of profit have always been allowed to be accounted for and utilized under the bank tax. Expenses are now, and always have been, allowed to be taken as a means to reduce taxable income for banks in South Carolina regardless of the terminology used. Today, an NOL carryforward (located on the balance sheet) is the manner in which accounting requires the excess expense from one year to be taken in a subsequent year for a publicly traded company. The Court placed improper weight on prior determinations of the Department that did not directly address the issues in this case and improperly disregarded the express language of the Legislature, both current and historical. The concept of entire net income is based on the application of a tax deduction for every expense incurred. For publicly traded companies, including banks, this benefit can only be achieved through NOL carryovers due to accounting rules. Under both conformity and through the accounting rules of GAAP, an NOL carryforward is allowed for a bank in South Carolina. As such, the Court should reconsider its decision denying an NOL carryforward to be taken by banks in South Carolina

V. Deference to the Department of Revenue is Not Appropriate and is Inconsistent with the Court's Order

Throughout the Court's Order, deference is repeatedly given to the Department's prior interpretation of "entire net income." Such deference is inappropriate under the circumstances in this case. The Court finds throughout the Order that the Department's own interpretation of the term "entire net income" has never been uniform and has never been codified in a regulation. The inconsistent application of the bank tax basis by the Department from the very beginning of the bank tax enactment is omnipresent in this dispute. The Department's inconsistency goes not just to the subject matter, but to the very terms used to describe the bank tax basis. In the decisions on which this Court relies, the Department does not even use consistent terminology. Instead, the

basis of the bank tax, which has never been clearly defined by the Department, is described to be net income, total net income, a franchise tax, book income and GAAP. *See* Order page 8. The bank tax form itself requires a bank taxpayer to begin their tax calculation based on taxable income, a position that the Department's own expert agreed "wasn't a very good way of starting." Tri. Tran. At p. 192. The Department's inconsistency on the basis of the bank tax and definition of entire net income included the Department changing its position on this critical term up to and including during the trial on this matter. *See* Order p. 24. If the Department does not know the meaning of – nor has a clear interpretation of – "entire net income" after 83 years of the bank tax, there is no valid basis for any deference to be given to the Department on any issue related to the bank tax. As shown in the Order and through the evidence presented at trial and in motions, the term "entire net income" has never been uniformly interpreted by the Department. The Court has acknowledged this in the Order. *See* Order, p. 26. Since the Court does not give deference to the Department on how to calculate "entire net income," deference cannot be given on any issue related to the bank tax. In light of the Department's inconsistent application and descriptions of the bank tax basis since its inception, there can be no more "compelling reason" to overrule an agency than its own unclear stance on the most basic issue of a tax statute – the basis of the tax. As such, *all* determinations in the Court's Order based on "deference to the Department" should be reconsidered by this Court.

VI. Tax Conformity Must be Determined by the Legislature, Not the Department of Revenue

The Department argued that tax conformity did not extend to the application of an NOL carryforward to banks because banks are treated "differently" in South Carolina from other corporations. *See* Order p. 10. The Department then admitted that conformity *does apply* to banks in South Carolina, but only in certain, limited situations. *See* Order p. 16; Order p. 20, referencing

Information Letter 94-35; Order p. 21, referencing P.L. Ruling #95-10 (Aug. 28, 1995); Order p. 21, referencing Form 1101 B. The Court improperly agreed with this conclusion and again gave deference to the Department's determination that conformity can, somehow, partially apply to the bank tax. *See* Order, p. 2; Order p. 19. The conclusion of the Court (and argument of the Department) are inherently inconsistent and do not comply with the will of the Legislature. Without specific exception by the Legislature, there is no such concept as partial conformity.

Either conformity applies or it doesn't. There is nothing in the conformity statute that instructs the Department to only apply conformity to banks in certain situations or to certain sections of the bank tax. In fact, the opposite is true. The Legislature has repeatedly, in every year since 2005, instructed the Department to apply conformity to ***all*** taxes contained in Title 12 of the South Carolina Code. There is no limitation or carve out for the bank tax or for certain sections of the bank tax. The Court's acknowledgment and admission that certain portions of the bank tax are subject to conformity while ignoring other sections of the bank tax is wholly inconsistent with the principals of statutory construction and the intent of the Legislature.

The Court's readings of § 12-6-40 and of the decoupling statute are incorrect. If the Legislature had intended for § 12-6-40 to exclude the bank tax, it would have affirmatively stated such. An exception to clear Legislative intent cannot be inferred. There is no mention that the Legislature intended to exempt banks from conformity when it used the language "this title and all other titles that provide for taxes administered by the department, except as otherwise specifically provided." *See* Order p. 17 (*quoting* S.C. Code § 12-6-50). The language from S.C. Code § 12-6-50 has no impact on the South Carolina Legislature's clear intent to apply conformity to the bank tax. The exceptions and exclusions specifically listed in 12-6-50 are the sections of the I.R.C. the South Carolina Legislature did not intend to adopt, nothing more.

As the Court correctly notes, the South Carolina Legislature did affirmatively decide not to include in its conformity of the I.R.C. to Title 12 certain provisions of the I.R.C. related to banks. These sections of the I.R.C. do not, however, contain the NOL deduction at issue in this litigation. The Court's inference that the decoupling of §§ 581, 582, 585-596 of the I.R.C. implies that conformity does not apply to banks in South Carolina is misguided and ignores the portions of the I.R.C. applicable to banks that were not decoupled. The sections of the I.R.C. applicable to banks are not limited to those that were decoupled.

Further, and more importantly, the South Carolina Legislature did not exclude the South Carolina bank tax from those taxes included in Title 12 upon which conformity applies. The fact that the bank tax is taxed at a different rate does not alter the Legislature's intent to include the bank tax in the broader conformity scheme. The Legislature did not "forget" to include language that exempts an entire industry (banking) from the most substantive overhaul to the state tax code the state has ever undergone.

Further, the Court's initial holdings related to § 12-6-630 on page 19 of the Order are wholly inconsistent with the Court's application of § 12-6-630 later on the same page of the order. On one hand, the Court holds that § 12-6-630, including Article 9 (containing carryforward deductions) is not applicable to banks in South Carolina while on the other hand holding that § 12-6-630 related to allocation and apportionment is applicable to banks. These counter holdings are illogical and do not conform to the intent of the Legislature, to conform ***all*** of Title 12 to the I.R.C. Based on the Court's Order, it is clear the Court took into account the language of the bank tax wherein the Legislature specifically instructed banks to conform to the Chapter 6 in § 12-11-40, but came to the wrong conclusion. There can be no distinction as to what parts of Chapter 6 apply to the bank tax. Again, in neither § 12-6-630 nor in § 12-11-40 did the Legislature include any

specific reference to any specific sections of the bank tax to exclude. To infer one exists and splice § 12-6-630 and § 12-11-40 goes beyond the clear intent of the Legislature and ignores the explicit language in § 12-11-40 that "***all*** of the provisions of Chapter 6 of this Title that may be appropriate or applicable are adopted and made part of this Chapter [chapter 11, bank tax chapter]." *See* Order p. 19, quoting S.C. Code § 12-11-40.

The language of the Legislature is clear, concise and unambiguous. Conformity applies to ***all*** taxes contained in Title 12 of the tax code. That includes the bank tax. The Department has conceded this point by applying conformity to certain portions of the bank tax. Both the conformity statute itself and the Department's application of the conformity statute to portions of the bank tax remove any question as to the application of conformity to the bank tax statute.

Further, the Court's conclusion that conformity does not apply because the bank tax is based on financial (book) income not taxable income is incorrect. The bank tax statute itself uses the term "tax on income". As agreed by all experts, the use of the term "franchise tax" in relation to the bank tax does not mean the tax is not a tax on income. Tri. Tran. at p. 82, 100. As stated above, the Court's deference to the Department on this issue is improper. As such, the Court should reconsider its conclusion that conformity does not apply to the bank tax and as such, an NOL carryforward is allowed.

VII. The Definition of "Entire Net Income" includes all income minus all expenses. To account for all expenses through the South Carolina bank tax, a NOL deduction must be allowed.

The Court found that the term "entire net income means all of a company's gross income minus gross expenses." *See* Order page 7. The Court has also concluded that "'entire net income' captures all different sources of income and all expenses. In fact, if the word 'entire' captures all different sources of income, it must also capture all expenses." Court Order, p. 32. The Court's

ultimate holding, however, is contradictory to this finding. The Court's holding has an end result that a ruling has been made that an NOL carryforward is not an expense and that expenses cannot be used in subsequent years. Both are incorrect determinations. As was presented at trial, the losses at issue that are claimed as an NOL carryforward are expenses that exceed income and have been carried over to the next year to allow utilization of all such expenses. Tri. Tran. at p. 140. As was presented at trial, there is no question as to the source of the NOL. *Id.* The NOL was, and is, an expense. *Id.* There is also no question that nothing in the statute or in any regulation promulgated by the Department limits the use of such expenses to one year. Tri. Tran. P.87, 205-208. As stated by the Department's expert, when using "net income" from the income statement alone to determine "entire net income" the expenses simply disappear showing the fallacy with the Department's argument and Court's decision. Tri. Tran. at pp. 177, 197.

As stated above, the Department has failed to issue any regulations related to how to calculate "entire net income" under the bank tax and failed to ensure the manner in which publicly traded banks must perform their financial accounting is in alignment with the bank tax. As argued by the Department, for the first time at the hearing of this matter, the Department now believes "entire net income" should generally be interpreted to be the equivalent of "net income" under GAAP. *See* Order, p. 24. The problem with this argument is two-fold. First, it would only apply to a publicly traded bank that uses GAAP (*see* Order, p. 26) and, second, it is inconsistent and irreconcilable with the term "entire net income" used by the Legislature. "Entire net income" and "net income" are different terms. "Net income" is a term with a specific meaning under GAAP. As all experts and this Court agree, the term "entire net income" does not exist under GAAP. *See* Order p. 25. All the experts also agreed that GAAP requires the use of multiple financial statements in conjunction with each other, not just the income statement on which the "net income" for one

year is found. Hr'g Tr. 8:81:2-22; 92:5-16; 172:1-4. Finally, all the experts agreed that the "net income" as applied to one year does not allow a bank to account for "all of a company's gross income minus gross expenses" which this Court has ruled is the definition of "entire net income." Hr'g Tr. 174:25-175:10. As a result, the "net income" found only on the income statements is not a proper or reasonable manner to determine "entire net income."

As was presented at trial, GAAP does allow for an NOL carryforward. *See* Tri. Tran. Branch at p. 83. The only manner for a publicly traded bank to calculate and include "all expenses" in the calculation of entire net income if there are more expenses than income in a 12 month period under GAAP is to use ASC 740. *Id.* ASC 740 is only applicable to taxes based on income (an income tax). ASC 740 looks beyond what a tax is called to how the tax is calculated. As a result, ASC 740 is applicable to some taxes that have been called franchise taxes, like the South Carolina bank tax. Hr'g Tr. 35:12-18; 43:3-20; 44:16-23; 45:3-9; 53:19-23; 82:14-24. ASC 740 discusses and specifically prescribes that a NOL carryforward is the manner in which excess expenses or losses from one year must be accounted for in a subsequent year. This is the result of changes in the accounting rules that publicly traded companies, including banks, must follow. While the calculation and accounting metric has changed, this has been the same process that has been in place since 1918. As quoted by the Court, in the 1918 Revenue Act, which uses the term "entire net income," all expenses and deductions were taken from year to year until "the entire net income ha[d] been accounted for." *See* Order, p. 28, quoting the Revenue Act of 1918. The change in how the accounting is performed, which today is performed according to ASC 740, does not change the underlying intent and purpose of the Legislature to allow all expenses to be accounted for in the calculation of "entire net income" for South Carolina bank tax purposes. As such, the Court should reconsider its ruling that NOLs are not expenses, that expenses cannot be taken in

subsequent years, that ASC 704/GAAP do not allow NOLs and that "entire net income" is equivalent to "net income" from the income statement.

VIII. The Bank Tax is an Income Tax

This Court acknowledges that the Petitioner "correctly observes the bank tax is statutorily referred to as an 'income tax' on banks or 'tax based on income.'" Order, p. 14. As noted by the Court, this definition of the bank tax basis is based on the plain language in the statute. Order, p. 14. The Court then disregards the plain language of the statute and instead gave unreasonable deference the Department and its labeling of the bank tax as a franchise tax. The interpretation of the bank tax to be a franchise tax mandates that the tax is to be calculated on income for the privilege of performing business in the state. A method for such a calculation has never been put forth by the Department. It is not the labeling the bank tax as a franchise that results in an incorrect determination. Instead, it is the implication asserted by the Department and acceptance by this Court that the labeling of the bank tax as a franchise tax somehow changes the basis of the tax from an income tax to a tax calculated based on net income – a term that has never once been used by the Legislature in reference to the bank tax. This determination is not logical based on the terminology expressly used by the Legislature. A tax based on income is an income tax. All references to the bank tax in the statute refer to the bank tax as an "income tax." There is no confusions about the use of the term "income tax" in the bank tax statute. As such, this conclusion by the Court should be reconsidered.

IX. Equity requires all Income and All Expenses to be Taken by a Bank including Through an NOL Carryforward Deduction

As the Court acknowledges, the principal behind an NOL carryforward is an issue of equity. *See* Order, p. 32. The fact that this can only be accomplished due to a deduction based on current accounting rules should not establish the standard in this case or undermine the intent of

the Legislature that a bank include all income and all expenses for purposes of calculating "entire net income" for tax purposes. As a result, the Court should apply a standard that acknowledges the equitable nature of the underlying issue. In this case, not only is the issue one of equity but the Court has held that the term "entire net income" means "all gross income minus all gross expenses" *See* Order, p. 7. The Court has further held that there is no manner to capture all expenses other than through an NOL carryforward deduction. As a result, any ambiguity should be construed in favor of the taxpayer, not the Department who has never proffered a clear and precise definition of "entire net income," the basis of the bank tax, in the 83 years the bank tax has been in existence. It is clear that the intent of the Legislature has been to repeatedly allow a bank to account for all income and all expenses in its payment of taxes. At all times, this has been accomplished through the Legislature's clear and decisive use of the term "entire." "Entire" includes an accounting of all expenses. The fact that this is only accomplished through an NOL carryforward deduction if there is an overflow of expenses from one year to the next, does not change the underlying intent of the Legislature to allow the expenses to be captured. This Court is improperly hyper-focused on the method (NOL carryforward) instead of the intent (to account for all income and all expenses). This problem is exacerbated by the Department's history of refusing to address the bank tax in any substantive means. Further, the Legislature was clear and has remained clear every year in which conformity has passed since 2005 that the IRC, which specifically allows for an NOL carryforward, be applied to the Title 12 of the tax code including the bank tax. The use of the term Title, instead of Chapter was not by accident. The Legislature does not make accidents. *See Gordon v. Phillips Utils., Inc.*, 362 S.C. 403, 608 S.E.2d 425 (2005) (citing *State ex rel. McLeod v. Montgomery*, 244 S.C. 308, 314, 136 S.E.2d 778, 782 (1964)) ("[T]he legislature intends to accomplish something by its choice of words, and would not do a futile thing.") There is no plainer

terms in statutory construction than "title" and "chapter." The meaning of each word is clear and unambiguous. If the Legislature had intended conformity to apply to anything other than all of Title 12 it would have stated so, it did not.

Based on both conformity and the use of the "entire net income," the Legislature has at all times made clear that all income and all expenses are to be taken by banks. If the manner through which that must be accomplished in the audit years at question is through an NOL carryforward deduction such a deduction was clearly intended by the Legislature.

C. CONCLUSION

Petitioner therefore respectfully requests this Court reconsider its Order in this case.

Dated this 8th day of May, 2020.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on the 8th day of May 2020, the foregoing Memorandum in Support of Motion to Reconsider the Findings of Fact, Conclusions of Law and Order has been served upon the following persons via U.S. Mail, First Class thereto:

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42742180.5

STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

Synovus Bank, Petitioner, vs. South Carolina Department of Revenue, Respondent.	DOCKET NO. 17-ALJ-17-0418-CC **RESPONDENT'S RESPONSE TO PETITIONER'S MOTION TO RECONSIDER**

Pursuant to SCALC Rule 29(D), Respondent South Carolina Department of Revenue (Department) hereby responds to the Motion to Reconsider filed by Petitioner Synovus Bank ("Synovus" or "Taxpayer") on May 8, 2020. The Department respectfully requests the Court deny Synovus' Motion to Reconsider ("Motion"). The Department incorporates into this response by reference the arguments and issues raised in its Proposed Final Order and Supplemental Brief. In response to Synovus' Motion, the Department would show the Court the following:

ARGUMENT

Before addressing each of the nine specific issues raised by Synovus in its Motion, the Department makes the following general responses to the Motion:

First, Synovus' Motion fails to meet the appropriate legal threshold for a motion to reconsider. SCALC Rule 29(D) permits a party to move for reconsideration of a final decision of an administrative law judge in a contested case, subject to the grounds for relief in Rule 59, SCRCP. A Rule 59(e) motion is "an extraordinary remedy that should be applied sparingly." *Mayfield v. Nat'l Ass'n for Stock Car Auto Racing, Inc.*, 674 F.3d 369, 378 (4th Cir. 2012).[1] Thus, "[t]he standard governing motions to reconsider

[1] South Carolina's appellate courts have not addressed in detail the standards governing a motion for reconsideration under Rule 59(e). However, the Notes for Rule 59, SCRCP, provide that "This Rule

are strict." *Greenville Cnty. Republican Party Exec. Comm. v. South Carolina*, No. 6:10-cv-01407-JMC, 2011 WL 2910360, at *1 (D.S.C. July 18, 2011). A court may only alter or amend its judgment if the movant shows: (1) an intervening change in the controlling law; (2) new evidence that was not available at the time of the ruling; or (3) that there has been a clear error of law or a manifest injustice. *Robinson v. Wix Filtration Corp.*, 599 F.3d 403, 407 (4th Cir. 2010). Synovus' Motion fails to show any of these three requirements.

Second, Synovus' Motion simply rehashes the same issues it raised in its extensive pre-trial briefing, argued during the bench trial and in its proposed final order, and upon which this Court has already ruled. The Motion should be denied because this is an improper basis for a motion to reconsider. *In re Building Materials Corp. of America Asphalt Roofing Shingle Products Liability Litigation*, 2013 WL 3337833, 2 (D.S.C. 2013) ("It is inappropriate to use a motion to reconsider as a means to rehash issues upon which the court has already ruled merely because the movant disagrees with the court's ruling. Accordingly, in order to prevail, the moving party must advance a legal basis for its motion beyond simply disagreeing with the court's judgment.").

Third, to the extent Synovus' Motion raises any new issues that it failed to raise prior to the Final Order, the Motion should be denied because a "party cannot use a motion to alter or amend a judgment to present to the lower court an issue the party could have raised prior to judgment but did not." *Gartside v. Gartside*, 383 S.C. 35, 677 S.E.2d 621 (Ct. App. 2009).

Fourth, Synovus devotes a significant portion of its Motion attacking a strawman.

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59 is substantially the Federal Rule." *See also, Elam v. S.C. Dep't of Transp.*, 361 S.C. 9, 22, 602 S.E.2d 772, 779 (2004) ("Rule 59(e) in the South Carolina and federal rules of civil procedure is practically identical."). Thus, "[s]ince our Rules of Procedure are based on the Federal Rules, where there is no South Carolina law, we look to the construction placed on the Federal Rules of Civil Procedure." *Gardner v. Newsome Chevrolet-Buick, Inc.*, 304 S.C. 328, 330, 404 S.E.2d 200, 201 (1991).

Throughout this litigation, and throughout the various objections raised in the Motion, Synovus repeatedly alleges the Department is *mandating* Synovus use GAAP. (*See* Motion, p. 7) ("The case before the Court . . . is what are the ramifications of the ***Department's mandating Synovus use GAAP*** for setting the rules defining 'entire net income.'") (emphasis added). No matter how many times Synovus states this claim, it is factually incorrect and unsupported by the record.

The Department has never asserted that a bank *must* use GAAP to calculate its entire net income, nor has the Department ever contended that GAAP is or should be a wholesale proxy or binding framework for calculating entire net income. Not only is this a mischaracterization of the Department's position, but Synovus has never actually identified a single document or statement in which the Department has "mandated" the use of GAAP like Synovus claims. Instead, the record demonstrates the Department's position has remained unchanged: "entire net income" in the bank tax is based on the net income (or book income) of the bank. This net income will generally (though not mandatorily) be computed using GAAP because that is the accounting method typically employed by banks:[2]

- "[B]anks compute their income subject to the bank tax **based on book income**. As a result, the bank tax income is *generally computed using GAAP*." (Tr. Ex. 26, p. 6) (SC Revenue Ruling # 16-x) (emphasis added).

- "Banks file using net book income. . . [T]he base tax for banks is the **company's book income**." (Tr. Ex. 19, p. 11) (Synovus Audit File).

[2] Synovus accuses the Department of "changing its position" on this issue during the trial of this matter, but its Motion is devoid of even an iota of testimony or evidence showing specifically when or how the Department "changed its position." Unfortunately, this misunderstanding of the Department's position also appears in the Court's Final Order. On pages 24 and 26, the Court suggests the Department changed its position regarding the use of GAAP in this matter, from contending that book income *must* be calculated pursuant to GAAP to now contending that book income should *generally* be equivalent to net income as calculated under GAAP. This Department is unsure the basis for the Court's finding, and the Department respectfully disagrees and maintains that its position has not changed but remained consistent throughout this contested case.

- "Banks determine their South Carolina tax base for purposes of the bank tax based on their book income." (Tr. Ex. 21) (Department Determination).

- "Entire net income is sometimes referred to as 'book income'. . . The Department's longstanding administrative policy is that the bank tax is based on financial accounting rather than federal income tax accounting. Thus, the bank tax is based on financial reporting income and should *generally be computed* using Generally Accepted Accounting Principles (GAAP)." (Department Response to Synovus Motion for Summary Judgment, p. 9) (August 8, 2018).

- "Therefore, the Department's conclusion that the "South Carolina bank tax is *generally* computed using financial reporting income based on GAAP" is not a prescriptive mandate. It merely recognizes a bank's book income will typically be computed using GAAP because GAAP is the predominant accounting method (and in some instances, required under federal law) by which most modern financial institutions keep their books— including Petitioner." (Department's Proposed Final Order, p. 27) (December 16, 2019).

Contrary to Synovus' contention (repeated again in its Motion) the Department's longstanding position does *not* require a particular accounting method to determine the bank tax base; rather, it is relying on a particular concept (net income) that exists within all financial accounting methods to determine the tax base.

Fifth, throughout its Motion Synovus complains *ad nauseam* that "in the 83 years the bank tax has been in existence" the Department has a history of "failing" or "refusing" to issue a regulation or policy document history "address[ing] the bank tax in any substantive means." (*See* Motion p. 2, 9, 10, 12, 16, 18-19). This tired refrain ignores the fact that Regulation 117-1500 (Bank Tax) addresses the bank tax in a substantive manner. This formal regulation promulgated by the Department (consistent with published Attorney General opinions) has provided guidance to taxpayers for over 50 years, and clearly indicates the Department holds the following interpretations of the bank tax and how it is to be calculated:

- It is a franchise tax for the privilege of operating, or doing business in this State.

- The term "entire net income" include income derived from any source whatsoever including interest on obligations of the United States, the United States Government or its possessions or of any state and any political subdivision thereof.

- "Entire net income" and "net income" are interchangeable.

- Net income is computed based on financial income under either a cash or an accrual basis.

- A bank may request permission to change its method of accounting from a cash to an accrual basis or from an accrual basis to a cash basis over a ten year period.

- Banks reporting on a cash basis may deduct Federal income estimated tax payments in the year in which they are paid. Cash basis banks using a method other than above may convert by using ten year conversion period as permitted under SC Regulation 117-1500.2.

In addition to the Regulation, the Tax Commission published opinions on the bank tax in 1975, and the Department issued a Revenue Ruling in 1992 (and a draft ruling in 2016) as well as its longstanding bank tax Form 1101B, all of which offer the additional formal guidance on the bank tax:

- The **bank tax is different from the corporate tax**. (Tr. Ex. 25).

- The phrase "entire net income" means "all income from whatever source derived, less all expenses incurred." (Tr. Ex. 25).

- "The special base of [the bank] tax is, therefore, **economic income rather than taxable income**." (Tr. Ex. 25).

- The bank tax is a franchise tax **based on "net income**." (Tr. Exs. 24, 27).

- The "method of measuring the [bank] tax would be circumvented unless a taxpayer is required to pay its tax based on the **economic gain** generated by the business **during the prior year**."

- **Expenditures should be deducted for the year in which they were paid**, which preserves the **economic concept** and allows all **expenditures during the tax year to be deducted**. (Tr. Ex. 25).

- The accounting period for which the South Carolina bank tax return is filed must be the same as the accounting period used for federal income tax purposes. (Tr. Ex. 27).

- NOL carryforward deductions are not permitted when calculating the bank tax— the very issue that is central to this case. (Tr. Ex. 45).

In short, Synovus' claim that the Department has a "history of refusing to address the bank tax in any substantive means" is bizarre, not supported by the record, and just plain wrong. (Synovus Motion, p. 19).

1. **The Court correctly concluded the bank tax is based on financial accounting and did not err in rejecting Synovus' unconstitutional delegation of power argument.**

Synovus argues the Court failed to rule on the unconstitutional delegation of authority issue, quoting the Court's finding that "any delegation of taxing power to the FASB *could* constitute a violation of the South Carolina Constitution." (Final Order, p. 24) (emphasis added). However, the very next sentence in the Final Order clearly states that "if GAAP is properly used as an evaluative tool rather than a binding standard, ***it does not constitute an unconstitutional delegation of regulatory authority*** to the FASB." (*Id.*) (Final Order, p. 24-25). The Court then concludes this is precisely how GAAP should be used in this case, and therefore it is not improper to use GAAP to determine a reasonable interpretation of "entire net income." This is a direct consideration and rejection of Synovus' argument that the Department had impermissible delegated its taxing authority by relying on financial accounting principles. The Court did not fail to rule on this issue.

The Court was correct in concluding the bank tax is based on financial accounting, not federal taxable income. As noted in the Final Order, tax laws typically describe the calculation of taxable income by defining gross income and then subtracting statutorily authorized deductions. (Final Order, p. 35). Gross income has to begin with some measure of an entity's income during the accounting and tax period in question, and that number is typically calculated based on a taxpayer's books and financial accounting. The legislative history of the bank tax demonstrates this is exactly the case in South Carolina. The tax on banks has always been imposed on a bank's "entire net income" and computed on the bank's "net income" which was defined as "the gross income of a taxpayer less the deductions allowed by this Act." *See* Act No. 1, 1927 S.C. Acts § 7, *codified at* S.C. Code Ann. §§ 65-255 (1952); *see also* Final Order, p. 27-32. Moreover, net income is computed *in accordance with the method of accounting regularly employed in keeping the books of such taxpayer*— that is, the taxpayer's book income based on

financial accounting— less any deductions specifically authorized by the Act, *see* Act No. 1, 1927 S.C. Acts §§ 7–9, 13,. *Id.* at § 9. In other words, since its inception the General Assembly has statutorily required the computation of the bank tax to begin with a number (net income) that is calculated based on financial accounting principles (the method of accounting regularly employed by the taxpayer in keeping its books). Thus, Synovus' argument that the Department has improperly delegated its taxing authority by relying on financial accounting to calculate the tax base for the bank tax is inconsistent with the language and history of the bank tax.

The Texas Court of appeals dealt with a similar issue in *Cent. Power & Light Co. v. Sharp*, 919 S.W.2d 485 (Tex. App. 1996), which was cited in the Department's proposed final order. 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. *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 an evaluative tool to determine a reasonable interpretation of 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." (Final Order, p. 25-26).

Moreover, Synovus' argument here is internally inconsistent. On the one hand, Synovus contends the Department has unconstitutionally delegated its taxing authority by requiring that banks *must* use GAAP to calculate entire net income. On the other hand, it contends the Department *must* permit a NOL carryforward deduction *because GAAP allows such a deduction*. Irrespective of the fact that neither of these contentions are factually correct, 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.

Regardless, the Court correctly found that Synovus uses GAAP accounting to keep its books, and therefore its book income is based on the financial accounting principles found in GAAP. (Final Order, p. 37). Therefore, the Court did not err in finding that Synovus' book income as calculated under GAAP is a proper starting point to determine the bank's entire net income and not an unconstitutional delegation of legislative authority.

2. The Court has not created an equal protection or due process issue.

Synovus' argument in Section II of its Motion is not entirely clear, but it appears Synovus takes issue with the Court's statement in footnote 33 that book income represents the revenues minus losses based on whatever accounting method may be used, which may include GAAP. Synovus contends this is a new issue not previously raised in this contested case proceeding. On the contrary, this is one of the primary issues at the heart of this case.

The Department has argued since the beginning of this litigation that book income means revenues minus expenses, whether under GAAP or other methods of accounting. The Department

Determination expressly argued that the bank tax is based on "book income," which can be computed under different accounting methods:

> **Book income means that a bank may deduct all of its expenses from all of its revenues to calculate entire net income**. *See* S.C. Code Ann. Regs. 117-1500.1, 117-1500.3 (West 2017); *see also* I-D-189 (Jan. 24, 1975) (stating that the bank tax has a special tax base that is economic income rather than taxable income). **A bank may use either the cash or accrual method of accounting**. S.C. Code Ann. Regs. 117-1500.2 (West 2017).

(Tr. Ex. 21, p. 5 and fn. 5) (emphasis added). At trial, Synovus' own expert testified that entire net income means all revenue minus all expenses. (Hr'g Tr. 50:20-22). And the uncontroverted expert testimony solicited at trial, which the Department subsequently included in its proposed final order, established that financial accounting and book accounting are interchangeable terms, that "book income" and "net income" are essentially synonymous, and that financial accounting ultimately produces a number that is the "net income" of the bank, *regardless of what financial accounting method is used.* (Hr'g Tr. 47:21–24, 104:18–105:11, 124:22–125:7, 131:16–132:9). Finally, Regulation 117-1500.2 (which has existed for decades) requires that "net income" be computed on either a cash or an accrual basis, and Synovus specifically noted in its opening argument and its proposed order that the regulation allows the bank tax to be based on different methods of accounting. (Hr'g Tr. 12:23-25). It is difficult to comprehend how Synovus can now claim the Court's straightforward finding that book income can be calculated using different accounting methods and equals revenues minus losses is a "*sua sponte* . . . new, first-time position not addressed by either side in their cases-in-chief."

It appears that Synovus' real objection is to the fact that different taxpayers could elect to use different accounting methods, which Synovus believes *might* result in different net incomes. Although Synvous contends this creates an equal protection and/or due process issue, there are no facts in the record to support this contention or objection and Synovus made no effort to advance such an

argument at trial. Furthermore, as discussed above, the Court's statement that different accounting methods can be used to compute "net income" is entirely consistent with the language of Regulation 117-1500.2 (describing how to compute the net income of a taxpayer) and the 1926 Act (stating that "net income' was computed "in accordance with the method of accounting regularly employed in keeping the books of such taxpayer."). Synovus never raised an equal protection or due process concern at any point during this hearing and it cannot now use its Motion to Reconsider to "present to the lower court an issue the party could have raised prior to judgment but did not." Gartside v. Gartside, 383 S.C. 35, 677 S.E.2d 621 (Ct. App. 2009).

3. The Court should not amend its Final Order to require the Department to issue a regulation.

In its argument regarding due process, Synovus once again complains that the Department has "fail[ed] to act for 83 years" by failing to issue a regulation or any guidance regarding the fundamental issue in this case (how entire net income is determined) and therefore the Court should order the Department to issue a regulation and rule in favor of Synovus. The Court should reject this argument out of hand.

The Department is unaware of any law— and Synovus did not cite to any— by which a court can mandate or order an agency to promulgate a regulation as part of its review of a final agency determination. Such an order would likely exceed the scope of the ALC's jurisdiction as it relates to reviewing final decisions of an agency in a contested case hearing.

Moreover, as discussed in length above, Synovus is simply wrong to suggest the Department has issued no regulation or guidance on the meaning or calculation of entire net income.[3] Regulation

[3] Synovus' request that the Court require the Department to issue a regulation is based on its apparent belief that the Department has an absolute duty to promulgate a regulation interpreting the meaning or calculation of "entire net income." This argument has no basis in law. The Department has no

117-1500 (Bank Tax), as well as the prior Tax Commission decision and Department Revenue Rulings were not secret pronouncements, but interpretations by the Department readily available to taxpayers and upon which taxpayers could—and did—rely. In fact, it is precisely because the Department's interpretation was known and understood that:

- the South Carolina Taxation Realignment Commission (TRAC) could conclude 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" (Tr. Ex. 28);

- the President of the South Carolina Bankers Association could testify 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 (Tr. Ex. 21);

- Synovus own expert could testify about (and publish a book about) the Department's "longstanding interpretation" of the bank tax as a franchise tax based on income, (Hr'g Tr. 35:12-15), which is calculated based on "book income," (Hr'g Tr. 62:4-63:12); and

- Tax accountants in South Carolina could have long understood the term "entire net income" to mean the net income or book income of a bank as determined under basic financial accounting principles (generally using GAAP) and recorded on the bank's income statement, and that banks are not permitted to claim NOL carryforward deductions; (Hr'g Tr. 131:16–132:5, 134:3–135:15, 136:4–137:1, (Hr'g Tr. 166:5–22, 223:14–25, 225:17–20).

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statutory obligation to make rules and regulations—Title 12 specifically includes the promulgation of regulations under the Department's *permissive*, rather than *mandated*, powers and duties. *See* S.C. Code Ann. § 12-4-310 and -320. Are there circumstances in which it may be prudent for the Department to issue a regulation or publish guidance? Yes. Is there a legal duty to do so? No.

In addition, the Department does not—nor should it be expected to—issue a formal ruling or publication a regulation regarding each of the thousands of statutory provisions the Department administers and enforces. It is a practical and administrative impossibility. It also makes little sense to do so when (as is the case here) the Department has interpreted and applied a specific provision consistently over time, that interpretation is consistent with other administrative guidance (attorney general opinions, commission decisions, and agency regulations), and tax practitioners, accountants and other industry professionals have generally understood and followed the Department's longstanding interpretation. In other words, for 83 years the interpretation and calculation of "entire net income" has been consistently applied by the Department and universally understood by banks and tax practitioners, and Synovus has put forth zero evidence to suggest that it was ever interpreted by or applied to other banks in South Carolina in any other manner.

It makes no sense that the above individuals could divine how to calculate the bank tax in a manner consistent with the Department if its interpretation of how to calculate the bank tax was as indecipherable as Synovus suggests.

Finally, Synovus asks the Court to amend its Final Order to adopt Synovus' interpretation of entire net income (that it is based on taxable income) solely because the Department "has not issued the required regulations." (Motion, p. 10). That is not how this process works, and that is not the proper standard for the Court to apply in a contested case hearing. The standard of review for the Court consists of two steps: (1) does the language of the statutes or regulations directly speaks to the issue, and (2) if not, is the agency's interpretation of the statute and regulation worthy of deference. *Kiawah Dev. Partners, II v. S.C. Dep't of Health & Envtl. Control*, 411 S.C. 16, 32–33, 766 S.E.2d 707, 717 (2014). Even if the Court were to conclude the agency's interpretation had not previously been set forth by a formal regulation, it does not follow that the Court must therefore enter judgement in favor of the taxpayer simply as a matter of course.

4. **The Court properly considered Legislative intent.**

The Court did not disregard the intent of the Legislature as it relates to the bank tax and whether a bank can claim a NOL carryforward deduction. In fact, the Court repeatedly echoed black letter law that the goal of statutory construction is to ascertain and effectuate the intent of the *legislature*, that tax policy is exclusively the business of the *legislature*, and that NOL carryforwards are allowed as a matter of *legislative* grace and a taxpayer has the burden of proving it squarely meets the requirements to take them. (Final Order, pp. 11, 39). Further, the Court devoted a large portion of its Final Order examining whether the Legislature intended the bank tax to conform with the Internal Revenue Code (IRC) such that banks can deduct NOL carryforwards and correctly concluded the Legislature did not intent such a result. (Final Order, pp. 16-22). The Court also engaged in a thorough examination of

the history of the income and bank taxes in South Carolina to determine how the Legislature used and defined "entire net income" and "net income." (Final Order pp. 27-35). Again, the Court correctly concluded that the legislative history and text of the relevant statutes demonstrate the NOL deduction is not inherently part of the meaning of "entire net income" and that if the Legislature had intended NOL carryforwards to apply to banks it could have expressly authorized such a deduction in the statute. (Final Order, p. 32).

In fact, the Court specifically noted that its conclusion may result in an outcome that is perceived by the banks as inequitable, and the Court further expressed its sympathy for Synovus' equitable argument, but properly concluded that "it is not this Court's place to judge the wisdom of the Legislature in enacting certain tax policies." (Final Order, p. 35). Synovus may not like the Court's conclusion, but it cannot claim the Court failed to consider or give due regard to the intent of the Legislature.

5. The Department's longstanding interpretation of "entire net income" is entitled to deference.

In its Motion, Synovus argues "throughout the Court's Order, deference is repeatedly given to the Department's prior interpretation of "entire net income" and that such deference is inappropriate. (Motion, p. 11). This argument is puzzling considering the explicit finding by the court that the Department did *not* have a long-standing statutory interpretation of how to calculate "entire net income" and therefore the Department's "nascent" interpretation was *not* entitled to deference (a finding from which the Department respectfully dissents). (Final Order, p. 25-27). To confuse matters more, in the same paragraph Synovus then argues the Court *did not give deference* to the Department on how to calculate entire net income. (Motion, p. 12) (emphasis added). Irrespective of whether Synovus believes the Court did or did not give deference to the Department on how to calculate entire net

income, it argues in its Motion that the Court should reconsider any finding that is based on "deference to the Department." Synovus further argues that if the Court declines to give deference to an agency on one aspect of the disputed issue, it cannot give deference to the agency on any issue related to the disputed issue. (Motion, p. 12). Synovus cites no legal authority for this proposition, and such an all-or-nothing approach is inconsistent with the fundamental tenets of the deference doctrine.

The facts of this case and well-established case law on agency deference demonstrate the Department's interpretation of the bank tax provisions is worthy of deference. *Kiawah*, 411 S.C. at 33, 766 S.E.2d at 717 ("[T]he court then *must* give deference to the agency's interpretation of the statute or regulation, assuming the interpretation is worthy of deference."). As discussed above, for decades the Department has consistently interpreted the South Carolina bank tax as a franchise tax based on ***book income*** rather than federal income tax accounting. *See* S.C. Revenue Rule 16-x (Ex 26., p. 4); Tax Commission Decision I-D-189 (Jan. 24, 1975).[4] Where an interpretation has been consistent and uniformly applied over time, that interpretation is entitled to deference. *Media Gen. Commc'ns, Inc.*, 388

[4] In its Motion, Synovus repeatedly accused the Department of being "inconsistent" in its interpretation and application of the term "entire net income". (Motion, p. 11-12). 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 taxpayer. That is because the record establishes precisely the opposite. Synovus' own expert testified that the Department's interpretation and practice (calculate the bank tax based on financial accounting book income rather than federal taxable income) has been consistent and uniform for at least 40 years. (Hr'g Tr. 51:25–53:8). Similarly, Mr. Beckwith testified that the Department's interpretation of the bank tax as it relates to book income and the disallowance of NOL carryforward deductions has been consistent and unchanged for the nearly two decades that he has been a bank tax accountant in South Carolina. (Hr'g Tr. 140:3–13).

The only concrete example of "inconsistency" that Synovus could identify is the Department's use of different terms related to "entire net income.' 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. (Hr'g Tr. 47:21-24, 49:11-13).

S.C. at 149, 694 S.E.2d at 530–31 ("An agency's long-standing interpretation of a statute is usually entitled to be given deference and should not be overruled by a reviewing court in the absence of cogent reasons, but the interpretation will not be sustained if it contradicts a statute's plain language."). Moreover, the deference doctrine provides that "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, 411 S.C. at 34–35, 766 S.E.2d at 718. Thus, 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." *Id.*

The Court 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. Actually, the Court found the exact opposite: it is *reasonable* to infer that Synovus' book income is equivalent to net income based on financial accounting principles (namely, GAAP), and as such Synovus was not entitled to claim a NOL carryforward deduction. (Final Order, p. 37, 39). The Court based its conclusion on the legislative history, the testimony of the experts, and the history of GAAP and accounting principles. (Final Order, p. 38). Not only did the Court not find any compelling reason to differ with the Department's interpretation, it found compelling and cogent reasons to affirm and defer to the Department's interpretation. Thus, to the extent the Court's deferred to the Department's interpretation, such deference was appropriate and warranted.[5]

[5] The Department respectfully disagrees with the Court's conclusion that 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 formal ruling or publication. As discussed above, under the deference doctrine "the court [] *must* give deference to the agency's interpretation of the statute or regulation,

6. **The Court correctly rejected Synovus' conformity argument.**

In asking the Court to reconsider its conclusion that conformity does not apply to the bank tax, Synovus merely objects to the Court's conclusion and regurgitates the same arguments and issues it raised regarding the conformity issue in its initial protest, the Summary Judgment briefings, and its proposed final order. The Court has already ruled upon these arguments, and Synovus' disagreement with the ruling is not a proper grounds for reconsideration. *In re Building Materials Corp. of America Asphalt Roofing Shingle Products Liability Litigation*, 2013 WL 3337833, 2 (D.S.C. 2013) ("It is inappropriate to use a motion to reconsider as a means to rehash issues upon which the court has already ruled merely because the movant disagrees with the court's ruling. Accordingly, in order to prevail, the moving party must advance a legal basis for its motion beyond simply disagreeing with the court's judgment."). Moreover, the Department has already rebutted these conformity arguments in its prior briefings, and for sake of ease it incorporates those refutations by reference here.

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assuming the interpretation is worthy of deference." *Sierra Club v. S.C. Dep't of Health & Envtl. Control*, 426 S.C. 236, 256, 826 S.E.2d 595, 606 (2019). A formal ruling or publication may be *sufficient* evidence of an agency's longstanding interpretation of a statute, but it is not *necessary* evidence. Similarly, although a position espoused in a formal document issued by the Department would be entitled to greater weight than an 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 formal ruling does not mean the Department does not have an interpretation. That is especially true where, as is the case here, expert testimony and other evidence establishes that the Department's longstanding interpretation has been consistent and known and understood by individuals and industries outside the Department.

Moreover, to the extent the Court declined to give deference to the Department's position because the position has not been "consistently applied to all applicable taxpayers," (Final Order p. 26), that finding is in error. There is no evidence in the record to suggest the Department has ever taxed another bank based on its federal taxable income and not its financial/book income.

7. **The Court correctly held that the definition of "entire net income" does not inherently include a NOL carryforward deduction.**

Similar to its argument regarding conformity, Synovus' request that the Court reconsider its holding that the definition of "entire net income" does not include a NOL carryforward deduction is nothing more than a re-arguing of the same issues already ruled upon by the Court. Synovus has not identified any new evidence or shown a clear error of law, and the Court should not reconsider its holding.

Regardless, the Courts conclusion that entire net income does not inherently include NOL carryforward deductions is supported by the history of the income tax and bank tax in South Carolina. The 1955 amendment to the corporate income tax makes this clear— if entire net income included a NOL carryforward deduction, there would have been no need for the Legislature to amend the statute in 1955 to specifically authorize an NOL carryforward deduction.

The Court should reject Synovus' misplaced argument that "nothing in the statute or in any regulation promulgated by the Department limits the use of such expenses to one year" and that the Department has "failed to issue *any* regulations related to how to calculate 'entire net income' under the bank tax." (Motion, p. 16). As discussed above, Regulation 117-1500.2 specifically describes the method of reporting the bank tax: "the *net income* of the taxpayer as provided for in Section 12-11-10 shall be computed on either a cash or an accrual basis." Note that the Regulation uses the term "net income" (not "entire net income") but references Section 12-11-10, which is the provision that imposes a tax on the "entire net income" of a bank. The importance of this Regulation cannot be overlooked: it is (1) a Regulation issued by the Department (2) related to the calculation of "entire net income" under the bank tax, (3) in which it equates "net income" with "entire net income" and (4)

directs that "net income" must be computed based on a cash or an accrual basis (which is an explicit reference to financial accounting methods).

When this Regulation is read in the context of the legislative history of the bank tax and general accounting principles, both of which the Court examined in detail in its Final Order, it demonstrates the logic and reasonableness of the Department's and Court's interpretation that "entire net income" means the net income of a bank as calculated in accordance with the method of accounting regularly employed in keeping the books of the bank. Accounting periods are typically limited to twelve months. A company's financial statements are based on an annual reporting period. For financial reporting purposes, an entity cannot take a loss generated in one year and use it in future years to calculate its net income. (Hr'g Tr. 228:2–10). Synovus' GAAP expert (who the Court found to be "extremely knowledgeable" in the area of GAAP) testified that **it is the income statement alone** that shows the net income, and it reflects the net income(loss) generated in **that** reporting period. (Hr'g Tr. 127:2-9). Thus, the bank tax is an annual tax on the net income that company earned during its reporting period, and that net income is limited to only the revenues and losses from the one-year accounting period. Synovus has yet to identify anything in the language of the bank tax or its predecessor statutes to suggest that "entire net income" would include anything other than the income and expenses of that particular twelve-month tax year.

Synovus raises two perceived problems with the Court's conclusion. First, it claims that if 'entire net income" should generally be interpreted as the equivalent of "net income" under GAAP, it would only apply to publicly traded banks that use GAAP. This is incorrect. As the experts for both parties testified and the Court correctly concluded, "net income" or "book income" are synonymous financial accounting terms. Every bank keeps its books by some accounting method, and its financial statements will always include an income statement with a bottom line that represents the company's

net income or book income— regardless of whether a company uses GAAP or some other method of accounting. (Hr'g Tr. 45:17--18, 80:7-16, 95:5-10, 105:8-11, 110:7-12, 127:16-128:1, 131:16-132:5; Final Oder p. 36). Second, Synovus objects that the term "entire net income" does not exist in GAAP. This fact is irrelevant. The Department has never claimed that "entire net income" was a term that exists in GAAP. Rather, the Department's longstanding interpretation is that the meaning of the term "net income" (or the colloquial term "book income"), which is well established within financial accounting principles (including GAAP), is a reasonable proxy for "entire net income" as is used in the bank tax statute.

8. **The Court correctly concluded that the bank tax is a franchise tax.**

Synovus contends the Court "disregarded the plain language of the statute and instead gave unreasonable deference the Department and its labeling of the bank tax as a franchise tax." (Motion, p. 18). Synovus cannot seek reconsideration of this issue when it conceded this point at trial. (Tr. Ex. 29) (in which Synovus identified John von Lehe as its expert who would provide testimony "on the history of the bank tax as a *franchise tax* based on income."); (Hr'g Tr. 30:17-22, 53:9-17) (Mr. von Lehe opined that the bank tax is in fact a franchise tax). Regardless, the Court correctly found that there is a long history of interpreting the bank tax as a franchise tax and that such an interpretation is entitled to deference.

Synovus also makes the remarkable claim that by interpreting the bank tax as a franchise tax, the Court has calculated the bank tax based on "net income – a term that has never once been used by the Legislature in reference to the bank tax." In fact, the history of the 1926 Act (which initially applied to banks) repeatedly used the term "net income" in reference to the tax base for banks and indicates that "net income" and "entire net income" were interchangeable terms. (Final Order, p. 30).

Regulation 117-1500 also explicitly states that the bank tax is a "franchise tax on banks" and indicates that "entire net income" and "net income" refer to the same thing.

Finally, although Synovus insists that the bank tax is an "income tax," it has offered no reasons its Motion why labeling the bank tax as an "income tax" (instead of a franchise tax) would alter how the bank tax is calculated. In fact, Synovus' proposed order argued that under its theory of the case it did not matter whether the bank tax is called a franchise tax or income tax. (Synovus Proposed Order, p. 15). What matters is that since the bank tax was enacted it has been interpreted to be different than the corporate income tax and has been calculated based on a bank's "net income" as computed under whatever accounting method it regularly employs. (*See, e.g.*, Tr. Ex. 25) (Attorney General opinion dated June 15, 1937) ("We wish first to emphasize 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.") (emphasis added).

9. **The Court properly rejected Synovus' equity arguments.**

Synovus argues that because the principle underlying the concept of a NOL carryforward deduction the court should rule in equity in favor of the taxpayer. The Court correctly rejected this argument in its Final Order, and it should reject this resurrected version of the argument as well. Other than simply saying so, Synovus has provided no legal basis for its claim that a determination of whether or not NOL carryforwards can be taken by a bank in South Carolina is a question of equity that should be construed in favor of Synovus. Well-settled law requires the opposite: NOL carryforward deductions are a matter of legislative grace, the taxpayer has the burden of proving there is a statute that authorizes such a deduction and that it applies to the taxpayer, and where a statute allowing a deduction is ambiguous the statute must be construed strictly *against* the taxpayer. *See*

CFRE, LLC v. Greenville Cty. Assessor, 395 S.C. 67, 74–75, 716 S.E.2d 877, 881 (2011); *Davis Mech. Contractors, Inc. v. Wasson*, 268 S.C. 26, 29, 231 S.E.2d 300, 301 (1977); *AVCO Corp. v. Wasson*, 267 S.C. 581, 588, 230 S.E.2d 614, 617 (1976).

CONCLUSION

For the reasons stated above, as well as the arguments and issues briefed by the Department in its Proposed Final Order and Supplemental Brief, the Department requests the Court deny Synovus' Motion to Reconsider.

Respectfully submitted,

SOUTH CAROLINA DEPARTMENT OF REVENUE

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Columbia, South Carolina
May 18, 2020

STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

Synovus Bank, Petitioner, vs. South Carolina Department of Revenue, Respondent.	)	DOCKET NO. 17-ALJ-17-0418-CC **PROOF OF SERVICE**

I, the undersigned employee of the South Carolina Department of Revenue, Office of General Counsel, do hereby certify that I have served the **Respondent's Response to Petitioner's Motion to Reconsider** regarding the above-captioned matter by causing a copy of the same to be deposited in the United States Mail on the below date, postage prepaid to the following parties at their address of record:

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