State of South Carolina
Department of Revenue
301 Gervais Street, P. O. Box 125, Columbia, South Carolina 29214

SC PRIVATE LETTER RULING #95-7 (TAX)

TO:	ABC Company
SUBJECT:	Apportionment Factor (Income Tax and License Fee)
DATE:	June 20, 1995
REFERENCE:	S. C. Code Ann. Section 12-7-230 (Supp. 1994) S. C. Code Ann. Section 12-7-250 (Supp. 1994) S. C. Code Ann. Section 12-7-1190 (1976) S. C. Code Ann. Section 12-19-70 (Supp. 1994) S. C. Code Ann. Section 12-19-80 (1976)
AUTHORITY:	S. C. Code Ann. Section 12-4-320 (Supp. 1994) SC Revenue Procedure #94-1
SCOPE:	A Private Letter Ruling is an official advisory opinion issued by the Department of Revenue to a specific person.
NOTE:	A Private Letter Ruling may only be relied upon by the person to whom it is issued and only for the transaction or transactions to which it relates. A Private Letter Ruling has no precedential value.

Questions:

1. Based upon the facts, what apportionment ratio should XYZ use in determining its South Carolina income?

2. Based upon the facts, how will XYZ determine its South Carolina corporate license fee?

Conclusions:

1. XYZ should use the gross receipts formula provided in Code Section 12-7-1190 with the numerator including royalties earned from sales that occur in South Carolina, and the denominator including royalties earned from sales that occur everywhere. Since, under the facts of this case, sales occur at the point of destination, the numerator of XYZ's gross receipts formula will include royalty receipts earned from licensees' sales delivered to customers in South Carolina, and the denominator will include royalty receipts earned from licensees' sales delivered to customers everywhere.

2. Based upon the facts and Code Section 12-19-70, XYZ's South Carolina corporate license fee is based upon the capital stock and paid in surplus accounts reflected on the books. According to Code Section 12-19-80, XYZ will use the apportionment method set forth in Code Section 12-7-1190 (see question 1) to determine its South Carolina corporate license fee since XYZ is doing business partly within and partly without South Carolina.

Facts:

ABC Company, a corporation engaged in X business, has a number of trademarks and service marks associated with its products and services. All of the trademarks and service marks were created, not purchased, by ABC Company and have a zero or de minimis basis. In order to properly manage its trademarks and service marks, to ensure they are properly valued, to provide flexibility in resisting takeovers and to insulate them from litigation risks, ABC plans to place its trademarks and service marks in a separate subsidiary, XYZ. The licenses are for the exclusive use of the trademarks and service marks under which products are sold by ABC and its affiliates.

XYZ will transact its business in South Carolina, but will not engage in manufacturing or any form of collecting, buying, assembling, or processing goods or materials, or selling or distributing or dealing in tangible personal property. All of its real and tangible personal property will be located in South Carolina. All employees, other than some officers, will be employed in South Carolina.

XYZ's only business will be licensing and protecting the use of the trademarks and service marks to affiliated corporations at this time, and possibly with third parties in the future. XYZ will exercise control over the quality of the goods, the labeling and advertising uses of the trademark, and the performance requirements of new products or services intended to be provided under the trademarks. Royalties paid to XYZ represent arm's length values and will be based upon a percentage of the licensees' sales. Sales occur when and at the place they are received by the licensees' customers throughout the United States.

XYZ will be formed in a straight stock for assets exchange which qualifies for tax-free treatment under IRC ' 351. There will be no assumptions of liabilities involved in the transfer.

ABC Company maintains its books and records in accordance with Generally Accepted Accounting Principles (GAAP).[1]

Discussion:

INCOME TAX

Code Section 12-7-230 imposes an income tax on corporations transacting or conducting business in South Carolina, and reads, in part:

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[1]This ruling expresses no opinion with respect to the appropriate GAAP treatment of this transaction.

> ...every corporation organized under the laws of this State, doing or transacting business partly within and partly without this State...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...

Therefore, XYZ is subject to tax in South Carolina. Next, we must determine how much of its income is subject to tax by South Carolina. XYZ is transacting business partly within and partly without South Carolina. See Geoffrey v. South Carolina Tax Commission, 437 SE 2d 13 (1993). Code Section 12-7-250 provides that "the income tax...is imposed upon a base which reasonably represents the proportion of the trade or business carried on within this State". The base upon which South Carolina imposes income tax is determined by an allocation and apportionment process. The allocation process under Code Section 12-7-1120 is applied first, then any remaining income is apportionable. To determine how much of XYZ's income is apportionable to South Carolina, we must determine the correct apportionment factor to be used by XYZ.

Code Section 12-7-1140 provides for the three-factor apportionment formula to apportion the income of corporations whose principal business in South Carolina is manufacturing, selling, distributing or dealing in tangible personal property within South Carolina. Based upon the facts presented, this statute is inapplicable to XYZ. Therefore, XYZ must use the gross receipts method of apportionment provided in Code Section 12-7-1190. Pursuant to this section, a taxpayer using the gross receipts method shall:

> ...make returns and pay annually an income tax upon a proportion of its remaining net income computed on the basis of the ratio of gross receipts from within this State during the income year to the total gross receipts of such year within and without the State.
> Next, we must determine what is included in the numerator and the denominator of the gross receipts factor used by XYZ. In Lockwood Greene Engineers v. South Carolina Tax Commission, 361 SE 2d 346 (1987), the court looked to the place where the income-producing activity occurred in order to satisfy the statutory requirement of identifying the "gross receipts from within this State". In Geoffrey, supra, the court determined that the activity that produced the royalty is the sale in South Carolina. It is the use of the trademark in each state that produces the gross receipts.

Based on the facts presented and the above analysis of recent court decisions, the numerator of XYZ's gross receipts ratio will include royalties earned from sales that occur in South Carolina, and the denominator will include royalties earned from sales that occur everywhere. XYZ's South Carolina apportioned income is then added to income specifically allocated to South Carolina, if any, under Code Section 12-7-1120. This sum results in South Carolina taxable income.

LICENSE FEE

Code Section 12-19-70 imposes the license fee on corporations, and reads, in part:

> In addition to all other license taxes or fees of whatever kind, every corporation...shall pay to the Commission...an annual license fee of fifteen dollars plus one mill on each dollar paid to the capital stock and paid in as surplus of the corporation as shown by the records of the corporation... The phrase 'paid in as surplus'...means the entire surplus of a corporation other than its earned surplus as defined below, and includes any charges against earned surplus reflected in the balance sheet except charges for reserves.

Based upon the above statute and the facts presented, XYZ's license fee will be based on the capital stock and paid in surplus account reflected on it's books. (Also see Commission Decision #89-114.)

Code Section 12-19-80 provides for a proration of the license tax where a corporation, like XYZ, conducts its business partly within South Carolina and partly without. Code Section 12-19-80 reads, in part:

> Where a corporation does business in part within this State and in part without this State...the amount of the license fee provided for in ' 12-19-70 shall be measured by a proportion of the dollars paid to the capital stock and paid in as surplus of the corporation, determined in accordance with the ratios prescribed for the income tax as set forth in...'12-7-1190.

As previously stated, XYZ is doing business partly within and partly without South Carolina. For income tax purposes, it was determined that XYZ will apportion its income under the gross receipts method set forth in Code Section 12-7-1190. Pursuant to Code Section 12-19-80, XYZ will use the same apportionment method to determine its corporate license fee.