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

SC PRIVATE LETTER RULING #95-9 (TAX)

TO: XYZ

SUBJECT: Apportionment Factor
(Income Tax)

DATE: August 14, 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)

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.

Question:

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

Conclusion:

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 the licensees' sales delivered to customers in South Carolina, and the denominator will include royalty receipts earned from licensees' sales delivered to customers everywhere.

Facts:

ABC is a Delaware corporation domiciled in South Carolina. ABC manufactures X products in South Carolina and North Carolina. ABC, also, operates a loading dock in Texas.

Once the X products are manufactured, the majority are shipped to ABC's loading dock in Texas and then shipped to a subsidiary, DEF, for assembly. (A small percentage of the X products are shipped directly to the customer.) DEF is a non U.S. corporation with manufacturing facilities in X country. After assembly, the X products are shipped back to ABC's loading dock in Texas for repackaging and distribution to customers.

ABC has set up a new subsidiary, XYZ, a Delaware corporation domiciled in South Carolina. XYZ owns title and rights to trademarks and tradenames. The trademarks and tradenames are used by ABC to generate sales of tangible personal property in numerous states, including South Carolina. The activities that generate the sales occur in the marketing and distribution process as the ABC name, mark, and reputation is presented to customers.

XYZ conducts its business in South Carolina, but does 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 property is located in South Carolina. All of its payroll is paid to employees in South Carolina.

XYZ's only business is licensing and protecting the use of the trademarks and tradenames. Under the terms of the contract, XYZ requires that ABC maintain quality specifications as instructed by XYZ related to all products sold under the licensed intellectual property. Based upon a proposed Royalty and Licensing Agreement, to be finalized and executed after this ruling is resolved, XYZ will receive from ABC a royalty fee of 1.5% of the net customer billings (gross billings of customers less related returns and sales credits) from the operations. Sales occur when and at the place they are received by the licensee's customers.

Discussion:

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

...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.