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SC TECHNICAL ADVICE MEMORANDUM #89-22

TO: Mr. Marvin Davant, Director
Field Services Division

FROM: John Swearingen, Manager
Policy and Procedures Dept.

DATE: July 19, 1989

SUBJECT: Net Operating Loss on Consolidated Returns
(Income Tax)

REFERENCE: S.C. Code Ann. Section 12-7-430(d)(2) (Law. Co-op. Supp. 1988)
S.C. Code Ann. Section 12-7-455(x)

AUTHORITY: S.C. Code Ann. Section 12-3-170 (1976)
SC Revenue Procedure #89-3

SCOPE: A Technical Advice Memorandum is a temporary document issued to an individual within the Commission, upon request, and it applies only to the specific facts or circumstances related in the request. Technical Advice Memoranda have no precedential value and are not intended for general distribution.

Question:

May the loss carry forward of one member of an affiliated group from the separate return years be used to offset the income of the other consolidated members in a consolidated return year?

Facts:

For the years 1980 through 1987, Corporation A, B, and C were members of an affiliated group owned by Corporation D. From 1980 through January 31, 1986, each company filed separate South Carolina income tax returns.

During these years, Corporation A sustained substantial net operating losses. Upon filing a consolidated return for the year ending December 31, 1986, these losses were applied against consolidated South Carolina income.

Discussion:

Section 12-7-430(d) allows a net operating loss (NOL) deduction computed in accordance with Internal Revenue Code Section 172 with certain modifications. The South Carolina NOL is adjusted for the modifications provided in Section 12-7-430 and 12-7-455 and no carry backs are allowed. This provision was adopted for tax years beginning on or after January 1, 1985.

Prior to enactment of Section 12-7-430(d), S.C. Code Section 12-7-705 allowed an NOL for South Carolina purposes. A transitional rule provided by 12-7-455(x) provides that any NOL under 12-7-705 in effect on December 31, 1984 is allowed before any NOL computed under IRC Section 172 as modified by 12-7-430(d). Any NOL that has not expired prior to January 1, 1985 will expire under IRC Section 172. While IRC Section 172 allowing the NOL was adopted, IRC Sections 1501 to 1504 and the related regulations relating to consolidated returns and NOLs on consolidated returns have specifically not been adopted. South Carolina consolidated returns are controlled by Section 12-7-1570 and Regulation 117-77. Section 12-7-1570 does not provide any guidance relating to a NOL deduction in a consolidated return. Prior to amendment in 1988, Regulation 117-77 included a requirement that a taxpayer utilizing an NOL under former 12-7-700 could not file a consolidated or combined return. After amendment, the regulation states that a consolidated return shall mean a return for two or more corporations in which income or loss is computed separately for each corporation and then combined into one return. Thus, the actual mechanics or manner in which an NOL is to be utilized on a consolidated return is not specifically addressed by statute or regulation.

The administrative positions of the Commission relating to the NOL deduction on consolidated returns have changed as the NOL law has changed. Under 12-7-700, a 3 year NOL was allowed for new businesses. The Commission allowed a corporation's loss to offset another corporation's income in a current year, but the NOL carry-over could only be used to offset the income of the corporation incurring the loss (See Brigadier Industries Corporation v. S.C. Tax Commission, Court of Common Pleas, April 28, 1972.) With the enactment of 12-7-705, which allowed a 5 year NOL for any business, a consolidated loss was allowed to be carried over and deducted from consolidated income for succeeding years. Currently, the Commission allows a loss on a consolidated return to be carried over to and deducted from consolidated income. There has been no clear policy or regulation relating to the carry-over of a loss from a separate return year to a consolidated return year.

Over the years the consolidated NOL rules applied by the Commission have been somewhat similar to Federal rules. The pre-'54 Internal Revenue Code restricted NOL's to the legal entity incurring the loss; similar to the rules applied when the State's NOL was limited to a 3 year NOL of a new business. When S.C. Section 12-7-705 allowed all corporations a five year NOL, the Commission allowed a consolidated loss to be carried over to offset a consolidated income. Since South Carolina has now adopted IRC Section 172 NOL's along with IRC Section 382 relating to restrictions in the amount of taxable income that can be offset by an NOL in taxable years after a change of ownership, it would appear that the legislative intent is to conform the State's NOL rules, as closely as possible, to the Federal NOL rules. Therefore, an NOL incurred during a separate return year by a member of a group that would meet the South Carolina requirements to file a consolidated return during the separate return year may be used to offset the income of other consolidated members. This conforms to the treatment allowed by the IRC and regulation on a consolidated return.

Conclusion:

The loss carry forward of one member from a separate return year may be used to offset the income of the other consolidated members in a consolidated return year, provided each member of the consolidated group could meet the South Carolina requirements for filing a consolidated return during the separate return years.