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SC PRIVATE LETTER RULING #94-8 (TAX)

TO: ABC Company

SUBJECT: Nexus
(Income Tax)

DATE: July 25, 1994

REFERENCE: S. C. Code Ann. Section 12-7-230 (Supp. 1993)
SC Revenue Ruling #93-10

AUTHORITY: S. C. Code Ann. Section 12-4-320 (Supp. 1993)
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:

Do ABC Company's leasing activities establish nexus in South Carolina for the tax year 1993?

Conclusion:

ABC Company's leasing activities do not establish nexus in South Carolina for the tax year 1993.

Facts:

ABC Company is a general equipment lessor domiciled in California.

In 1985, ABC's leasing portfolio in South Carolina consisted of a limited partnership interest in a computer leasing limited partnership. Accordingly, ABC began filing South Carolina Corporate income tax returns in 1985. ABC sold its computer leasing limited partnership interest on January 1, 1992. In 1989, ABC's leasing portfolio expanded to include leveraged leases of aircraft.

Currently, ABC is winding down its leasing operations and its current portfolio is made up entirely of leveraged leases of five aircraft to commercial airlines. At this time, ABC has no interests in any partnership doing business in South Carolina, no employees in South Carolina, and no bank accounts, telephone listings or post office boxes in South Carolina.

With respect to its current portfolio of aircraft leveraged leases, ABC has provided the following facts:

ABC does not hold legal title to the aircraft. Legal title is held by the "owner-trustee" (i.e. a bank or trust company). ABC is the "owner-participant" (i. e. the trust beneficiary) and does not have any rights to the aircraft during the term of the lease.

The debt associated with the leased aircraft is nonrecourse to ABC (the lessor) and the airlines (lessees). The airlines make the debt payments directly to the lenders. In the event of default by the airlines, ABC may choose to pay off the debt, make the current debt payment or walk away from the transaction. The only recourse by the lender is to repossess the aircraft.

ABC negotiated and executed all leases in California.

ABC has no control over where the lessee takes possession of the aircraft or flies the aircraft.

ABC has not registered with any South Carolina agencies with respect to the aircraft.

The aircraft are not hangered in South Carolina, have no fixed place of business in South Carolina, and fly in and out of most of the continental United States.

In addition, ABC has provided the following facts with respect to the accounting and tax treatment of the aircraft leveraged leases:

For book purposes, the leased aircraft are recorded by ABC as investments. Debt associated with the leases is not recorded on ABC's books.

For income tax purposes, ABC is the owner of the aircraft. As such, ABC recognizes rental income equal to the total lease payments, deducts the portion of the total lease payments representing interest expense, amortizes capitalized fees over the life of the leases and depreciates the airplanes over five years. Upon disposition of the plane or lease transaction, ABC would report any gain or loss. Flight information (i. e. "take-offs and landings") received from the airlines is used to arrive at apportionment factors.

ABC has requested and received an extension of time to file their South Carolina income tax return. ABC has provided the following information with respect to calculating their South Carolina property factor apportionment ratio for 1993, if a return is required to be filed:

Airline	Landings in SC	Landings Everywhere
X	1	2871
Y	2	2223
Z	0	53,628*

ABC is currently leasing two Boeing 737's to X, one Boeing 737 to Y, and two Boeing 737's to Z. ABC has no other activity in South Carolina at this time and expects its activity to decrease.

* Z reports its landings for the entire fleet of 737's, whereas X and Y report landings on an individual plane basis.

Discussion:

Code Section 12-7-230 (A) imposes a tax on the income derived within South Carolina by foreign corporations and reads, in part:

...every foreign corporation transacting, conducting, doing business, or having an income within the jurisdiction of this State, whether or not the corporation is engaged in or the income derived from intrastate, interstate, or foreign commerce, 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...

We must now determine whether mobile property leased by ABC to airlines which fly into South Carolina subjects ABC's rental income to South Carolina taxation.

In Geoffrey, Inc. v. South Carolina Tax Commission, 437 S.E. 2d 13 (S.C. 1193), cert. denied 114 S. Ct. 550 (1993), the South Carolina Supreme Court held that Code Section 12-7-230 extended "to the limits of the constitution South Carolina's authority to tax foreign corporations."

In Quill Corp v. North Dakota, 112 S. Ct. 1904 (1992), the U.S. Supreme Court reviewed the nexus requirements contained in the Due Process Clause and the Commerce Clause. The Due Process Clause requires, in part, that some definite link or minimum connection exist between the state and the person, property, or transaction it seeks to tax. Further, an activity must have substantial nexus with the taxing state in order to satisfy the Commerce Clause. See Complete Auto Transit, Inc. v. Brady, 97 S. Ct. 1076 (1977).

The courts, however, have not set forth a clear test to determine what contacts between an out of state company and a state creates a substantial nexus. Guidance in making a determination concerning substantial nexus is found in Quill, Geoffrey, and Wisconsin Department of Revenue v.

William J. Wrigley, Jr. Co., 112 S. Ct. 2447 (1992), and South Carolina Code Section 12-7-340 pertaining to the taxation of interstate motor carriers.

The Court in Quill held that the nexus requirements of the Due Process and Commerce Clauses of the U.S. Constitution are two different standards "animated by different constitutional concerns and policies". The Commerce Clause nexus requirement is concerned with structural concerns about the effects of state regulation on the national economy. A Commerce Clause analysis generally uses a balancing test to insure that state taxation does not unduly burden interstate commerce.¹

In the process of construing 15 U.S.C. 381, the Court in Wrigley stated that a de minimis rule "is part of the established background of legal principles against which all enactments are adopted, and which all enactments (absent contrary indication) are deemed to accept". In Quill the Court appeared to apply a de minimus rule when it agreed that "the existence in North Dakota of a few floppy diskettes to which Quill holds title seems a slender thread upon which to base [Commerce Clause] nexus".

Finally, South Carolina Code Section 12-7-340 was enacted in June, 1990 and sets forth certain standards to determine whether interstate motor carriers are doing de minimis business in South Carolina to file income tax returns. While not controlling, this is somewhat analogous to ABC's leasing business.

If an interstate motor carrier meets any of the requirements set forth below it must file a South Carolina income tax return:

1. owns or rents real or personal property in South Carolina, except mobile property; or
2. travels more than 25,000 mobile property miles in South Carolina, even if the ratio of total mobile property miles traveled for the tax year in South Carolina to all states is less than 10%; or
3. makes over 12 pick ups or deliveries in South Carolina during its tax year.

Based upon the above discussion and all of the facts and circumstances of ABC's business, including its sale in 1992 of its limited partnership interest in a computer leasing limited partnership and the winding down of its aircraft leasing operations, the leasing of aircraft by ABC does not establish substantial nexus for Commerce Clause purposes in South Carolina for the tax year 1993.

¹An exception to this balancing analysis is provided in Quill which provides a "bright line" physical presence test for sales and use taxes. It does not apply to income taxes. See Geoffrey holding that a taxpayer did not need to have a tangible physical presence in a state for income to be taxable there.

It should be noted that this conclusion would likely change if there were more landings or other business activities in South Carolina, or if a substantial portion of ABC's total business for 1993 consisted of those three landings.

NOTE: IF ABC's future activity in South Carolina will not increase, a final South Carolina income tax return for 1993 should be filed stating that insufficient nexus exists to subject ABC to South Carolina income taxation. A copy of this ruling should be attached to the South Carolina final return.