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Comments Due by: **September 22, 2016**

SC REVENUE RULING #16-x [Draft – 8/25/16]

SUBJECT: Bank Tax Overview
(Bank Franchise Tax)

EFFECTIVE DATE: Applies to all periods open under the statute.

SUPERSEDES: All previous advisory opinions and any oral directives in conflict herewith.

REFERENCES: Chapter 11 of Title 12 (2014)
Chapter 6 of Title 12¹ (2014, Supp. 2015)
Chapter 65 of Title 12 (2014)
Chapter 67 of Title 12 (Supp. 2015)
S.C. Code Ann. Section 12-20-110(4)(2014)
S.C. Code Ann. Section 12-2-25 (2014)
S.C. Code Ann. Section 6-34-40 (Supp. 2015)
S.C. Code Ann. Section 12-54-70 (2014)
S.C. Code Ann. Section 12-54-25 (2014)
S.C. Code Ann. Section 12-54-43(D) (2014)
S.C. Code Ann. Section 12-54-85 (2014)
S.C. Code Ann. Section 12-54-250 (2014)
27 S.C. Code Regs. 117-1500 (Supp. 2011)
27 S.C. Code Regs. 117-1500.1 (Supp. 2011)

AUTHORITY: S.C. Code Ann. Section 12-4-320 (2014)
S.C. Code Ann. Section 1-23-10(4) (Supp. 2015)
SC Revenue Procedure #09-3

SCOPE: The purpose of a Revenue Ruling is to provide guidance to the public. It is an advisory opinion issued to apply principles of tax law to a set of facts or general category of taxpayers. It is the Department's position until superseded or modified by a change in statute, regulation, court decision, or another Department advisory opinion.

I. Introduction

¹ Only certain provisions of Chapter 6 of Title 12 apply to the bank tax.

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Chapter 11 of Title 12 imposes a tax of 4½% on the “entire net income” of a bank doing business in the State.² This revenue ruling provides a series of frequently asked questions and answers concerning the South Carolina bank franchise tax (bank tax). The document is not a comprehensive explanation of the bank tax.

This Revenue Ruling includes:

- Definition of a Bank and Type of Tax
- Tax Returns and Tax Payments
- Franchise Tax Base
- Apportionment and Sourcing Income
- Credits
- Miscellaneous Issues

II. DEFINITION OF BANK AND TYPE OF TAX

1. What is a bank for purposes of the bank tax?

Banks are defined in Code Section 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.” The Department interprets this definition to include only taxpayers regulated as banks by federal or state banking regulators.³

2. What type of tax is the bank tax?

The bank tax is a franchise tax, not an income tax. Although the bank tax chapter is titled “Income Tax on Banks” and several sections refer to the bank tax as an income tax, the bank tax has always been considered a franchise tax. See, SC Regulation 117-1500; 1947-48 Op. S.C. Att’y Gen. 294 (March 12, 1948); Commission Decision I-D-189 (1975). See Section IV for information on the bank tax base.

III. TAX RETURNS AND TAX PAYMENTS

3. What return does a bank file to report the South Carolina bank tax?

² Code Section 12-11-20.

³ Savings and Loan Associations are not banks for South Carolina tax purposes. Savings and Loan Associations are taxed under Chapter 13 of Title 12. Finance companies not regulated as banks are taxed under the income tax provisions in Chapter 6 of Title 12.

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Banks file a Form SC1101B, Bank Tax Return, for South Carolina purposes. Returns are due at the same time as corporate income tax returns. For tax years beginning after December 31, 2016, corporate returns and the bank tax return are due on the fifteenth day of the fourth month following the close of the tax year. Code Section 12-6-4970 (as amended by Act 169 (2016)).

4. Do banks pay the South Carolina corporate license fee?

No. Code Section 12-20-110(4) provides that banks are not subject to the South Carolina corporate license fee.

5. What is the tax year of a bank for filing the bank tax return?

For South Carolina bank tax purposes, a bank must use the same tax year used for federal income tax purposes. SC Revenue Ruling #92-9.

Code Section 12-11-40 provides that for purposes of administration, the provisions of Chapter 6 of Title 12 (Income Tax) that are appropriate or applicable are adopted for the administration of the bank tax. In SC Revenue Ruling #92-9, the Department found that the provisions of Chapter 6 concerning the proper tax years applies to banks. Code Section 12-6-4410 provides, in part:

(A) A taxpayer's taxable year under this chapter must be the same as the taxpayer's taxable year for federal income tax purposes. ...

6. Is a bank required to make estimated payments of the bank tax?

Yes. Code Section 12-11-40 requires banks to make declarations of estimated tax and make estimated tax payments in the same manner as corporations under Chapter 6 of Title 12. Code Section 12-6-3910 provides that South Carolina estimated tax payments must be made in accordance with Internal Revenue Code Section 6655, except the small amount provision in Internal Revenue Code Section 6655(f) is one hundred dollars and income for the first installment for corporations is annualized using the first three months of the taxable year.

Payments are due on or before the fifteenth day of the fourth, sixth, ninth and twelfth month of the bank's tax year. A SC 1120-CDP, Corporation Declaration of Estimated Income Tax, is used to submit estimated tax payments. Any payment of \$15,000 or more must be made with "immediately available funds" which includes payment by cash to the main office of the South Carolina Department of Revenue by 5:00 p.m. or by electronic

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means established by the Department.⁴ Electronic payment options and the electronic Form SC1120-CDP can be accessed through the Department of Revenue website.

7. Can a bank extend the time for filing the bank tax return?

Yes. Code Section 12-11-40 provides that for purposes of administration, the provisions of Chapter 6 of Title 12 that are appropriate or applicable are adopted for the administration of the bank tax. The Department allows an automatic 6 month extension period for the South Carolina bank tax return. SC Revenue Procedure #14-1. A taxpayer must request the extension on or before the due date of the return and pay the full amount of any tax due. The South Carolina corporate extension form (SC 1120-T) is used to file an extension for the South Carolina bank tax.

If a taxpayer does not have to pay any additional taxes at the time of the extension and the taxpayer has been granted an extension of time to file a federal income tax return, the taxpayer is not required to apply to the Department for an extension of time to file the South Carolina bank tax return. A copy of the South Carolina extension form or federal extension form does **not** need to be attached to the South Carolina paper or electronic return when filed. SC Revenue Procedure #14-1.

An extension will not be granted to a taxpayer who has been granted an extension for a previous period and has not fulfilled the requirements of the previous period. Code Section 12-6-4980(C).

8. If a bank prepares consolidated financial statements, can the bank file a consolidated bank tax return?

No. There is no provision in Chapter 11, Title 12 which allows the filing of a consolidated bank tax return. Code Section 12-6-5020, which authorizes corporate consolidated returns in Chapter 6 of Title 12, requires that consolidated members be subject to the corporate income tax in Code Section 12-6-530. Code Section 12-6-5020(B). Therefore, consolidated returns are not allowed for bank tax returns.⁵

IV. FRANCHISE TAX BASE

9. In general, what is the tax base for calculating the bank franchise tax?

Code Section 12-11-20 provides that the bank tax is imposed on the entire net income of the bank from any source whatsoever. Based on the Department's longstanding administrative

⁴ Code Section 12-54-250.

⁵ Nonbank subsidiaries may be able to file a "consolidated" return under Code Section 12-6-5020.

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policy, the South Carolina bank tax is a franchise tax based on book income rather than federal income tax accounting. See, Commission Decision I-D-189 (1975).

The South Carolina bank tax is generally computed using financial reporting income based on Generally Accepting Accounting Principles (GAAP) (See Questions #15 and 16). For example, banks are permitted to deduct federal and state income taxes and other expenses allowed under GAAP but disallowed by the Internal Revenue Code when determining its South Carolina bank franchise tax.

10. Are the provisions of the Internal Revenue Code that have been adopted for South Carolina income tax purposes in Chapter 6, Title 12 adopted for bank tax purposes in Chapter 11, Title 12?

Unless South Carolina law specifically provides that an Internal Revenue Code section applies to the bank tax, the provisions of the Internal Revenue Code adopted by South Carolina in Chapter 6, Title 12 (Code Section 12-6-50) do not apply to the bank tax.

11. Does the bank tax base include interest on obligations of the United States or states and political subdivisions?

Yes. Code Section 12-11-20 provides that the bank tax is imposed on the entire net income of the bank. The entire net income is income from any source whatsoever including interest on obligations of the United States, or its possessions or of any state, including South Carolina, or political subdivision. SC Reg. 117-1500.1.

12. Is the federal dividends received deduction in Internal Revenue Code Sections 243-250 allowed in computing the bank tax?

No. The bank tax is based on all income from any source whatsoever. Commission Decision I-D-189 (1975). Dividends received from subsidiaries are a source of income for the bank. As previously indicated, the Internal Revenue Code has not been adopted for purposes of the bank franchise tax. As a result, even though the dividends received deduction is adopted by South Carolina for income tax purposes under Chapter 6, Title 12, the dividends received deduction in the Internal Revenue Code cannot be used in calculating the South Carolina bank tax.

13. Is a net operating loss deduction allowed in calculating the bank tax?

No. The net operating loss deduction is part of the Internal Revenue Code which is adopted for South Carolina income tax purposes (Code Sections 12-6-40 and 12-6-50) but not for purposes

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of the bank tax. South Carolina law must specifically provide that an income tax section of the Internal Revenue Code applies to the bank tax.

14. Can banks claim a bad debt deduction based on the reserve method for calculating bad debts?

Yes. To the extent a reserve method is used for calculating bad debts for financial accounting purposes, the reserve method can be used in calculating the South Carolina bank tax.

15. How do banks report income from investments in corporations when calculating the South Carolina bank tax?

As previously discussed, banks compute their income subject to the bank tax based on book income. As a result, bank tax income is generally computed using GAAP. Under GAAP, investments in corporations are accounted for using consolidation, the equity method, the cost method, or fair value method.⁶

A brief description of each GAAP method follows. For the reasons explained below, when accounting for investments in corporations, only the cost method may be used for calculating income subject to the bank tax.

Consolidation. In general, consolidation is used if one entity owns, directly or indirectly, more than 50% of the outstanding voting shares of another entity. Less than 50% ownership may still require consolidation if control exists in a manner other than through ownership. FASB 810-10-15-8⁷ and 810-10-15-10. Under consolidation the consolidating entities are treated as a single economic entity and on a line by line basis the income, assets, and liabilities are combined after all appropriate eliminations. FASB 810-10-10-1.

Equity Method. The equity method is used if the investor exercises significant influence over the investee, but the control requirements for consolidation are not met. FASB 323-10-25-1 and FASB 323-10-25-2. Generally the equity method will be used for investments of 20% or more and less than 50% of the voting stock of the investee whether owned directly or indirectly. A 20% or more ownership leads to a presumption that an investor has the ability to exercise significant influence over the investee. FASB 323-10-15-8. Under the equity method of accounting, the investor recognizes its share of the earnings and losses of the investee in the

⁶ The GAAP rules are complex with many caveats. GAAP is discussed in this document in very general terms and does not cover all situations; however, this general discussion provides guidance needed for purposes of this document.

⁷ FASB cites are Financial Accounting Standards Board which are the GAAP standards.

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periods they are reflected in the accounts of the investee. FASB 323-10-35-4. The equity method is basically a single line consolidation for income purposes. FASB 323-10-35-8.

Cost Method. There is a presumption that if an investor owns less than 20% of the voting stock of an investee, that the investor does not have the ability to exercise significant influence over the investee and the cost method of accounting is used. FASB 323-10-15-8. Under the cost method of accounting for investments in common stock, an investor recognizes dividends as income as provided under FASB 325-20-35-1.

Fair Value Accounting. Fair value accounting generally applies to equity securities that have a readily determinable fair value, although it does not generally apply if the equity securities are required to be accounted for under consolidation or the equity method. Under fair value accounting, trading securities are measured at fair value and unrealized holding gains and losses are included in earnings, along with dividend and interest income. FASB 320-10-35-1.

For the reasons explained below, banks are only allowed to use the cost method of accounting for investments in corporations for South Carolina bank tax purposes. Banks are not allowed to file South Carolina consolidated bank tax returns.⁸ If banks use consolidation to calculate South Carolina bank tax income, the bank is effectively filing a consolidated return which is not allowed for the South Carolina bank tax. Similarly, the bank cannot use the equity method of accounting for reporting income from investments in corporations. When using the equity method, an investor initially records an investment in stock at cost and adjusts the cost to recognize the investor's share of earnings or losses after the date of acquisition. The equity method is similar to the consolidated method in that it is basically a one-line consolidation. Since consolidated returns are not allowed under the bank tax, the equity method cannot be used to calculate income. The income of a bank must be computed on a separate entity basis.⁹

Additionally, although the bank tax is a franchise tax based on book income, the tax is based on the book income of just the bank, not the income of all of its corporate investments that would be included in financial statement income when using consolidation or the equity method of accounting. If consolidation or the equity method were used, the income of a nonbank investee would be subject to tax twice, once under the bank tax and once under the income tax in Chapter 6 of Title 12. As a result, neither of these accounting methods is appropriate when accounting for corporate subsidiaries under the bank tax.

Banks also cannot use the fair market value method in calculating its South Carolina bank tax income. The fair market value method requires unrealized gains and losses to be included in book income. Taxes are generally not imposed on unrealized income, and unrealized losses are

⁸ See Question #8.

⁹ Non-bank subsidiaries may be able to file a "consolidated" return under Code Section 12-6-5020.

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not allowed to reduce taxable income. As a result, the fair market value method is not used in calculating book income for South Carolina bank tax purposes.

The appropriate method of computing the bank tax for investments in corporations is the cost method. The cost method of accounting treats the investor and the investee as separate entities. Under the cost method, the investor only records income earned by the investee when dividends are paid. The cost method most clearly reflects the separate income of the bank for purposes of computing its entire net income. As a result, banks are required to report dividends as part of their entire net income for the bank tax.¹⁰

16. How do banks account for investments in partnerships and unincorporated joint ventures?

Investors in unincorporated entities such as partnerships and other unincorporated joint ventures generally account for their investments using the equity method of accounting if the investor has the ability to exercise significant influence over the investee. FASB 323-30-25-1. There are also situations in which consolidation is appropriate. See, generally, FASB 810 topics.

Unlike investments in nonbank C corporations which are subject to tax as a separate entity under Chapter 6 of Title 12, income from pass-through entities will not be separately taxed under South Carolina law. As a result, to the extent banks have investments in partnerships and other pass-through entities which require the use of the equity method of accounting or consolidation for financial reporting purposes, that method must also be used for reporting the income under the bank tax. Unlike consolidation and equity accounting for corporate investments, partnerships and other pass-through entities are not subject to tax under Chapter 6 of Title 12 and, therefore, it is appropriate to account for this income as part of the income of the banks.

In the event the cost method is used to account for a partnership interest for financial reporting purposes, that method is appropriate for pass-through entities and income will be taxed when distributed by the pass-through entity.

V. APPORTIONING AND SOURCING INCOME

17. How does a bank doing business in more than one state apportion income?

Code Section 12-11-40 provides that for purposes of allocation and apportionment, the provisions of Chapter 6, Title 12 are adopted for the bank tax. Since banks' primary business does not involve tangible personal property, banks must use the gross receipts method for

¹⁰ Additionally, as discussed in Question #12, the dividend received deduction is not allowed in computing the bank tax.

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apportioning income using a fraction in which the numerator is gross receipts from within this State during the taxable year and the denominator is gross receipts from everywhere during the taxable year. Code Section 12-6-2290. See also, SC Information Letter #94-35.

18. How is income from interest, yearly credit card fees, and late fees charged to customers sourced under the apportionment formula?

Banks must use the gross receipts method of apportionment. The Department's longstanding administrative policy is that banks will comply with sourcing principles similar to those used by multistate non-bank financial businesses, such as finance companies. SC Information Letter #94-35 and Code Section 12-11-40. Based on the Department's longstanding administrative practices, the Department sources income from loans to where the borrower is located. Accordingly, payments on loans are receipts from within the South Carolina when paid by a borrower located in South Carolina. See, *Lockwood Greene Engineers, Inc. vs. South Carolina Tax Commission*, 293 S.C. 447, 361 S.E.2d 346 (SC Ct. App. 1987), Brief of Plaintiff-Appellant, *Lockwood Greene Engineers, Inc. vs. South Carolina Tax Commission*, *supra*. Stipulation of Facts, Transcript of Record p. 27, *Lockwood Greene Engineers, Inc. vs. South Carolina Tax Commission*, *supra*. For banks that issue credit cards, interest paid by credit card users is sourced to the location of the credit card customer. Similarly, yearly credit card fees and late fees charged to customers are sourced to the location of those customers since the production of that income is most significantly associated with the customer.

19. How are credit card "swipe" fees charged to merchants sourced under the apportionment formula?

Merchants are charged a fee each time a credit card is "swiped" for a customer to purchase a product or services. These fees are sourced to South Carolina if the merchant is located in South Carolina since the source of the income is the in-state merchant and the purchase of goods or services which generates the swipe fees is from within the state.

20. Do the provisions of Code Section 12-6-2320, dealing with when the allocation and apportionment provisions do not fairly represent the extent of a taxpayer's business activity in South Carolina, apply to the bank tax?

Yes. Code Section 12-11-40 provides that for purposes of allocation and apportionment, the provisions of Chapter 6, Title 12 are adopted for the bank tax. Code Section 12-6-2320 deals specifically with alternative allocation and apportionment and should be used only when the statutory methods do not fairly represent the bank's business activities in South Carolina. See, SC Revenue Procedure #15-2 for instructions on how to request an alternative apportionment formula.

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VI. CREDITS

21. Which tax credits can banks claim?

Banks are only allowed to claim tax credits from Chapter 6, Title 12 that specifically apply to banks or credits which specifically provide that they are available to all income taxes, including those income taxes not in Chapter 6.¹¹ Examples of some of the credits currently allowed against the South Carolina bank tax include:

- Job Tax Credit (Code Section 12-6-3360);
- Construction and Improvement of Infrastructure Credit (Code Section 12-6-3420);
- Abandoned Building Revitalization Credit (Chapter 67, Title 12);
- Community Development Corporation Investment Credit (Code Section 12-6-3530);
- Historic Structure Rehabilitation Credit (Code Section 12-6-3535);
- Textile Revitalization Credit (Chapter 65, Title 12); and
- Retail Facilities Revitalization Credit (Code Section 6-34-40)

Each credit provision must be read to determine if it can be used against the bank tax.

VII. MISCELLANEOUS ISSUES

22. Can a bank elect S Corporation status for South Carolina bank tax purposes?

No. There is no provision in South Carolina bank tax law that allows a bank to elect to file as an S Corporation. Banks that file an S Corporation return for federal tax purposes must prepare a proforma federal Form 1120 for South Carolina in order to enter federal taxable income on the Bank Tax Return (Form SC1101B).

Code Section 12-6-590 provides a tax credit for the shareholders of a bank that has a valid federal S Corporation election. The purpose of the credit is to provide some tax relief to shareholders who report their share of the bank's income on their South Carolina income tax return. The credit equals the difference between: (i) the shareholder's tax as computed under Chapter 6 of Title 12, including all credits other than the credit allowed in this section; and (ii) the tax as computed under Chapter 6 of Title 12, including all credits other than the credit allowed in this section, but excluding the shareholder's prorata share of the net items of income and expense of the bank. The credit cannot exceed the shareholder's prorata share of the tax

¹¹ 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 of the credit does not limit the credit to income taxes in Chapter 6.

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imposed on the bank under Code Section 12-11-20.¹² These shareholders are also allowed to use the provisions of Code Section 12-6-545 which are the reduced rates for pass-through trade or business income if there is active trade or business income.

23. How are single member LLCs treated for bank tax purposes?

Code Section 12-2-25(B)(1) provides that “[f]or South Carolina tax purposes a single-member limited liability company, which is not taxed for South Carolina income tax purposes as a corporation, is not regarded as an entity separate from its owner.” The single member LLC is disregarded and treated as a division of the single member. This section is not limited to income taxes in Chapter 6, but applies to all South Carolina taxes including the South Carolina bank tax.

24. If a bank makes an error correction to financial statements that requires retroactive application, how does the bank report those error corrections to the Department?

If a bank makes error corrections that result in a restatement of prior period income which are reflected in retained earnings, the bank should file amended returns reporting the changes in the prior years for the years within the statutory time limitation.

Under GAAP, error corrections generally require the correction to be applied retrospectively. FASB 250-10-05-4. Retrospective application requires application of the change to prior periods and the total correction is reflected in the opening balances of the balance sheet. Changes to income would be reflected in the opening balance of retained earnings.

Code Section 12-54-85 provides the time limitations for the Department to assess taxes and for the taxpayer to request refunds. These time limitations apply to bank taxes. As a result, if a bank tax error occurs within the time limitations, the bank should file amended returns to report the corrected amount of income for years still within the statutory time limitation.

25. Are interest and/or penalties assessed by the Department for failure to pay the amount of bank tax due with the extension?

Yes. Code Section 12-54-70 provides extension requirements for all taxes administered by the Department. Any interest due in connection with payments on returns is calculated using the interest rate provided in Code Section 12-54-25. If at least 90% of the tax due is not remitted with the extension, the failure to pay penalty provided in Code Section 12-54-43(D) applies from the date the tax was originally due.

¹² The code section actually referenced in the statute is Code Section 12-11-30, but it is clear from the context that the correct reference should be Code Section 12-11-20.

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26. Does Chapter 54, Title 12, Uniform Method of Collection and Enforcement of Taxes Levied and Assessed by South Carolina Department of Revenue apply to the bank tax?

Yes. Chapter 54 applies to all taxes assessed by the Department including the bank tax. Chapter 54 deals with interest and penalties, assessment of taxes, tax liens, electronic payments, and other administrative issues.