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

SC REVENUE ADVISORY BULLETIN #01-1

SUBJECT: Sales Tax Exemption for Depreciable Assets When an Entire Business is Sold
(Sales & Use Tax)

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

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

REFERENCES: S. C. Code Ann. Section 12-36-2120(42) (2000)

AUTHORITY: S. C. Code Ann. Section 12-4-320 (2000)
S. C. Code Ann. Section 1-23-10(4) (Supp. 2000)
SC Revenue Procedure #99-4

SCOPE: The purpose of a Revenue Advisory Bulletin is to provide guidance to the public and to Department personnel. It is a written statement issued to apply principles of tax law to a specific set of facts or a general category of taxpayers. **A Revenue Advisory Bulletin does not have the force or effect of law, and is not binding on the public.** It is, however, the Department's position and is binding on agency personnel until superseded or modified by a change in statute, regulation, court decision, or advisory opinion.

Question:

When will the sale of a business qualify as the sale of the "entire business" of the taxpayer thereby qualifying for the sales and use tax exemption for the sale of depreciable assets described in Section 12-36-2120(42) of the South Carolina Code of Laws ("Code")?

Conclusion:

In the Department's opinion, the sale of a business will qualify as the sale of the entire business and will qualify for the exemption under Code Section 12-36-2120(42) under two circumstances: 1) when the taxpayer sells all the assets of the legal entity (other than a single member limited liability company or a grantor trust which is ignored for tax purposes); or 2) when the taxpayer sells all of the assets of a "discrete business enterprise" that is contained within the legal entity. In the Department's opinion, whether the taxpayer has sold a discrete business enterprise is determined under the principles relating to a unitary business as set forth in the case law of the South Carolina courts and the United States Supreme Court. If the business is unitary with other

businesses of the taxpayer, the taxpayer will not be considered to have sold a discrete business enterprise and the taxpayer will not qualify for the exemption provided in Code Section 12-36-2120(42). However, if the business being sold is not unitary with other businesses of the taxpayer, the taxpayer will be considered to have sold a discrete business enterprise and will qualify for the exemption provided in Code Section 12-36-2120(42).

In addition to the requirement that the taxpayer sell all the assets of the legal entity or all of the assets of a discrete business enterprise contained within the legal entity as provided above, the exemption will only apply if the sale is made pursuant to a written contract and the purchaser continues operation of the business.

Discussion:

Code Section 12-36-2120(42) provides as follows:

Exempted from the taxes imposed by this chapter are the gross proceeds of sales, or sales price of:

...depreciable assets, used in the operation of a business, pursuant to the sale of the business. This exemption only applies when the entire business is sold by the owner of it, pursuant to a written contract and the purchaser continues operation of the business. The exemption allowed by this item is effective for sales after June 30, 1987. [emphasis added]

Code Section 12-36-20 defines “business” to include:

All activities, with the object of gain, profit, benefit, or advantage, either direct or indirect. Subactivities of a business which produce marketable commodities, used or consumed in the business, are taxable transactions. [emphasis added]

Code Section 12-36-2120(42) is a statute that creates an exemption from the sales and use tax. Constitutional and statutory language creating exemptions from taxation will not be strained or liberally construed in favor of the taxpayer claiming the exemption. York County Fair Association v. S.C. Tax Commission, 154 S.E. 2d 361 (S.C. 1967). Thus, a narrow construction of the statute is required.

There is no authority in South Carolina sales and use tax law allowing the combination of separate legal entities. There is guidance in the area of income tax concerning whether separate corporations will be combined for income tax purposes. In Emerson Electric Co. v. Wasson, 339 S.E. 2d 118 (S.C. 1986), the South Carolina Supreme Court recognized that South Carolina corporate income tax was calculated on a single entity basis. Since the South Carolina Supreme Court has held that for income tax purposes separate corporations will be respected, in the Department’s opinion, the sale of all of the assets contained in a separate legal entity will qualify for the exemption provided in Code Section 12-36-2120(42).

Note: There is one exception in South Carolina law to the single entity rule. Under Code Section 12-2-25(B), “Single member limited liability companies which are not taxed for South Carolina income tax purposes as a corporation, and grantor trusts, to the extent they are grantor trusts, will be ignored for all South Carolina tax purposes.” Thus, these entities are treated as part of their member or part of their grantor, respectively, for South Carolina sales and use tax purposes as well as South Carolina income tax purposes. Because of this special rule, if a taxpayer sells all of the assets of a grantor trust or a single member limited liability company not taxed as a corporation for income tax purposes, the grantor trust or single member limited liability company will not be treated as a separate legal entity. To qualify for the exemption provided in Code Section 12-36-2120(42), a taxpayer who sells the assets of an entity which is treated as part of its owner must show that the business, and the assets associated with that business, constitute a discrete business enterprise as described below. The sale of such assets must also be pursuant to a written contract and the purchaser of the assets must continue the operations of the business.

The definition of “business” contained in Code Section 12-36-20 might be construed to mean that the only time that Code Section 12-36-2120(42) will apply is if there is a sale of all of the assets of the legal entity. However, in the Department’s opinion, in certain instances, a taxpayer may be able to sell a business enterprise that is contained within the structure of the legal entity and still qualify for the exemption provided in Code Section 12-36-2120(42).

On occasion, a taxpayer will have several different types of operations in one legal entity. For example, a taxpayer may operate Division A in State X, but taxpayer’s Division B may not have any operations in State X. Over the years, questions have arisen concerning whether State X could tax any income that is attributed by the taxpayer to an out-of-state division. The United States Supreme Court and South Carolina courts have looked to whether Division A and Division B are each part of a “unitary” business or whether they are “discrete business enterprises” in determining if a state could tax income that is attributed by the taxpayer to out-of-state operations.

Under the unitary approach, if a particular operation is “unitary” with operations in the taxing state, an appropriately apportioned amount of all activities that are unitary with the business conducted in the taxing state may be taxed. If the business activity conducted out-of-state constitutes a discrete business enterprise from the activities conducted within the taxing state, the taxing state cannot tax the income related to that discrete out-of-state business. See, Allied Signal, Inc. v. Director of Taxation, 504 U.S. 768, 119 L. Ed. 2d 533, 112 S. Ct. 2251 (1992). Therefore, if a single corporation operates two or more “non-unitary” businesses, South Carolina will only apportion and tax income from businesses that operate in South Carolina. Exxon Corporation v. South Carolina Tax Commission, 258 S.E. 2d 93 (S.C. 1979), *appeal dismissed* 447 U.S. 917 (1980). Since South Carolina has recognized the concept of a “non-unitary” or discrete business enterprise as constituting a separate business, in the Department’s opinion, it is appropriate to use this concept in determining whether a taxpayer has sold an “entire business” and therefore may qualify for the exemption provided for in Code Section 12-36-2120(42), even if both of the businesses are operated in South Carolina.

When a taxpayer is trying to determine if it is selling a discrete business enterprise, it should review the cases decided by the United States Supreme Court and the South Carolina courts addressing the unitary business principle. These cases include the following:

1. **Mobil Oil v. Commissioner of Taxes of Vermont**, 445 U.S. 425, 100 S. Ct. 1223, 63 L.Ed. 2d 510 (1978). The taxpayer in this case was involved in the petroleum business. The Supreme Court held that the taxpayer and its related affiliates were engaged in a unitary business, even though the activity of the taxpayer in Vermont consisted solely of marketing petroleum since the production and sale of the petroleum were parts of a functionally integrated enterprise.
2. **F.W. Woolworth v. New Mexico**, 447 U.S. 207, 100 S. Ct. 2109, 65 L. Ed. 2d 66 (1980). The taxpayer was engaged in the operation of retail stores. The taxpayer held stock in several foreign corporations that engaged in a business that was similar to the taxpayer. The court found that the subsidiaries operated independently of the taxpayer. The Supreme Court held that the taxpayer and the subsidiaries were each engaged in discrete business enterprises since there was no functional integration, centralization of management and economies of scale realized between the taxpayer and its subsidiaries.
3. **Exxon Corporation v. Wisconsin Department of Revenue**, 447 U.S. 207, 100 S.Ct. 2109, 65 L. Ed. 2d 66 (1980). The Supreme Court held that a company that was engaged in the petroleum business and that had divided itself into three different divisions - exploration and production, refining, and marketing - was conducting a unitary business since there was an interrelationship among the three divisions and there was functional integration, centralization of management, and economies of scale among the different divisions.
4. **ASARCO, Inc. v. Idaho State Tax Commission**, 458 U.S. 307, 102 S. Ct. 3103, 73 L. Ed. 2d 787 (1982). Taxpayer was a corporation engaged in the mining, smelting, and refining of non-ferrous metals. The taxpayer held stock in a number of corporations, some of which also engaged in the refining or smelting of non-ferrous metals. The taxpayer owned 51.5% of the stock of one of the corporations, but had effectively limited its ability to control the corporation by entering into a management agreement which limited the taxpayer's ability to elect the board of directors. The taxpayer held 52.7% of another corporation, however, the court found that although the taxpayer had the potential to control that corporation, no claim had ever been made that it had exercised such control. The Supreme Court went on to find that the taxpayer and its subsidiaries were each engaged in a discrete business enterprise since there was a lack of an integrated relationship between the subsidiaries and the taxpayer.
5. **Container Corporation of America v. Franchise Tax Board**, 463 U.S. 159, 103 S. Ct. 2933, 77 L. Ed. 2d 545 (1983). The taxpayer was engaged in the manufacturing of paperboard packaging. The taxpayer also held stock in a number of foreign subsidiaries that were also engaged in the paperboard packaging business. The Supreme Court found that the taxpayer and its subsidiaries were engaged in a unitary business because there were a number of indicia of functional integration, centralization of management and economies of scale and there was a flow of value between the businesses.

6. **Allied Signal, Inc. v. Director of Taxation**, 504 U.S. 768, 112 S. Ct. 2251, 119 L. Ed. 2d 533 (1992). Taxpayer's primary business was the manufacturing of aviation and auto parts. The taxpayer held a 20.6% stock interest in a corporation that was engaged in metal mining. The Supreme Court held that the businesses were each discrete business enterprises and that the holding of the stock interest in the metal mining corporation served an investment function as opposed to an operational function for the taxpayer.

7. **Exxon Corporation v. South Carolina Tax Commission**, 258 S.E. 2d 93 (S.C. 1979), *appeal dismissed* 447 U.S. 917 (1980). The taxpayer was engaged in the petroleum business and divided its business into three different divisions - exploration and production, refining, and marketing. The South Carolina Supreme Court found that the company was conducting a unitary business since there was an interrelationship among the three divisions and there was unity of ownership, unity of management and unity of operation.

8. **M. Lowenstein Corporation, et. al. v. South Carolina Tax Commission**, 378 S.E. 2d 272 (S.C. Ct. App. 1989). The taxpayer (parent) was engaged in the manufacturing of textiles, while its subsidiary was engaged in the manufacture of fiberglass fabrics. The subsidiary received interest income on loans that it made to the taxpayer (parent), while the taxpayer recognized income on the repurchase of some of its own bonds. The South Carolina Court of Appeals held that the interest income received by the subsidiary was unitary with the subsidiary's operations in that it was connected to the business of the subsidiary and the loans were part of the unitary business of the subsidiary. The income on the repurchase of the bonds was also found to be connected with the taxpayer's (parent's) business because the funds were used to continue taxpayer's (parent's) operations.

9. **Eastman Kodak Company v. South Carolina Tax Commission**, 418 S.E. 2d 542 (S.C. 1992). Safe harbor lease transactions were part of the unitary business of the taxpayer as the funding for the leases came from the general fund of the corporation, and provided a significant contribution to the overall business of the corporation, particularly by freeing up working capital.

Some older cases that are relevant to the unitary business inquiry are **Underwood Typewriter v. Chamberlin**, 25 U.S. 113, 41 S. Ct. 45, 65 L. Ed. 165 (1920); **Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n**, 266 U.S. 271, 45 S. Ct. 82, 69 L. Ed. 282 (1924); **Butler Brothers v. McColgan**, 315 U.S. 501, 62 S. Ct. 701, 86 L. Ed. 991 (1942).

Examples

Example A

Seller F operates ten retail clothing outlets throughout the State of South Carolina. Seller F proposes to sell two of the outlets to Buyer Q. The sale will occur pursuant to a written contract and Buyer Q will continue to operate the two stores under a different name once the stores have been purchased. Seller F will continue to operate the remaining eight outlets. Seller F has historically operated all ten of these outlets through a single corporate entity.

While the ten stores are located throughout South Carolina, management of each store must consult with a centralized management team before making any changes or any major decisions regarding a store. Leases for all ten outlets are negotiated by a central management team and purchasing is also conducted at the corporate level to assure cost savings through bulk purchases and uniformity of product between all ten stores. All advertising for the stores is initiated and approved by the management team and is consistent among all ten stores. Also, the stores are all operated under the same trade name. Personnel and product are often transferred among the stores, and all the outlets use the central management team and its assistants for activities such as accounting, warehousing, and human resource functions.

In the Department's opinion, all of the stores will be considered part of one unitary business. Therefore, the sale of the assets associated with two of the ten clothing stores **will not** constitute the sale of the entire business and **will not** qualify for the exemption allowed by Code Section 12-36-2120(42). In order to qualify, all ten stores would have to be sold and the other statutory requirements would have to be met.

Example B

Corporation X is engaged in the manufacturing, distribution and sale of housewares, such as china and crystal. Corporation X owns the following facilities in South Carolina, a distribution center that distributes Corporation X's product throughout the Southeast, a manufacturing plant that manufactures Corporation's X's line of china, and three retail stores that sell the complete line of Corporation X's products.

Corporation X operates its manufacturing as one division of the company, its distribution facilities are handled by a second division of the company, and its retail operations and marketing are operated as a third division of the company.

While each of the divisions has its own vice-president, all three vice-presidents report to a central management team and the Corporation X Board of Directors. The vice-presidents are not allowed to make major decisions involving site location, product line, etc. without receiving approval from the management team. The company uses centralized purchasing techniques in order to save money and all three groups utilize a single headquarters staff for human resources and financial functions.

The retail operations sell solely products that are manufactured by Corporation X and the distribution center only distributes goods that have been manufactured by Corporation X. Further, the manufacturing division provides the retail division with imperfect product at no cost which the retail division sells as "seconds" in its retail stores.

Corporation X now sells its three retail stores to Buyer D who will operate the stores independently. The sale will occur pursuant to a written contract and Buyer D will continue to operate all three retail stores after the sale. After the sale, Buyer D will continue to sell Corporation X's product, but will have the option of selling other merchandise as well. Corporation X and Buyer D will execute a contract that will allow Buyer D to continue to purchase Corporation X's products at a reduced rate.

In the Department's opinion, the three divisions of Corporation X are considered to be part of one unitary enterprise. Therefore, the sale of the South Carolina stores associated with the retail division **will not** constitute the sale of the entire business and **will not** qualify for the exemption allowed by Code Section 12-36-2120(42).

Example C

Corporation Y owns two businesses - Division 1, a camera business which consists of five retail shops that sell photographic materials and cameras and Division 2, a business that operates three beauty spas. Investor A has a 100% interest in Corporation Y. The beauty spa business is run by Individual K while the photography retail shops are run by Individual L. Neither K nor L is required to consult with Investor A or the Board of Directors of Corporation Y prior to making major decisions involving the operations of their respective divisions.

There are no intercompany transactions between the businesses and there is no borrowing between the businesses. All outside financing is done individually by each of the respective businesses and the assets of the retail shops are never allowed to be pledged as collateral for loans made to the beauty spa business. Likewise, the beauty spa assets are never pledged as collateral for the retail businesses. The payroll and hiring for the retail shops is handled by Individual L, while hiring and payroll for the beauty spa business is handled by Individual K. There is no sharing of materials or personnel between the beauty spa business and the photography business and the two businesses do not share any services such as accounting, bookkeeping, etc.

Corporation Y has decided to sell its beauty spa business to Mr. V. In connection with the sale, Mr. V will purchase all of the assets of Division 2, the beauty spa business. The sale will occur pursuant to a written contract and Mr. V will continue to run the beauty spa business after the sale.

There are no other relevant facts. In the Department's opinion, the beauty spa division of Corporation Y and the photography retail division are considered to be discrete business enterprises. Therefore, the sale of the South Carolina stores associated with the beauty spa business **will** constitute the sale of the entire business and **will** qualify for the exemption allowed by Code Section 12-36-2120(42).

For questions concerning this advisory opinion, contact Jerilynn VanStory at (803) 898-5151.

SOUTH CAROLINA DEPARTMENT OF REVENUE

s/Elizabeth Carpentier
Elizabeth Carpentier, Director

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Columbia, South Carolina