

SC REVENUE RULING #09-15

SUBJECT: Phase-In of Single Sales Factor Apportionment Method
(Income Tax and License Fee)

EFFECTIVE DATE: For income tax years beginning in 2007 through 2010 and associated license fees.

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

AUTHORITY: S. C. Code Ann. Section 12-6-2250 (Supp. 2008)
S. C. Code Ann. Section 12-6-2252 (Supp. 2008)
S. C. Code Ann. Section 1-23-10(4) (2008)
SC Revenue Procedure #09-3

SCOPE: The purpose of a Revenue Ruling is to provide guidance to the public and to Department personnel. 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 It is the Department's position until superseded or modified by a change in statute, regulation, court decision, or another Departmental advisory opinion.

PURPOSE:

In 2006, the South Carolina Legislature enacted a change in the apportionment method provided in Code Section 12-6-2250 for taxpayers whose principal business in South Carolina is manufacturing or any form of collecting, buying, assembling, or processing goods and materials within South Carolina, or selling, distributing, or dealing in tangible personal property within South Carolina. The current three factor apportionment method for a multistate taxpayer (based on property, payroll, and double weighted sales) is changing to a single sales factor apportionment method. This change is being phased-in for income tax years beginning in 2007 through 2010. For income tax years beginning in 2011, the single sales factor apportionment method in Code Section 12-6-2252 will replace the current three factor apportionment method in Code Section 12-6-2250.

For purposes of simplification, this advisory opinion will refer to a taxpayer of the type cited in Code Section 12-6-2250 and 12-6-2252, *i.e.*, a taxpayer whose principal business in this State is manufacturing or a form of collecting, buying, assembling, or processing goods and materials within this State, or selling, distributing, or dealing in tangible personal property within this State, as "a taxpayer whose principal business in South Carolina is dealing in tangible personal property", and will refer to the three factor

apportionment method (based on property, payroll, and double weighted sales) as the “three factor apportionment method”.

During the phase-in period, a multistate taxpayer dealing in tangible personal property will determine income apportioned to South Carolina as follows: (1) by using the existing three factor apportionment method and, if applicable, (2) by using the new single sales factor apportionment method. If the new single sales factor apportionment method results in a reduction in income apportioned to South Carolina, then the taxpayer is allowed to use a 20% - 80% reduction (as applicable for income tax years beginning in 2007 – 2010) to determine the “phase-in” apportionment ratio. For purposes of the license fee calculation in Code Section 12-20-60, if applicable, the percentage reduction is applied in the same manner as for income tax purposes.

The purpose of this advisory opinion is to confirm the Department’s position (published in Department manuals, tax forms, and instructions) regarding the single sales factor phase-in apportionment methodology for income tax and license fee purposes that has been in effect since the legislation was enacted in 2006.¹

SUMMARY OF LAW:

Existing Three Factor Apportionment Method.² Code Section 12-6-2250 contains the three factor apportionment method and provides:

A taxpayer whose principal business in this State is (a) manufacturing or any form of collecting, buying, assembling, or processing goods and materials within this State, or (b) selling, distributing, or dealing in tangible personal property within this State, shall make returns and pay annually an income tax which includes its income apportioned to this State. Its income apportioned to this State is determined by multiplying the net income remaining after allocation under Sections 12-6-2220 and 12-6-2230 by a fraction, the numerator of which is the property ratio, plus the payroll ratio, plus twice the sales ratio, and the denominator of which is four. However, where the sales ratio does not exist [*i.e.*, there is zero sales everywhere], the denominator of the fraction is the number of existing ratios, and where the sales ratio exists but the payroll ratio or the property ratio does not exist, the denominator of the fraction is the number of existing ratios plus one. The property, payroll, and sales ratios must be determined in accordance with Sections 12-6-2260, 12-6-2270, and 12-6-2280, respectively.

¹Administrative interpretations of statutes by the agency charged with their administration and not expressly changed by the legislative body are entitled to great weight. Marchant v. Hamilton, 279 S.C. 497, 309 S.E.2d 781(1983).

²The tax forms and instructions refer to the three factor apportionment method (with double weighted sales) as the four factor apportionment ratio.

New Single Sales Factor Apportionment Method. For tax years beginning after 2010, Code Section 12-6-2252 (*i.e.*, the new single sales factor apportionment method) provides that a taxpayer whose principal business in South Carolina is dealing in tangible personal property will apportion income to South Carolina by multiplying the net income remaining after allocation under Code Sections 12-6-2220 and 12-6-2230 by the sales factor defined in Code Section 12-6-2280. However, if a sales factor does not exist, the remaining net income is apportioned to the business's principal place of business.

Phase-In of Single Factor Apportionment Method, As Applicable. For income tax years beginning in 2007 through 2010 only, Code Section 12-6-2250(B) provides that a taxpayer whose principal business in South Carolina is dealing in tangible personal property shall apportion income by using the existing three factor apportionment method in Code Section 12-6-2250(A) and, if applicable, the new single sales factor apportionment method in Code Section 12-6-2252. If the calculation under Code Section 12-6-2252 results in a reduction in income apportioned to South Carolina, the reduction is allowed as follows:

Income tax year beginning in	Percentage of reduction
2007	20%
2008	40%
2009	60%
2010	80%

License Fee Apportionment. Code Section 12-6-2250(C) provides that for purposes of the calculation of the license fee pursuant to Code Section 12-20-60 for multistate corporations, the 20% - 80% reduction discussed above is allowed in the same manner as in Code Section 12-6-2250(B).

Code Section 12-20-60 provides that when a corporation does business or uses its capital partly within and partly without South Carolina, the amount of the license fee provided in Section 12-20-50 must be apportioned in accordance with the ratio prescribed for income tax purposes in the taxable year preceding the year in which the annual report is filed. The minimum license fee, however, may not be apportioned. Code Section 12-20-50 provides that the annual report and license fee are based on the capital stock and paid in capital of the corporation as shown by the records on the first day of the tax year the report is filed.

In other words, the license fee is computed and paid in advance of the taxpayer's income tax year. For example, a South Carolina calendar year corporate taxpayer is required to file its 2009 SC 1120 for the January – December 2009 corporate income tax year and for the January – December 2010 corporate license fee year by March 15, 2010 (without regard to an extension of time.) (South Carolina's corporate license fee computation schedule and annual report are included and filed with the taxpayer's South Carolina corporate income tax return.) The 2010 corporate license fee reported on the 2009 SC 1120 is computed using the apportionment ratios used or available for use on the 2009 income tax return (*i.e.*, the three factor apportionment ratio or modified phased-in ratio.)

QUESTIONS AND ANSWERS:

1. Q. Does the single factor phase-in reduction apply to taxpayers with either South Carolina taxable income or a South Carolina loss?
 - A. Yes. Code Section 12-6-2250(B) provides that if the calculation permitted in Code Section 12-6-2252 results in a “reduction in income” apportioned to this State, then the appropriate amount of phase-in reduction percentage is allowed. In viewing the legislation as a whole to determine the intent of the Legislature, it is the Department’s position that the single sales factor phase-in provisions are not limited to only those taxpayers that have South Carolina taxable income. Accordingly, the phase-in period allows a taxpayer to use the method in Code Section 12-6-2250(A) or in 12-6-2252 and 12-6-2250(B) which gives the lower South Carolina income subject to tax or the larger South Carolina net operating loss.

Income Tax Example. The following example illustrates the legislative intent of the single sales factor phase-in reduction in Code Section 12-6-2250(B) for income tax purposes for two taxpayers whose principal business in South Carolina is dealing in tangible personal property.³

Assume the following facts about Taxpayer A and Taxpayer B for an income tax year beginning in 2009:

- The three factor apportionment ratio of both taxpayers is 55%.
- The single sales factor ratio of both taxpayers is 65%.
- Taxpayer A has income apportioned to South Carolina for the phase-in tax year.
- Taxpayer B has a loss apportioned to South Carolina for the phase-in tax year.
- The capital and paid in surplus of both taxpayers is \$100,000.

What is the apportionment ratio for income tax purposes used by Taxpayer A who has South Carolina taxable income? Since the new single sales factor apportionment ratio (65%) is greater than the existing three factor apportionment ratio (55%), using the single sales factor ratio to apportion taxable income to South Carolina would not provide a reduction in income, or benefit, to Taxpayer A. Taxpayer A must use the existing three factor ratio (55%) for income tax purposes. No phase-in reduction calculation is required.

What is the apportionment ratio for income tax purposes used by Taxpayer B who has a South Carolina loss? Since the new single sales factor apportionment ratio (65%) is greater than the existing three factor apportionment ratio (55%), using

³Of course, “[a]ll rules of statutory construction are subservient to the one that the legislative intent must prevail if it can be reasonably discovered in the language used, and that language must be construed in the light of the intended purpose of the statute.” Peoples National Bank of Greenville v. S.C. Tax Commission, 250 S.C. 187, 156 S.E.2d 769 (1967). See also State ex rel. McLeod v. Montgomery, 244 S.C. 308, 313-314, 136 S.E.2d 778, 781.

the new single sales factor ratio to apportion a tax loss provides a reduction in income, or benefit, to Taxpayer B (*i.e.*, it results in a larger South Carolina net operating loss.) Taxpayer B must use the three factor apportionment method modified by the phase-in of the single sales factor for income tax purposes. The modified phased-in ratio computed for income tax purposes is 61%. (The 61% phased-in ratio is illustrated in Appendix 1 - Taxpayer 3 for the 2009 income tax year.)

2. Q. Does the corporate license fee amount have to be apportioned using the same apportionment ratio used for income tax purposes during the single factor phase-in period?

A. Not automatically.⁴ Code Section 12-6-2250(C) provides that the calculation of the corporate license fee is applied in the same manner as the income tax reduction. In viewing the legislation as a whole to determine the intent of the Legislature, it is the Department's position that the single sales factor phase-in provision provides that a multistate taxpayer whose principal business in South Carolina is dealing in tangible personal property must use the method in Code Section 12-6-2250(A) (*i.e.*, three factor apportionment method) or in Code Section 12-6-2252 and 12-6-2250(B) (*i.e.*, three factor method modified by the phase-in of the single sales factor), whichever gives the lower South Carolina corporate license fee. Accordingly, after making the applicable computations in Code Section 12-6-2250(B) (*i.e.*, phase-in reduction computation), a taxpayer must determine the apportionment ratio for corporate license fee purposes in the same manner as an income tax reduction would be determined, (*i.e.*, use the ratio that provides a "reduction in corporate license fee" or benefit), notwithstanding the apportionment ratio used for income tax purposes.

License Fee Example. The following example illustrates the legislative intent of the single sales factor phase-in reduction in Code Section 12-6-2250(B) for corporate license fee purposes for two taxpayers whose principal business in South Carolina is dealing in tangible personal property.

Assume the following facts about Taxpayer A and Taxpayer B for the corporate license fee year 2010 (income tax year beginning in 2009):

- The three factor apportionment ratio of both taxpayers is 55%.
- The single sales factor ratio of both taxpayers is 65%.
- Taxpayer A has income apportioned to South Carolina for the phase-in tax year.

⁴ **Caution:** This position only applies to the phase-in provision in Code Section 12-6-2250 applicable for tax years beginning in 2007 - 2010. After the phase-in is complete, Code Section 12-20-60 provides that the amount of the corporate license fee provided for in Section 12-20-50 must be apportioned in accordance with the ratio prescribed for income tax purposes. Further, a taxpayer using an alternative apportionment method under Code Section 12-6-2320 to apportion income must use that alternative method to compute its corporate license fee, without regard to the phase-in provision.

- Taxpayer B has a loss apportioned to South Carolina for the phase-in tax year
- The capital and paid in surplus of both taxpayers is \$100,000.

What is the apportionment ratio for corporate license fee purposes used by Taxpayer A who has South Carolina taxable income? As illustrated in Question 1, Taxpayer A must use the existing three factor ratio (55%) for income tax purposes. Taxpayer A must also use the three factor ratio (55%) for corporate license fee purposes since it results in a lower South Carolina corporate license fee than the single sales factor ratio (65%).

What is the apportionment ratio for corporate license fee purposes used by Taxpayer B who has a South Carolina loss? As illustrated in Question 1, Taxpayer B must use the three factor apportionment method modified by the phase-in of the single sales factor (61%) for income tax purposes. Taxpayer B, however, must use the existing three factor apportionment ratio (55%) for corporate license fee purposes; if not, Taxpayer B would pay more in South Carolina corporate license fees than Taxpayer A on the same \$100,000 of total capital and paid in surplus. It is the Department's opinion that the Legislature did not intend that two taxpayers with the same amount of capital and the same apportionment ratios would pay a different amount of corporate license fees.

SOUTH CAROLINA DEPARTMENT OF REVENUE

s/Ray N. Stevens

Ray N. Stevens, Director

November 17 _____, 2009
Columbia, South Carolina

**APPENDIX 1: Computation and comparison of
single sales factor phase-in apportionment method.
(Illustrated for a corporate taxpayer filing a 2009 SC 1120)**

The following chart and explanations are written in general terms to illustrate the single sales factor phase-in methodology used by the Department for South Carolina income tax purposes and license fee purposes.

- Taxpayers 1 and 3 illustrate two taxpayers who have the same South Carolina three factor and single sales factor apportionment ratios (55% and 65%, respectively, as indicated in column 1), but one has South Carolina income and one has a South Carolina loss for the tax year. If the use of the single sales factor results in a reduction in income for the taxpayer, the calculation of the “phase-in” ratio is shown.
- Taxpayers 2 and 4 illustrate two taxpayers who have the same South Carolina three factor and single sales factor apportionment ratios (80% and 65%, respectively, as indicated in column 1), but one has South Carolina income and one has a South Carolina loss. If the use of the single sales factor results in a reduction in income for the taxpayer, the calculation of the “phase-in” ratio is shown.

	SC single sales factor ratio < SC three factor ratio	SC single sales factor ratio > SC three factor ratio	Income tax apportionment ratio shown on the <u>2009</u> income tax return ⁵	License fee apportionment ratio shown on the <u>2009</u> income tax return (if the taxpayer is a corporation)
Taxpayer 1 – SC Income SC apportionment ratio: 55% = SC three factor ratio 65% = SC single sales ratio		X	Three factor ratio is used = 55% (i.e., no single sales factor phase-in benefit)	Three factor ratio is used = 55% (i.e., no single sales factor phase-in benefit)
Taxpayer 2 – SC Income SC apportionment ratio: 80% = SC three factor ratio 65% = SC single sales ratio	X		“Phase-in” ratio is used = 71% (decrease three factor ratio by phase-in allowed since SC income exists to result in “less” taxable income) 80% - 65% = 15% ratio difference 15% x 60% phase-in = 9% “tax reduction” 80% - 9% = 71% phase-in ratio	“Phase-in” ratio is used = 71%
Taxpayer 3 – SC Loss SC apportionment ratio: 55% = SC three factor ratio 65% = SC single sales ratio		X	“Phase-in” ratio is used = 61% (increase three factor ratio by phase-in allowed since SC loss exists to result in a larger SC net operating loss) 55% - 65% = 10% ratio difference 10% x 60% phase-in = 6% “loss increase” 55% + 6% = 61% phase-in ratio	Three factor ratio is used = 55% (i.e., no benefit to use the 61% phase-in ratio for license fee purposes)
Taxpayer 4 – SC Loss SC apportionment ratio: 80% = SC three factor ratio 65% = SC single sales ratio	X		Three factor ratio is used = 80% (i.e., no single sales factor phase-in benefit)	“Phase-in” ratio is used = 71% (decrease three factor ratio by phase-in allowed to result in lower license fee) See “phase-in” ratio computation for Taxpayer 2

⁵This chart is only illustrating the 60% phase-in reduction applicable to a 2009 income tax return. The phase-in reduction percentage applicable to income tax years beginning in 2007, 2008, and 2010 (and license fees computed on those returns) is 20%, 40%, and 80%, respectively. See Code Section 12-6-2250(B).

CHART EXPLANATIONS

Taxpayer 1 and 2 Explanation – Taxpayers with South Carolina taxable income.

Taxpayer 1 - The taxpayer’s single sales factor apportionment ratio (65%) is more than the three factor apportionment ratio (55%). Since the single sales factor apportionment method does not result in less South Carolina income and license fee subject to tax, the three factor apportionment ratio (55%) is used for both income tax and corporate license fee apportionment purposes.

Taxpayer 2 - The taxpayer’s single sales factor apportionment ratio (65%) is less than the three factor apportionment ratio (80%). Since the single sales factor apportionment method results in less South Carolina income and license fee subject to tax, the “phase-in” ratio (71%) is used for both income tax and corporate license fee apportionment purposes.

The “phase-in” ratio for Taxpayer 2 with South Carolina income is calculated as follows:

Step 1: Determine the difference in the three factor and the single sales factor apportionment ratios	$80\% - 65\% = 15\%$ ratio difference
Step 2: Determine the reduction ratio for the applicable tax year and multiply it by the factor difference computed in Step 1	$15\% \times 60\%$ “phase-in” allowed on the 2009 income tax return = 9% reduction amount
Step 3: Apply the reduction amount in Step 2 to the three factor ratio (Note: the reduction amount is <u>subtracted</u> to decrease the ratio apportioning income and the license fee base to South Carolina.)	$80\% - 9\% = 71\%$ “ phase-in ” ratio

Taxpayers 3 and 4 Explanation - Taxpayers with a South Carolina loss.

Taxpayer 3 - The taxpayer’s single sales factor apportionment ratio (65%) is more than the three factor apportionment ratio (55%). Since the single sales factor apportionment method results in a larger South Carolina net operating loss, the “phase-in” ratio (61%) is used for income tax purposes. The three factor apportionment ratio (55%), however, is used license fee apportionment purposes since it results in a lower South Carolina corporate license fee.

The “phase-in” ratio for Taxpayer 3 with a South Carolina loss is calculated as follows:

Step 1: Determine the difference in the three factor and the single sales factor apportionment ratios	$55\% - 65\% = 10\%$ ratio difference
Step 2: Determine the reduction ratio for the applicable tax year and multiply it by the factor difference computed in Step 1	$10\% \times 60\%$ “phase-in” allowed on the 2009 income tax return = 6% reduction amount
Step 3: Apply the reduction amount in Step 2 to the three factor ratio (Note: the reduction amount is <u>added</u> to increase the ratio apportioning a loss to South Carolina.)	$55\% + 6\% = 61\%$ “ phase-in ” ratio

Taxpayer 4 - The taxpayer's single sales factor apportionment ratio (65%) is less than the three factor apportionment ratio (80%). Since the existing three factor apportionment method (80%) results a larger South Carolina net operating loss, it is used for income tax purposes. The "phase-in" ratio (71%) is used for license fee apportionment purposes on the 2009 income tax return since it results in a lower corporate license fee. (Note: The computation of the 71% "phase-in" ratio is illustrated for Taxpayer 2 above.)