



SC TECHNICAL ADVICE MEMORANDUM #89-15

TO: Mr. Marvin N. Davant, Director
Field Services Division

FROM: John Swearingen, Manager
Tax Policy and Procedures Department

DATE: May 17, 1989

SUBJECT: Consolidated Return - Method of Computing
South Carolina Net Income
(Income Tax)

REFERENCE: S.C. Code Ann. Section 12-7-1570 (Law. Co-Op. 1976)
Regulation 117-77(IV) (Prior to 1988 Amendment)

AUTHORITY: S.C. Code Ann. Section 12-3-170 (1976)
SC Revenue Procedure #87-3

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:

What consolidation method is appropriate for XYZ and its subsidiaries?

Facts:

XYZ Company is a multistate taxpayer and uses the three factor formula. Prior to 1985 XYZ filed South Carolina income tax returns on a separate basis. ABC Company and JKL Corporation wholly owned subsidiaries of XYZ also filed separate South Carolina income tax returns. JKL conducts 100% of its business entirely within South Carolina. ABC Company is a multistate taxpayer and apportions income to South Carolina using the three factor formula.

Beginning in 1985, XYZ filed a consolidated South Carolina income tax return with JKL and ABC pursuant to South Carolina Code of Laws Regulation 117-77. Pre-refund audits were implemented for these years. Upon audit, an initial recommendation was made by the auditor to allow the refunds as filed. Upon review, the supervisor adjusted the refunds. He determined JKL Corporation was transacting a business solely within this state. He computed income separately for each corporation and combined them into one return. The taxpayer contested this computation.

Discussion:

South Carolina Code Section 12-7-1570 states that "consolidated returns may be permitted."

Regulation 117-77, prior to amendment in 1988, states:

- III. A corporation doing business entirely within this state may not consolidate with a corporation doing a multistate business. The South Carolina net income must be computed separately for each corporation and then combined into one return.
- IV. Two or more corporations doing a multistate business may file a consolidated return provided all corporations in the consolidation are subject to the same method of apportionment. Corporations not subject to the same method of apportionment must compute the South Carolina net income of each corporation separately and then combine the South Carolina net income of each into one return.

The taxpayer has filed a consolidated return as if all taxpayers were multistate taxpayers. The method used by the taxpayer was a "homogenized" consolidated method where the apportionable income of each of the consolidated corporations is added together and then multiplied by a single consolidated ratio. Section III provides that a corporation doing business entirely within South Carolina cannot consolidate with corporations doing a multistate business. Since the consolidation method used by the taxpayer is clearly incorrect, the question that arises is what consolidated method is proper. Should the South Carolina net income for each corporation be computed separately, then combined into one return or should the taxpayer be allowed to use the "homogenized" consolidated method for the two multistate corporations and file a separate return for the corporation doing business entirely within South Carolina?

A Commission decision dated December 20, 1988 found that the regulation requires each corporation to determine its South Carolina net income separately only for those corporations "not subject to the same method of apportionment." This decision addressed four multistate corporations using the three factor formula that were using the "homogenized" consolidation method in filing with a multistate corporation using the gross receipts formula. The Commission concluded that the four corporations using the three factor formula may properly file using the homogenized method of consolidation. The corporation using the gross receipts formula was required to file a separate return.

Applying the rationale of the Commission's decision to the facts at hand; XYZ and ABC may properly file using the homogenized consolidation method as both are multistate taxpayers using the three factor formula. JKL may not consolidate with the two multistate taxpayers as 100% of its income is entirely within South Carolina.

It should be noted that for taxable years beginning on or after January 1, 1988, Regulation 117-77 has been amended to allow only one consolidation method. Each corporation will compute in South Carolina net income separately, then combine the South Carolina net incomes to yield South Carolina consolidated income.

Conclusion:

XYZ and ABC may properly file using the "homogenized" consolidation method. JKL may not consolidate with the other two corporations, and therefore must file a separate return.