

# PUBLIC DRAFT

Circulated for Public Comments

Comments Due by: **May 14, 2015**

SC REVENUE RULING #15-x (DRAFT – 4/21/2015)

- SUBJECT:** Use of Alternative Allocation or Apportionment Methods - Including Combined Unitary Reporting (Income Tax)
- EFFECTIVE DATE:** Applies to all periods open under the statute.
- SUPERSEDES:** All previous advisory opinions and any oral directives in conflict herewith.
- REFERENCES:** S. C. Code Ann. Section 12-6-2252(A) (2014)  
S. C. Code Ann. Section 12-6-2280 (2014)  
S. C. Code Ann. Section 12-6-2290 (2014)  
S. C. Code Ann. Section 12-6-2295 (2014)  
S. C. Code Ann. Section 12-6-2310 (2014)  
S. C. Code Ann. Section 12-6-2320 (2014)  
S. C. Code Ann. Section 12-54-85 (2014)  
S. C. Code Ann. Section 12-54-155 (2014)
- AUTHORITY:** S. C. Code Ann. Section 12-4-320 (2014)  
S. C. Code Ann. Section 1-23-10(4) (2005)  
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 It is the Department's position until superseded or modified by a change in statute, regulation, court decision, or another Departmental advisory opinion.

## **I. Introduction**

Taxpayers that do business in more than one state are required to determine the amount of income taxed in each state. This division of income is generally done through allocation and apportionment. First, certain types of income are allocated to a specific state for taxation. Following the allocation of income to specific states, the remaining income is apportioned between the states in which the taxpayer does business on a formula basis. Apportionment formulas differ from state to state. For example, some states adopt a three factor formula that equally weighs sales, property, and payroll; some states adopt a three factor formula that double weights the sales factor; and some states adopt a single sales factor. States generally use one of two basic methods of reporting to determine the amount of income that will be apportioned to the taxing state: separate entity reporting and combined unitary reporting. Separate entity reporting applies the apportionment factor for each separate entity to the income of that separate entity.

# PUBLIC DRAFT

Circulated for Public Comments

Comments Due by: **May 14, 2015**

Combined unitary reporting combines the income of unitary group members and apportions that combined income to the state.

This revenue ruling addresses some of the issues that may arise when South Carolina requires or a taxpayer requests an alternative apportionment method, including combined unitary reporting.<sup>1</sup>

## **II. South Carolina's Statutory Apportionment Method**

Depending on the business of the taxpayer, South Carolina's statutory apportionment formula apportions income on a separate entity basis using either the single sales factor or a single gross receipts factor.<sup>2</sup> Code Section 12-6-2252(A) provides that businesses principally dealing in tangible personal property apportion income for each taxpayer separately using a single sales factor. The sales factor is defined in Code Section 12-6-2280 as the "fraction in which the numerator is the total sales of the taxpayer in this State during the taxable year and the denominator is the total sales of the taxpayer everywhere during the taxable year."

For taxpayers whose principal business is not dealing in tangible personal property, Code Section 12-6-2290 provides that taxpayers apportion income for each taxpayer using a gross receipts factor which is defined as "a fraction in which the numerator is gross receipts from within this State during the taxable year and the denominator is total gross receipts from everywhere during the taxable year." A non-exclusive list of sales and gross receipts is set forth in Code Section 12-6-2295.

## **III. Alternative Apportionment Under Code Section 12-6-2320(A)**

### **A. Introduction**

Code Section 12-6-2320(A) provides:

If the allocation and apportionment provisions of this chapter do not fairly represent the extent of the taxpayer's business activity in this State, the taxpayer may petition for, or the department may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

- (1) separate accounting;

---

<sup>1</sup> This ruling was drafted following a series of meetings held by the Department to discuss alternative apportionment, including the use of combined unitary reporting as an alternative method. The meetings were held at the end of 2014, were open to the public, and attended by tax professionals, as well as representatives from specific businesses and business associations.

<sup>2</sup> Specific types of corporations, including various transportation companies and telephone companies, have special apportionment formulas. See Code Section 12-6-2310. Also, Code Section 12-6-2320(B) allows certain taxpayers opening new facilities in the State to negotiate special allocation and apportionment formulas for a period of five to ten years.

# PUBLIC DRAFT

Circulated for Public Comments

Comments Due by: **May 14, 2015**

- (2) the exclusion of one or more of the factors;
- (3) the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in the State;  
or
- (4) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

Generally, the Department will apply an alternative apportionment method as the result of an audit.<sup>3</sup> A taxpayer generally will request an alternative method when it believes the statutory method does not fairly represent its business activity in the State. SC Revenue Procedure #15-XX (currently circulating for public comments) outlines the procedure for taxpayers to request an alternative apportionment method.

The party advocating an alternative apportionment method has the burden of proving by a preponderance of the evidence that: “(1) the statutory formula does not fairly represent the taxpayer’s business activity in South Carolina and (2) its alternative accounting method is reasonable.” *Carmax Auto Superstores West Coast, Inc. v. South Carolina Dep’t of Revenue*, 411 S.C. 79, 767 S.E.2d 195 (2014).

## B. Determining When To Use An Alternative Apportionment Method

Determining whether or not a state’s statutory apportionment method fairly represents a taxpayer’s business activity in the state involves a factual analysis. No two fact situations are exactly alike and the Department is not aware of any state or federal cases that have established a bright-line test for determining if the statutory method fairly represents the business activities in the state.

Some taxpayers have suggested that alternative apportionment should only be applied if the use of the standard statutory method would be unconstitutional.<sup>4</sup> Along with most courts and commentators, the Department rejects this standard as a matter of statutory construction and tax policy for several reasons. First, if the application of the standard formula is unconstitutional, an alternative formula would be required under the Constitution and this provision would not be necessary. Second, the language of the statute applies if the formula does not fairly represent the business activity in the state. This standard is much lower than the constitutional requirement which generally looks to whether the application of the formula produces a result out of all proportion to the taxpayer's activities in the taxing state or a grossly distorted result. See, Hellerstein and Hellerstein, *State Taxation*, ¶ 9.20[3][a]; *Twentieth Century-Fox Film Corp. v.*

---

<sup>3</sup> Although the statute refers to allocation and apportionment, this document primarily addresses alternative apportionment and the discussion herein will refer to alternative apportionment.

<sup>4</sup> The leading case dealing with constitutional distortion is *Hans Rees’ Sons v. North Carolina*, 283 U.S. 123 (1931), in which the United States Supreme Court found that the state’s apportionment method led to a distorted constitutional result.

# PUBLIC DRAFT

Circulated for Public Comments

Comments Due by: **May 14, 2015**

*Department of Revenue*, 299 Or. 220, 700 P.2d 1035, 1039 (1985); *Microsoft Corp. v. Franchise Tax Bd.*, 39 Cal. 4<sup>th</sup> 750 (year), 139 P.3d 1169 (2006).

Some taxpayers have also suggested that an alternative apportionment method should only be used in unusual fact situations (which ordinarily will be unique and nonrecurring). This language was once included in the Multistate Tax Commission (MTC)<sup>5</sup> Regulations for Uniform Division of Income for Tax Purposes Act (UDITPA) Section 18.<sup>6</sup> The language was removed from the MTC regulations in 2010.<sup>7</sup> Furthermore, this language is not in the South Carolina law or regulations. South Carolina is not a UDITPA compact member state, never adopted this regulation, and never applied this standard.<sup>8</sup> While many of the alternative apportionment situations may involve unusual or unique circumstances, the Department will not require unusual or unique fact situations before it requires or allows a taxpayer to use an alternative apportionment method. The Department will focus on whether the statutory apportionment method fairly represents the taxpayer's business activity in the state.

The party seeking an alternative method must factually identify why the use of the standard apportionment method does not fairly represent the taxpayer's business activity in the State. The party must then propose a reasonable alternative method that will correct the factually identified problem.

## C. Selecting an Alternative Apportionment Method

Once it is determined by a preponderance of the evidence that the standard statutory apportionment method does not fairly represent the taxpayer's business activity in South Carolina, Code Section 12-6-2320(A) provides that, "**if reasonable, a different method can be used including:** (1) separate accounting; (2) the exclusion of one or more of the factors; (3) the inclusion of one or more additional factors; or (4) **use of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income**" (emphasis added). In other words, the statute requires the use of a reasonable method that fairly reflects the taxpayer's business activity in South Carolina.<sup>9</sup>

One of the few courts to address when an alternative apportionment method will be considered reasonable is the Oregon Supreme Court in *Twentieth Century-Fox Film Corp., supra*. In connection with UDITPA Section 18, the Court found:

---

<sup>5</sup> The MTC was created in 1967. One of its purposes is to propose uniform tax legislation.

<sup>6</sup> The language of UDITPA Section 18 is virtually identical to the language in Code Section 12-6-2320(A).

<sup>7</sup> The current MTC UDITPA Section 18 regulation permits the use of an alternative allocation and apportionment method "in limited and specific cases where the apportionment and allocation provisions [in section 18] produce incongruous results." South Carolina has not adopted this regulation.

<sup>8</sup> Compact members are states that have enacted the Multistate Tax Compact into their state law. South Carolina is not a compact member of the MTC, but it is an associate member that participates in particular projects or programs.

<sup>9</sup> The South Carolina General Assembly has specified that South Carolina is a single sales factor state and, absent a compelling reason, any alternative apportionment should be based on a sales factor.

# PUBLIC DRAFT

Circulated for Public Comments

Comments Due by: **May 14, 2015**

[R]easonableness has at least three components: (1) the division of income fairly represents business activity and if applied uniformly would result in taxation of no more *or* no less than 100% of taxpayer's income; (2) the division of income does not create or foster lack of uniformity among UDITPA jurisdictions;<sup>10</sup> and (3) the division of income reflects the economic reality of the business activity engaged in by the taxpayer in Oregon.

*Id.* at 1043.

There is no single alternative apportionment method that fits every scenario. Furthermore, any alternative apportionment method should be determined in relation to the reasons the standard statutory method does not fairly represent the business activity in the state.

## **IV. Combined Unitary Reporting as an Alternative Apportionment Method**

### **A. Introduction**

Under combined unitary reporting, taxpayers apportion their income to a state based on a unitary group of entities rather than on a separate entity basis. In very general terms, a unitary group is one in which the members of the group all contribute to income through functional integration, centralization of management, and economies of scale. *Container Corp. of America v. Franchise Tax Bd. of California*, 463 U.S. 159, 181 (1983). These contributions are evidenced by a flow of value (not necessarily a flow of goods) between the components of the business operation. *Id.* at 178.

Combined unitary reporting essentially treats the parent corporation and most subsidiaries as one entity for state apportionment purposes. The unitary group's nationwide ("water's edge") or worldwide<sup>11</sup> income is combined and the state taxes a share of that combined income. The share is calculated by a formula that takes into account the combined unitary group's level of activity in the state as compared to the group's level of activity in all states.

The constitutionality of combined unitary reporting has been affirmed by the United States Supreme Court. See *Container Corp. of America v. Franchise Tax Bd. of California*. In *Container Corp.*, the Court held that California's combined unitary reporting requirement did not violate the Commerce Clause or the Due Process Clause. In fact, the Court ruled that the key to constitutional apportionment of income from a multi-state business is the unitary business principle. The Court further acknowledged that combined unitary reporting is a better method of

---

<sup>10</sup> South Carolina is not a UDITPA state and does not use the standard UDITPA three factor formula, so this second component would not apply in South Carolina which has a single factor sales/gross receipts formula as its standard method of apportionment.

<sup>11</sup> Whether nationwide or worldwide income is used depends on whether a state adopts a water's edge or worldwide unitary approach. South Carolina adopts a water's edge approach as described in Section V.B. of this document.

# PUBLIC DRAFT

Circulated for Public Comments

Comments Due by: **May 14, 2015**

measuring income of a unitary business than separate entity reporting and is a safeguard against taxpayer manipulation. *Id.* at 165.

## B. *Media General Communications, Inc. v. South Carolina Dep't of Revenue*

In *Media General Communications, Inc. v. South Carolina Dep't of Revenue*, 388 S.C. 138, 694 S.E.2d 525 (2010), the South Carolina Supreme Court held that the combined unitary reporting method is an appropriate alternative apportionment method under Code Section 12-6-2320(A)(4).

In *Media General*, the taxpayers argued that South Carolina's standard apportionment method did not fairly represent their business activity in South Carolina because of related party transactions. *Media General, Inc.* was the parent company of a consolidated group of communication companies with interests in newspapers, television stations, and interactive media. Several of the companies held intangible operating licenses needed by related companies to conduct their business in South Carolina. The communication companies paid royalties to the related intangible-owning companies for the use of the licenses ultimately resulting in losses for the communication companies and income for the related intangible-owning companies.<sup>12</sup>

The taxpayer argued that it should be allowed to file on a combined unitary reporting basis claiming that apportionment on a separate entity basis did not fairly represent the taxpayer's business activity in South Carolina. The Department agreed that South Carolina's statutory separate entity reporting method did not fairly represent the taxpayer's business activity in the State. *Id.* at 529. The Department, however, argued that Code Section 12-6-2320(A)(4) did not allow for combined unitary reporting as an alternative apportionment method. The South Carolina Supreme Court disagreed and held that combined unitary reporting is an appropriate alternative apportionment method under Code Section 12-6-2320(A)(4).

In accordance with the *Media General* decision, the Department may require and a taxpayer may request combined unitary reporting as an alternative method, if reasonable, to effectuate equitable apportionment of the taxpayer's income when separate entity reporting does not fairly represent the taxpayer's business activity in the State.

## C. Department's Use of Combined Unitary Reporting

The Department may use combined unitary reporting as the alternative method when it determines that the standard statutory apportionment method does not fairly represent the taxpayer's business activity in South Carolina for a company that is part of a unitary group. Some of the facts that the Department may examine when analyzing whether the standard formula fairly represents the taxpayer's business activity in South Carolina when that taxpayer is a member of a unitary group include:

---

<sup>12</sup> The intangibles companies did not originally file returns in South Carolina. South Carolina asserted nexus over the intangibles companies resulting in South Carolina income tax assessments for these companies.

# PUBLIC DRAFT

Circulated for Public Comments

Comments Due by: **May 14, 2015**

- (1) amounts paid to related parties for goods and services;
- (2) profit margins associated with business activities;
- (3) capital investments associated with business activities;
- (4) whether goods and services are provided to both related and unrelated parties on similar terms;
- (5) whether taxpayers in similar industries provide similar goods and services to unrelated parties under similar terms; and
- (6) whether the taxpayer would be willing to enter into a similar arrangement with an unrelated third party considering the relinquishment of control over the business activity.

An Internal Revenue Code Section 482 pricing study to support pricing between related entities is not determinative of whether South Carolina's apportionment formula fairly represents the taxpayer's business activities in South Carolina.

The Department has required or approved combined unitary reporting as a reasonable alternative apportionment method in situations involving the use of purchasing companies,<sup>13</sup> management fee companies,<sup>14</sup> and "east/west" companies<sup>15</sup> within a unitary group.

## **V. Methodology Used by South Carolina for Combined Unitary Reporting**

The unitary business concept is not, "so to speak, unitary: there are variations on the theme and any number of them are logically consistent with the underlying principles motivating the approach." *Container Corp. of America*, 463 U.S. at 167. South Carolina generally will determine unitary combined income and South Carolina apportionment using the following methodology.

### **A. Unitary Business Requirement**

Since only members of a unitary business can be part of the unitary combined report, the first step is to determine the members of the unitary group. Over the years, the courts have developed various tests for determining whether different components of a business, whether carried out in a single entity or multiple entities, are unitary. As previously discussed, in general, these tests focus on a flow of value between businesses through functional integration, centralization of

---

<sup>13</sup> A purchasing company is generally a member of the unitary group that handles all, or substantially all, inventory purchases for a related retail company which in turn sells the inventory to customers in South Carolina.

<sup>14</sup> A management fee company is generally a member of the unitary group that provides general management services to related operating companies for a fee. This fee may be calculated as a percentage of gross profits from the operating companies.

<sup>15</sup> East/west companies are generally members of a unitary business divided into two corporations. The west company is located in a state where combined unitary reporting including both the west and east company is required. The east company is located in a state where separate entity reporting is required. The east company pays the west company for the use of intangibles, management fees, or other services generating an expense for the east corporation. The west company's income is not increased by these payments since the west company is already filing a combined unitary report that includes the east company.

# PUBLIC DRAFT

Circulated for Public Comments

Comments Due by: **May 14, 2015**

management, and economies of scale. When identifying members of a unitary business, the Department will construe the term unitary to the broadest extent permitted under the United States Constitution.

## B. Water's Edge Combined Reporting

South Carolina will generally use a "water's edge" approach for determining the apportionable income of a combined unitary group. Income and apportionment factors of the following entities will be considered using water's edge as follows:

1. The entire income and apportionment factors of any member incorporated in the United States or formed under the laws of any state, the District of Columbia, or any territory or possession of the United States;
2. The entire income and apportionment factors of a member which is a domestic international sales corporation as described in Internal Revenue Code Sections 991-927 or any member which is an export trade corporation as described in Internal Revenue Code Sections 970-971;
3. Any member that is a "controlled foreign corporation" as defined in Internal Revenue Code Section 957, to the extent of the income of that member as defined in Internal Revenue Code Section 952 or Subpart F of the Internal Revenue Code (Subpart F income); and
4. Any member that earns more than 20 percent of its income, directly or indirectly, from intangible property or service related activities that are deductible against the business income of other members of the combined unitary group to the extent of that income and the apportionment factors related to that income.

The Department generally will include all members of the "water's edge" unitary group for combined unitary reporting. If the parties agree, a group other than the entire water's edge unitary group may be included for combined unitary reporting purposes.

## C. Treatment of Partnerships

Any business conducted by a partnership is treated as conducted by its partners, whether held directly or indirectly through a series of partnerships, to the extent of the partner's distributive share of the partnership's income.

# PUBLIC DRAFT

Circulated for Public Comments

Comments Due by: **May 14, 2015**

## D. Use of the *Finnigan* Apportionment Method

There are two basic approaches to apportioning income when using combined unitary reporting: (1) “*Joyce*” and (2) “*Finnigan*.”<sup>16</sup> *Joyce* and *Finnigan* refer to two different methods of calculating the sales or gross receipts factor numerator for unitary apportionment purposes. (For simplicity, this document will use the term “sales factor” to refer to both the sales factor and gross receipts factor.) As a theoretical matter, the difference between the two methods is based on whether the combined unitary group is considered a single taxpayer or a group of separate taxpayers. As a practical matter, the difference between *Joyce* and *Finnigan* is how sales are treated in the numerator of the sales factor.

*Joyce* is considered a separate company method of combined reporting. Under *Joyce*, the income of all unitary members is multiplied by the *Joyce* sales factor for each unitary member that has nexus with South Carolina and is not protected by PL 86-272 (“South Carolina member”). Each South Carolina member has its own sales factor. The denominator of the sales factor for each South Carolina member includes the total sales of all unitary members (including those protected by PL 86-272 and those that do not have nexus with South Carolina). The numerator includes only the South Carolina sales of the South Carolina member. For each South Carolina member, the resulting apportionment factor is multiplied by the combined income of all unitary members.

Under *Finnigan*, all members of the combined unitary group are viewed more like a single entity. The unitary group income is apportioned to the state for the group as a whole. The income of all unitary members is multiplied by a single sales factor (*Finnigan* sales factor). The numerator of the *Finnigan* sales factor includes total sales to South Carolina of all members of the unitary group including those members are protected by PL 86-272 and/or do not have nexus with South Carolina. The denominator includes total sales everywhere for all unitary members.

South Carolina will apply the *Finnigan* method to apportion the unitary income using a two-step process. As previously discussed, South Carolina’s apportionment is a single factor sales/gross receipts formula. Total sales to South Carolina are divided by total sales everywhere and then multiplied by unitary income subject to apportionment. First, the unitary group income is apportioned to South Carolina for the group as a whole. This apportionment formula uses the South Carolina sales of all members of the combined unitary group in the sales factor numerator, including those members that are not subject to tax in South Carolina. The denominator includes total sales everywhere for all unitary members. The second step is to divide that state income among the members that are taxpayers subject to tax in South Carolina. In other words, the second step does not assign any of the South Carolina income to members without South Carolina nexus or those members protected by PL 86-272.

---

<sup>16</sup> These methods are named after cases decided by the California Board of Equalization. *Appeal of Joyce Inc.*, No. 66-SBE-069, California Board of Equalization (opinion filed Nov. 23, 1966); *Appeal of Finnigan*, No. 88-SBE-022, California Board of Equalization (opinion filed Aug. 28, 1988). California has used both approaches in the past and is currently using the *Finnigan* method.

# PUBLIC DRAFT

Circulated for Public Comments

Comments Due by: **May 14, 2015**

Additionally, since South Carolina is using the *Finnigan* method to apportion income rather than *Joyce*, all members will be allowed to use the South Carolina net operating losses and credits of all members of the combined unitary group.<sup>17</sup>

## E. Step by Step Approach to Calculating Combined Unitary Income in South Carolina

When the Department requires or allows a unitary group of corporations to use combined unitary reporting, the following methodology will be used. The term “taxpayer” as used in this discussion is the combined unitary group.

1. The starting point for calculating South Carolina combined unitary income is the federal taxable income computed on a pro forma Federal 1120 for each corporation in the unitary group. Each pro forma Federal 1120 must represent federal taxable income "as if" each corporation were not part of a consolidated federal return. The unitary group for South Carolina combined unitary reporting may include corporations that are not part of the consolidated return because they do not meet the federal ownership requirement for filing as part of the consolidated group.<sup>18</sup>
2. The taxpayer must combine the pro forma Federal 1120s of the corporations to be included in the combined unitary group resulting in a combination of each corporation's line items in determining combined income.
3. The taxpayer next eliminates the intercompany transactions between members of the combined unitary group in arriving at combined federal taxable income.
4. The taxpayer then makes South Carolina modifications (additions and subtractions) and allocates any income as provided under South Carolina law to determine combined income subject to apportionment.
5. South Carolina will apportion the unitary income using the single factor sales/gross receipts formula. As previously discussed, the Department will use the *Finnigan* method to apportion income to South Carolina. The taxpayer includes in the apportionment factor the sales or gross receipts of all corporations included in the combined unitary group. All sales or gross receipts in South Carolina of entities within the combined unitary group are included in the sales or gross receipts factor numerator. Where an intercompany transaction has occurred and been eliminated in the calculation of combined income, this amount is also eliminated from the numerator and denominator of the factor. One apportionment factor is calculated for the entire combined unitary group. The combined

---

<sup>17</sup> Generally states that adopt *Joyce* do not allow the use of net operating losses or credits against the income of other members of the unitary group.

<sup>18</sup> There may be members of the unitary group that do not meet the 80% ownership requirement for a federal consolidated return.

# PUBLIC DRAFT

Circulated for Public Comments

Comments Due by: **May 14, 2015**

apportionment factor will be applied to the combined apportionable income to determine income apportioned to South Carolina. This income apportioned to South Carolina will then be divided among the members of the group that have nexus with South Carolina and are not protected by PL 86-272 (“intrastate apportionment”).

6. For each member of the unitary group, the taxpayer will add any nonapportionable income allocated to South Carolina to the income apportioned to this State to determine total income subject to South Carolina tax. Any income subject to South Carolina tax as a result of allocation by members that do not have nexus or are protected by PL 86-272 will be allocated to the members subject to tax in South Carolina using the same percentages used for intrastate apportionment in #5.
7. A net operating loss sustained by the combined unitary group in a combined return year is allocated among the members of the group that reported losses on their pro forma Federal 1120s, after elimination of intercompany transactions between members of the combined unitary group and appropriate allocations. The amount allocated to each member will be determined by dividing that member's loss (after elimination of intercompany transactions) by the total losses (after elimination of intercompany transactions) of all members of the combined unitary group in that tax year. To the extent the net operating losses are not used by the group during the years the corporation is part of the group, the group's net operating losses allocated to a corporation that is a member of the group may be claimed by the corporation in the tax years after the corporation ceases to be a part of the group. Net operating loss carryforwards will be considered used in order beginning with the earliest tax year. If more than one corporation brought net operating losses from the same tax year into the combined unitary group and a portion of the losses from that year is used, the amount of used net operating losses will be prorated among the members bringing losses from that year based on the ratio of each member's losses to the total losses carried forward from that year.
8. The eligibility for and calculation of a tax credit amount is determined at the separate entity level but can be used against the unitary group income. Any unused carryforward of a tax credit earned by a member of the combined unitary group remains with that entity if that entity is no longer a member of the combined unitary group or the group is no longer required to file a combined return. This is applicable whether the credit was earned by the entity before becoming a member of the combined unitary group or while a member of the combined unitary group.

# PUBLIC DRAFT

Circulated for Public Comments

Comments Due by: **May 14, 2015**

## VI. Alternative Apportionment Administrative Issues

### A. Procedure for a Taxpayer to Request an Alternative Apportionment Method

SC Revenue Procedure #15-XX (draft document currently circulating for public comment) provides the procedure for a taxpayer to request an alternative apportionment method under Code Section 12-6-2320(A). The Revenue Procedure discusses the information that the taxpayer must provide so that a determination can be made as to whether the taxpayer can adopt the requested method. The procedure further provides that the Department must approve the new method prior to the taxpayer's use of the new method.

### B. Changes from an Approved Alternative Apportionment Method

If the Department approves an alternative apportionment method for a taxpayer, that agreed upon method will not be revoked by the Department with respect to transactions or activities that have already occurred, unless there has been a material change in, or a material misrepresentation of, the facts provided by the taxpayer upon which the Department reasonably relied in approving the alternative method.

### C. Statutory Time Limitations When the Department Requires an Alternative Apportionment Method

Code Section 12-54-85 provides the time limitations for assessing a tax deficiency. As a general rule, the amount of taxes due must be determined and assessed within 36 months from the date the return was filed or due to be filed, whichever is later. In certain instances, the Department may determine and assess taxes after the 36 month limitation. The statute for assessment is 72 months if there is a substantial understatement of the total tax required to be shown on the return (*i.e.*, an understatement of 20% or more). Code Section 12-54-85(C)(3).

If the Department requires the use of an alternative apportionment method which results in an additional tax of 20% or more, with limited exceptions described below, the Department will not extend the statute for assessment to 72 months, but the Department will apply the 36 month time limitation in Code Section 12-54-85(A). Additional taxes may still be determined and assessed after the 36 month period if a substantial understatement results from reasons other than the imposition of an alternative apportionment method. In that case, the Department will only require the taxpayer to use the alternative apportionment method for the 36 month period.

If the taxpayer was required to use an alternative apportionment method as a result of an audit (or settlement) and the Department and taxpayer agreed that the taxpayer would continue to use the alternative apportionment method until the parties agreed otherwise, then the Department may require the use of the alternative apportionment method for up to 72 months if there is a substantial understatement resulting from the failure to use the alternative method. Additionally, when the taxpayer has requested and received permission to use an alternative method and then fails to use the alternative method in future years, the Department may require the use of the

# PUBLIC DRAFT

Circulated for Public Comments

Comments Due by: **May 14, 2015**

alternative method for up to 72 months if there is a substantial understatement resulting from the failure to use that alternative method.

## D. Substantial Understatement Penalties When an Alternative Apportionment Method is Required by the Department

Code Section 12-54-155 provides for a penalty of 25% of the amount of the understatement if there is a substantial understatement of tax. Except as described below, the Department will not impose substantial understatement penalties if the Department requires a taxpayer to use an alternative apportionment method and the use of that alternative apportionment method causes the substantial understatement.

If the taxpayer was required to use an alternative apportionment method as a result of an audit (or settlement) and the Department and taxpayer agreed that the taxpayer would continue to use the alternative apportionment method until the parties agreed otherwise, then the Department may impose substantial understatement penalties if there is a substantial understatement resulting from the failure to use the alternative method. Additionally, when the taxpayer has requested and received permission to use an alternative method and then fails to use the alternative method in future years, the Department may impose substantial understatement penalties for failure to use the alternative apportionment method.

## VII. Conclusion

Under Code Section 12-6-2320(A)(4), the Department may require or a taxpayer may request an alternative method of apportionment as discussed in this Revenue Ruling. This document provides guidance to taxpayers on when and how the Department will apply an alternative apportionment method. Taxpayers that request to use an alternative apportionment method, including combined unitary reporting, should follow the procedure outlined in SC Revenue Procedure #15-xx (draft document currently circulating for public comment).