South Carolina Tax Commission
301 Gervais Street, P.O. Box 125, Columbia, South Carolina 29214

SC Technical Advice Memorandum #94-2 (TAX)

TO: JKL, Inc.

SUBJECT: Apportionment Ratio
(Income Tax)

DATE: September 20, 1994

SCOPE: This Technical Advice Memorandum is Policy's official advisory opinion on how laws administered by the Department of Revenue are to be applied to a specific audit of a particular person. It may only be relied upon by the person to whom it is issued and only for the transaction or transactions to which it relates. This Technical Advice Memorandum has no precedential value.

Question:

Based upon the facts, what apportionment ratio should be used by JKL, Inc., in determining its South Carolina income?

Conclusion:

Based upon the facts, JKL, Inc., should use the gross receipts formula provided in Code Section 12-7-1190 in determining its South Carolina income.

Facts:

JKL, Inc., (JKL), began doing business in November 1991 in Delaware. JKL's principal asset is the ownership of the "ABC" tradename and associated trademarks. It performs functions related to the licensing of the ABC tradename and trademarks and the receipt and investment of royalties from the exploitation of the ABC tradename and trademarks.

Over 90% of the royalties which JKL receives are generated pursuant to its licensing agreements with its parent company, XYZ Company, (XYZ). XYZ is a manufacturer of industrial and consumer packaging products and is headquartered in South Carolina.

JKL also licenses trademarks to affiliated domestic companies for use on JKL's and its subsidiaries associated products. The royalties which are paid by JKL's licensees are based on each licensees' sales of licensed products throughout the United States and foreign countries.

The licenses in question are licenses for the exclusive use of trademarks or tradenames under which products are sold by JKL and its subsidiaries. No manufacturing or any form of collecting, buying, assembling, or processing goods or materials, or selling, distributing or dealing in tangible personal property is performed by JKL.

Discussion:

Code Section 12-7-230 imposes an income tax on corporations transacting or conducting business in South Carolina, and reads, in part:

> ...every foreign corporation transacting, conducting, doing business, or having an income within the jurisdiction of this State, whether or not the corporation is engaged in or the income derived from intrastate, interstate, or foreign commerce, shall make a return and shall pay annually an income tax equivalent to five percent of a proportion of its entire net income, to be determined as provided in this chapter...

Based upon the facts and Geoffrey v. South Carolina Tax Commission, 437 SE 2d 13 (1993), SPCR is taxable under Code Section 12-7-230. The base upon which South Carolina imposes income tax is determined by an allocation and apportionment process. The allocation process under Code Section 12-7-1120 is applied first, then any remaining income is apportionable. We have received no facts that indicate any of JKL's income is allocable under Code Section 12-7-1120, therefore, for purposes of this document, we will assume that all of its income must be apportioned. To determine how much of JKL's income is apportionable to South Carolina, we must determine the correct apportionment factor to be used by JKL.

Code Section 12-7-1140 provides for the three-factor apportionment formula to apportion the income of corporations whose principal business in South Carolina is manufacturing, selling, distributing or dealing in tangible personal property within South Carolina. This statute is inapplicable to JKL.

Therefore, JKL must use the gross receipts apportionment ratio provided in Code Section 12-7-1190. Pursuant to this section, a taxpayer using the gross receipts method shall:

> ...make returns and pay annually an income tax upon a proportion of its remaining net income computed on the basis of the ratio of gross receipts from within this State during the income year to the total gross receipts of such year within and without the State.

Based on this analysis, JKL is subject to South Carolina income tax and the gross receipts method of apportionment should be used to determine its South Carolina taxable income. The numerator of the gross receipts ratio will include royalties earned from South Carolina sales, and the denominator will include royalities earned from sales everywhere.

The interpretation is consistent with Geoffrey v. South Carolina Tax Commission, 437 SE 2d 13 (1993) and Lockwood Green Engineers v. South Carolina Tax Commission, 361 SE 2d 346 (1987).

NOTE: Since JKL has not filed a South Carolina income tax return, the guidelines set forth in SC Information Letter #94-5 for voluntary and non-voluntary filers should be reviewed by JKL.