STAFF DRAFT

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SC REVENUE RULING #14-**STAFF DRAFT (2/28/14)**

SUBJECT:	Use of Alternative 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 12-6-2220(4) (2000) S. C. Code Ann. Section 12-6-2252(A) (Supp. 2012) S. C. Code Ann. Section 12-6-2280 (Supp. 2012) S. C. Code Ann. Section 12-6-2290 (Supp. 2012) S. C. Code Ann. Section 12-6-2295 (Supp. 2012) S. C. Code Ann. Section 12-6-2310 (2000) S. C. Code Ann. Section 12-6-2320 (2000 and Supp. 2012)
AUTHORITY:	S. C. Code Ann. Section 12-4-320 (Supp. 2012) S. C. Code Ann. Section 1-23-10(4) (Supp. 2012) 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 It is the Department's position until superseded or modified by a change in statute, regulation, court decision, or another Departmental advisory opinion.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 divide their income between those states to determine the income subject to tax 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. For example, South Carolina law requires that gains and losses from the sale of real property are allocated to the state where the real property is located.[1] Code Section 12-6-2220(4). Following the allocation of income to specific states, the remaining

[1] Regardless of location, the gain that represents a return of amounts previously deducted as depreciation in South Carolina is allocated to South Carolina..

income is generally apportioned between the states in which the taxpayer does business on a formula basis. The formula differs from state to state. For example, some states adopt a three factor formula of 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.

Within the realm of apportionment, there are two basic methods states use to determine the income of a multistate entity that is apportioned to the taxing state: separate entity reporting and combined unitary reporting. South Carolina's standard statutory method of apportionment is separate entity reporting. This revenue ruling addresses when South Carolina may require or a taxpayer may request an alternative apportionment method, including combined unitary reporting.

II. South Carolina's Statutory Apportionment Method

South Carolina's statutory apportionment formula apportions income on a separate entity basis using the sales factor or a gross receipts factor depending on the business of the taxpayer. [2] Code Section 12-6-2252(A) provides that businesses 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 businesses not dealing in tangible personal property, Code Section 12-6-2290 provides that the taxpayer apportions income using a gross receipts factor based on "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." Both sales and gross receipts are defined in Code Section 12-6-2295 and have the same meaning when calculating the sales factor or the gross receipts factor.[3] In other words, the sales factor and gross receipts factor are calculated the same way.

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;

[2] 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 not to exceed five years.

[3] Code Section 12-6-2252(A) formerly provided a three factor formula of property, payroll and double weighted sales for taxpayers dealing in tangible personal property. The three factor formula was phased-out for tax years after 2010 to a single sales factor. As a result, although the law provides a single sales factor formula and a gross receipts formula, the two formulas are calculated the same way.

(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.

Code Section 12-6-2320(A) is used by the Department to require an alternative allocation or apportionment method or by a taxpayer to request an alternative allocation or apportionment method when the standard allocation and apportionment methods do not fairly represent the taxpayer’s business activities in the South Carolina. [4]

III. Alternative Apportionment Methods

A. Introduction

The Department will generally apply an alternative apportionment method as the result of an audit. A taxpayer will generally request an alternative method when it believes the statutory method does not fairly represent the taxpayer’s business activity in the State. SC Revenue Procedure #09-1 outlines the procedure a taxpayer uses to request an alternative apportionment method.

The party advocating an alternative apportionment method has the burden of proving that the use of the statutory method does not fairly represent the taxpayer’s business activity in this State. *Carmax Auto Superstores West Coast, Inc. v. South Carolina Dep’t of Revenue*, 397 S.C. 604, 725 S.E.2d 711 (Ct. App. 2012), *cert. granted* August 29, 2013. It is not necessary for the party seeking an alternative method to prove that constitutional distortion will result from the use of the standard apportionment method.[5] Instead, the party asserting the alternative method must prove that the statutory method as a whole does not reasonably or equitably represent the extent of the taxpayer’s business activity in the State. *Twentieth Century-Fox Film Corp. v. Department of Revenue*, 299 Or. 220, 228, 700 P.2d 1035, 1039 (1985).

B. When the Use of an Alternative Apportionment Method Is Appropriate

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 there are no absolute rules that can be applied to determine if the statutory method fairly represents the business activity performed in South Carolina. Several courts, however, have decided cases which provide some guidance as to when an alternative method is appropriate.

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[4] Although the statute refers to allocation and apportionment, this document deals with alternative apportionment, not alternative allocation, and the discussion will refer to alternative apportionment.

[5] The leading case dealing with constitutional distortion is *Hans Rees’ Sons v. North Carolina*, 283 U.S. 123 (1931), in with the United States Supreme Court found that the state’s apportionment method led to a distorted constitutional result since the formula resulted in a tax which exceeded 250% of the tax owed by the taxpayer using an accepted alternative method.

Twentieth Century-Fox Film, supra, involves the apportionment of income to Oregon. Twentieth Century-Fox Film produced and distributed movies throughout the United States. The only activity in Oregon was the distribution of movies for showing by independent theaters. Oregon used a three factor formula of sales, property, and payroll to apportion income. Twentieth Century-Fox Film included a very small property value for prints of film ($800-$1,000 per print) that were located in Oregon for the property numerator. On the other hand, the company valued the film negatives located in vaults in California at the cost of the movie production ($5 million to over $20 million per movie) in the property denominator. The court determined that the inclusion of the film prints at this low value resulted in a property value in the numerator as compared to the cost of producing the movie in the denominator that did not represent the business activity of Twentieth Century-Fox Film in Oregon.

In *Microsoft Corp. v. Franchise Tax Board*, 39 Cal.4th 750, 139 P.3d 1169, 47 Cal. Rptr. 3d 216 (2006), the California court found that Microsoft's sales factor did not represent the company's business activity in California. Microsoft included the gross receipts from the sale of short-term securities by Microsoft's treasury department located in Washington in the denominator of the gross receipts factor. This treatment inflated the denominator since the same funds were reinvested multiple times during the year. As a result the court found that the apportionment formula did not properly represent Microsoft's business activities in California.

In *Media General Communications, Inc. v. South Carolina Dep't of Revenue*, 388 S.C. 138, 694 S.E.2d 525 (2010), the taxpayer claimed that South Carolina's standard apportionment formula did not fairly reflect the business activities in South Carolina because of related party transactions. Media General, Inc. was the parent company of a consolidated group of communications 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 intangibles companies for the use of the licenses resulting in income for the intangibles companies and losses for the communication companies.[6] The parties agreed that the result did not fairly represent the companies' business activity in South Carolina.

Each of these cases has unique facts and each has a different reason why the standard apportionment formula did not fairly represent the taxpayers' business activities in the particular state.

C. Selecting an Alternative Method of Apportionment

Once it is determined that the standard apportionment method does not fairly reflect 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.** In other words, the statute requires the use of a reasonable method that will result in a fair apportionment of the taxpayer's business income.

[6] 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.

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 the Uniform Division of Income for Tax Purposes Act (UDITPA) 18 provision[7], the court found:

> [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; [8] 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. The alternative method must be determined in relation to the reason the standard method does not does not fairly reflect the business activity in the State. For the cases previously discussed, the courts or the parties found the following alternative apportionment methods were reasonable.

Twentieth Century-Fox Film Corp., supra, focused on the property factor of Oregon's three factor sales, property, and payroll apportionment formula. The court adjusted the property factor to revalue the film prints for the property numerator using an alternative method. The court revalued the film prints based on the ratio of receipts from the movie in Oregon to receipts from the movie everywhere. This ratio was multiplied by the production cost of the movie to determine the Oregon property numerator. With this change, the court found that the alternative method fairly reflected the taxpayer's business activity in Oregon.

On the other hand, in *Microsoft Corp., supra*, the California Supreme Court found that the taxpayer's inclusion of gross proceeds from the sale of short-term securities in the denominator of the sales factor skewed the sales factor so that it did not properly reflect business activity in California. The court found that to fairly represent the business activity in California it was reasonable to include only the net receipts from the treasury functions in the sales factor denominator.

Media General Communications, Inc., supra, involved transactions between related parties. The taxpayer argued that combined reporting was the reasonable method to correct the failure of the statutory formula to fairly reflect the business activity in South Carolina as a result of a single business enterprise being split into separate corporations. The related party transactions resulted in losses in South Carolina for the companies actually conducting the communications business in South Carolina and income in South Carolina for the companies that owned the licensing agreements.

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[7] The language of UDITPA 18 is very similar to the language in Code Section 12-6-2320(A).

[8] 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.

The companies argued that apportionment on a separate company basis did not fairly represent the business activities in the State and the companies requested to file on a combined unitary basis. The Department agreed that South Carolina's statutory separate entity apportionment formula did not fairly represent the taxpayers' business activities in the State. *Id.* at 529. The parties also agreed that combined unitary reporting would fairly represent the taxpayers' business activities in South Carolina. *Id.*at 527. The Department, however, argued that combined unitary reporting was not allowed as an alternative apportionment method under Code Section 12-6-2320(A)(4). The South Carolina Supreme Court held that the combined unitary method is an appropriate method that can be used to provide equitable apportionment of a taxpayer's income to the State under Code Section 12-6-2320(A)(4).

In each of these cases, the alternative apportionment method was crafted to cure the specific fact situation which caused the business activity in the state to not be fairly reported using the standard statutory apportionment method.

D. Combined Unitary Reporting as an Alternative Apportionment Method

1. Introduction to Combined Unitary Reporting

Since the *Media General* decision, questions have arisen as to when and how the Department will apply combined unitary reporting either through audit or when the taxpayer makes a request for an alternative apportionment method under Code Section 12-6-2320(A)(4). By way of background, it is necessary to understand the basic concepts of combined unitary reporting.

As previously discussed, South Carolina's statutory apportionment method is based on separate entity reporting. Under separate entity reporting, each legal entity doing business in more than one state separately apportions its income to determine the income subject to tax in that state.

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 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[9] 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 group's level of activity in the state as compared to the group's level of activity in other states.

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[9] 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 IV.B.2 of this document.

The constitutionality of combined reporting has been affirmed by the United States Supreme Court. *Container Corp. of America v. Franchise Tax Bd. of California*, 463 U.S. 159 (1983). The Court held that California's combined 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 reporting is a better method of measuring income of a unitary business than separate entity reporting and is a safeguard against taxpayer manipulation.

> The problem with [formal geographical or transactional accounting] is that formal accounting is subject to manipulation and imprecision, and often ignores or captures inadequately the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise. The unitary business/formula apportionment method is a very different approach to the problem of taxing businesses operating in more than one jurisdiction. It rejects geographical or transactional accounting, and instead calculates the local tax base by first defining the scope of the "unitary business" of which the taxed enterprise's activities in the taxing jurisdiction form one part, and then apportioning the total income of that "unitary business" between the taxing jurisdiction and the rest of the world on the basis of a formula taking into account objective measures of the corporation's activities within and without the jurisdiction.

Container Corp. of America, 463 U.S. at 165. [Citations omitted].

Combined reporting is a revenue neutral accounting system and its application to any separate taxpayer could either increase or decrease the amount of tax due, depending on the facts of the particular case.

<u>IV. South Carolina's Use of Combined Unitary Reporting as an Alternative Method of Apportionment</u>

<u>A. When South Carolina Will Require or Allow the Use of an Alternative Apportionment Method</u>

In accordance with the *Media General* decision, the Department may require combined unitary reporting as a reasonable method to effectuate equitable apportionment of the taxpayer's income when the standard method does not reflect the taxpayer's business activity in the State. The taxpayer may also petition the Department for an alternative apportionment method, including combined unitary reporting. In making a determination of whether a combined unitary reporting request is appropriate or whether the Department will require a combined unitary filing, the Department's main focus is on transactions between members of a unitary group. When a unitary group has been formed or reorganized such that separate, but related, corporations are paid, for example (1) to perform services, (2) to use a business asset (tangible or intangible), or (3) to lease, sell and/or buy assets which are an integral part of the same core business operation conducted in South Carolina, the Department may require combined unitary reporting to reflect the taxpayer's business activities in the State.

For example, as previously discussed, in *Media General, supra*, there were substantial intercompany transactions and interdependence among commonly controlled and owned entities. As the South Carolina Supreme Court noted:

> Media General and its affiliates comprise a "unitary group," which as used herein is defined as a business in which there is a high degree of interrelationship and interdependence among related entities so that the value of the business as a whole exceeds the sum of its individual elements. Unitary groups generally share a unity of management, ownership, and control of operations resulting in unquantifiable flows of value among the related entities of the business. Media General and its affiliates operate converged media operations where television, newspaper, and online products and information are merged and leveraged off of each other.

Media General Communications, Inc., 694 S.E.2d at 526 (2010).

In situations with a high degree of interdependence between related parties through intercompany transactions, the Department may find that the intercompany relationships are such that, without combined unitary reporting, the business activity in South Carolina will not be fairly reflected using the standard separate company apportionment method. The integral functions of the core business operation have been divided among legal entities resulting in unquantifiable value flowing between the entities which cannot be captured using separate company apportionment.

Situations in which the Department has determined that an integral function of the core business operations is performed in separate, but related, corporations requiring a combined unitary filing include the use of purchasing companies, management fee companies, and "east/west" companies. Descriptions of these types of situations are discussed below.

> <u>Purchasing Companies.</u> A purchasing company handles all or substantially all inventory purchases for a related retail company which in turn sells the inventory to customers in South Carolina. The retail company is required or through practice purchases its inventory from the related purchasing company. The retail company cannot operate without inventory to sell. The related purchasing company has a "captive" customer for its products. Both the purchasing company and the retail company are an integral part of the same core retail business.
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> <u>Management Fee Companies.</u> A corporate member of the unitary group provides general management services to related operating companies for a fee. Often this fee will be calculated as a percentage of gross profits from the operating companies. The management company may provide a variety of services such as establishing standard operating procedures for business operations, developing training methods for employees, providing human resource services, and performing other similar management functions. These management functions are integral to the business of the related operating companies.

> East/West Companies. A unitary business is divided between two corporations. One corporation is located in the western states where combined reporting is generally required. The other corporation is located in the eastern states where separate entity reporting is generally used. The unitary business will use this structure to generate expenses for the east corporation through payments for the use of intangibles, management fees, or other payments for services that are an integral part of the east corporation's business. The west corporation's income and/or apportionment ratios are not affected since the west corporation is already filing a combined return with the east corporation. Again, integral parts of the east corporation's business operations have been shifted to the west corporation resulting in an apportionment of income that does not reflect the business activity in the taxing state.

In each of the above situations, unitary combined reporting will generally be required to fairly reflect the overall business activity in the State.

Certain facts will not be considered by the Department in determining whether combined unitary reporting is required. 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 business done in South Carolina. Additionally, the fact that a business purpose exists for a corporate structure or transaction will not preclude the Department from requiring an alternative method if the integral operations of a single business are divided among separate corporations creating related party transactions for that single business's integral functions.

B. 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 will generally determine unitary combined income and South Carolina apportionment using the following principles.

1. Unitary Business Requirement

Since only members of a unitary business can be part of the unitary combined reporting, 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 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.

2. Water's Edge Combined Reporting

South Carolina will generally use a "water's edge" approach for determining the apportionable income base. 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 that is defined in Section 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 group subject to tax to the extent of that income and the apportionment factors related to that income.

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

3. Treatment of Partnerships

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

4. Use of the *Finnigan* Apportionment Method

There are two basic approaches to apportioning income when using combined unitary reporting called (1) "*Joyce*" and (2) "*Finnigan.*" These methods are named after cases decided by the California Board of Equalization.[10] *Joyce* and *Finnigan* refer to two different methods of calculating the sales factor numerator for unitary apportionment purposes. As a theoretical matter, the difference between the two methods is based on whether the combined group is

[10] *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.

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 apportionment factor is multiplied by the combined income of all unitary members.

Under *Finnigan* all members of the combined 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 that might contend they 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 the South Carolina for the group as a whole. This apportionment formula uses the South Carolina sales of all members of the combined group in the sales factor numerator, including those members that are not subject to tax in South Carolina. The second step is to apportion that state income among the members that are taxpayers subject to tax in South Carolina.

Additionally, since South Carolina is using the *Finnigan* method to apportion income, all members will be allowed to use the South Carolina net operating losses and credits of all members of the combined unitary group.[11]

C. 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. The pro forma Federal 1120s must represent federal taxable income "as if"

[11] 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.

each corporation were not part of a consolidated federal return. Because of the 80% ownership requirement for a federal consolidated 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.

2. The taxpayer must combine the pro forma Federal 1120s of the corporations to be included in the combined 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 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 group. All sales or gross receipts in South Carolina of entities within the combined 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 by the taxpayer for the combined group. The taxpayer will apply the combined apportionment factor to the combined apportionable income to determine income apportioned to South Carolina. This income apportioned to South Carolina will be divided among the members of the group that have nexus with South Carolina ("intrastate apportionment").

6. 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 will be allocated to the members that do have South Carolina nexus using the same percentages used for intrastate apportionment in #5.

7. A net operating loss sustained by the 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 group. 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 group in that tax year. To the extent 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 earliest tax year. If more than one corporation brought net operating losses from the same tax year into the combined 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. Any unused carryforward of a tax credit earned by a member of the combined group remains with that entity if that entity is no longer a member of the combined 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 group or while a member of the combined group.

D. Filing Annual Reports and Paying the License Fee

Each corporation required to file an annual report and pay a license fee pursuant to Chapter 20 of Title 12 will do so on a separate company basis using the apportionment factor for that single entity. The annual license fee is due from the corporations with South Carolina nexus that are reporting their combined income to South Carolina.

IV. Conclusion

The Department may require or a taxpayer may request the use of combined unitary reporting as an alternative method of apportionment under Code Section 12-6-2320(A)(4) as discussed in this Revenue Ruling. Taxpayers requesting to use combined unitary reporting should follow the procedure outlined in SC Revenue Procedure #09-1.