



# This Week in State Tax (TWIST)

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## SOUTH CAROLINA



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### South Carolina: Administrative Law Court Approves Combined Reporting Alternative Apportionment Method

Recently, the South Carolina Administrative Law Court upheld the Department of Revenue's assertion that a group of subsidiaries were required to file a combined return to properly reflect business activity in South Carolina. The overall business consisted of almost 1,600 rural lifestyle retail stores in 49 states and an e-commerce website. The named taxpayer in the case, TSC, operated retail stores in every state but Texas, Michigan, Utah, and Alaska, and provided services to the group from its headquarters in Tennessee. The other two subsidiaries, Michigan and Texas, operated stores in those states. The Michigan entity leased all its employees from TSC, and the Texas entity held the group's intangibles, but did not charge the entities for their use. As part of a 2001 restructuring, Texas was assigned the role of providing the procurement function for TSC and Michigan. TSC had previously performed this function. During the audit years, TSC filed its South Carolina corporate income tax returns using separate entity reporting. Texas and Michigan did not file in South Carolina. During an audit, the Department concluded that separate entity reporting did not fairly represent TSC's business activity in South Carolina and allowed TSC to minimize its taxes by shifting income from its retail sales (including its South Carolina retail sales) to Texas through a 9.7 percent markup on inventory Texas charged pursuant to the parties' Procurement Agreement. As such, the Department asserted that under its authority to apply an alternative apportionment formula, TSC should file a combined return with Michigan and Texas. The taxpayer protested and the matter eventually came before the Administrative Law Court.

In a 65-page opinion, the court first determined that combined reporting was an alternative method of apportionment because reporting methods fell under the umbrella of "apportionment." Therefore, the Department had the authority to modify both South Carolina net income and the sales factor to fairly reflect the business activity of TSC. The taxpayer also argued that the Department could not impose combined reporting (or combined entity apportionment, as it was referred to in the decision) because the term "taxpayer" was used in the statutes in the singular. Citing to the *Media General* South Carolina Supreme Court case, the court concluded that the use of the term taxpayer in the singular did not bar the Department from requiring unitary combined reporting. Having concluded that the Department was permitted to require combined reporting as an alternative apportionment method, the court next addressed whether the Department had proven (1) that the statutory formula did not fairly represent TSC's business activity in South Carolina and (2) that the proposed alternative formula was reasonable. Interestingly, the court recognized that the reporting method was not the true problem in this case—it was the transfer pricing. But none of the experts involved had produced a corrected transfer price, which in the court's view meant it could not fix the issue by adjusting the transfer pricing. The court concluded that it was constrained by the evidence before it and without a corrected transfer price, the application of separate entity reporting resulted in a taxable base that did not fairly reflect TSC's business activity in South Carolina. The taxpayer next made several arguments that combined reporting was not a reasonable alternative method. In the court's view, combined unitary reporting, by the very nature of how it is applied, reasonably carved out and fairly represented the income associated with TSC's business activity in South Carolina, which were its retail sales. While no method of apportionment is perfect, the court determined that combined unitary reporting had the benefit of removing the unreliable transfer price while recognizing the value flowing between the entities and carving out only the income from retail sales associated with South Carolina. Please contact [Jeana Parker](#) with questions on *Tractor Supply Company v. South Carolina Department of Revenue*.

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