This Week in State Tax (TWIST)

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South Carolina: Tough Sledding for Banks in Palmetto State

In recent weeks, the South Carolina Administrative Law Court and the Court of Appeals have issued decisions regarding the state Bank Tax Act that were averse to taxpayers. In the first matter, the Administrative Law Court (ALC) affirmed a Department of Revenue (Department) Determination that a national bank must source its mortgage loan interest, credit card interest and fees, and credit card interchange fees based on the location of the borrower for purposes of the Bank Tax.

For income relating to mortgages, the ALC first found that mortgages should be classified as intangible property because they are "evidence of debt" and statutorily excluded from the definition of tangible personal property. Under South Carolina law, income from intangible property is sourced to the location where the property is "used," which, according to ALC, was the location of the real estate. Further, the ALC noted the Department had a "longstanding administrative practice" of using location of the borrower as a proxy for location of the real estate. The taxpayer had argued that its mortgage activities constituted service income and should be sourced based on the income producing activities regarding the issuance, approval and servicing of the mortgage, which occurred primarily outside of South Carolina. While the ALC rejected this framing, it noted that, even if the activities constituted a service, the true income-producing activity is the issuance of mortgage loans to South Carolina borrowers, as without the mortgage, the taxpayer would have received no income. The ALC analogized to the state supreme court decision in DIRECTV, holding that receipts from digital television subscriptions should be sourced to the location of the subscriber.

For fees related to the issuance of credit cards, the ALC held that the extension of credit to cardholders created accounts receivable and fell within the definition of intangible property. Thus, interest, late fees, and annual fees associated with the cards should be sourced based on the borrower's location. Even if the issuance was treated as a service, the income was sourced to the South Carolina borrower because the customer is paying for the ability to spend money on credit. The ALC did agree that interchange and merchant fees received by the taxpayer were service income. It found, however, that the true income producing activity occurred where the credit card transaction was initiated because the transaction could not be concluded (and income received) without the approval or denial decision being transmitted to that location.

In the second case, the Court of Appeals affirmed an ALC decision holding that the bank tax does not permit certain deductions allowed by the federal income tax, specifically the federal net operating loss carryforward. The South Carolina bank tax is imposed on the entire net income of a bank. In reaching its decision, the court relied on the general rule that a deduction statute should be construed against the taxpayer. The court first noted that unlike the bank tax, the South Carolina corporate income tax explicitly authorizes a net operating loss deduction from entire net income, rather than including them as part of the computation of entire net income. While the state corporate income tax also was imposed previously on entire net income, the legislature had specifically authorized a deduction for federal net operating losses in 1955. As such, net operating loss carryforwards are not an inherent part of entire net income and must be statutorily authorized as deductions, and there is no such deduction under the bank tax. Moreover, the court rejected the taxpayer's argument that the bank tax base was to be identical to the corporate income tax base. Based on legislative history and established practice, the court determined that the bank tax was a franchise tax (not an income tax) and was not intended to conform to the state corporate tax, except for certain specified elements such as administration, enforcement, and enforcement. For more information on U.S. Bank National Association v. South Carolina Department of Revenue or Synovus Bank v. South Carolina Department of Revenue, please contact Jeana Parker.

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