



This Week in State Tax (TWIST)

October 26, 2026



South Carolina: Appeals Court rules Banks' Services are Sourced to South Carolina

The South Carolina Court of Appeals recently issued two decisions addressing how financial services companies must source service and intangible income for corporate income and bank tax purposes. In both cases, the court upheld Administrative Law Court (ALC) determinations that a company's income-producing activity occurs within South Carolina when its services relate to a transaction with a cardholder, merchant, or borrower located in the state, rejecting taxpayer arguments that the relevant activity is confined to out-of-state processing, decisioning, or servicing functions. Both panels relied heavily on the court's 2017 decision in *DIRECTV, Inc. & Subsidiaries v. South Carolina Department of Revenue*, which sourced a satellite provider's income to the location where it delivered its signal to subscribers.

In *Mastercard*, the taxpayer, the operator of a worldwide credit card network, generated revenue by charging fees based on the number of credit and debit transactions from branded cards and the gross dollar volume of those transactions. The transactions were initiated when cardholders presented branded credit or debit cards to merchants as payment for goods and services. The taxpayer argued that none of its gross receipts should be sourced to South Carolina because its payment processing and related services were performed outside the state and its customers were financial institutions, not cardholders or merchants. Specifically, it characterized its income-producing activity as the "final act" of delivering authorization messages to the Mastercard Interface Processors (MIPs) at its financial institution customers' facilities or processing facilities, with all MIPs located outside South Carolina.

Although the court rejected the Department's position and subsequent ALC's finding that cardholders were the taxpayer's true customers, it held that the taxpayer's income-producing activity was providing a network that enabled cashless transactions at South Carolina merchants. The court explained that neither the state's income-producing activity sourcing methodology nor its previous decision in *DIRECTV* requires sourcing based solely on which party technically pays for the service; instead, the inquiry focuses on the activity that actually earns the revenue. The court also upheld the Department's proxy methodology as a reasonable approximation of South Carolina receipts, using the state's share of U.S. transaction dollar volume for assessment fees and transaction counts for processing fees, with other fees and rebates and incentives allocated proportionately. Moreover, sourcing based on its financial institution customers' South Carolina billing addresses would capture only a fraction of the income generated by transactions in the state, including purchases by out-of-state cardholders.

In *U.S. Bank*, the taxpayer originally excluded mortgage interest; servicing fees; gains from pooled mortgage sales to government-sponsored entities such as Fannie Mae; and credit card interest, fees, and interchange income from its South Carolina receipts for purposes of its bank tax apportionment factor. The court upheld the

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ALC's sourcing determinations but reclassified credit card interest and fees as service income. For mortgage servicing fees, the court upheld the ALC's finding that the services were directed into South Carolina and inextricably tied to mortgages secured by property in the state, even though the employees performing those services were located elsewhere. The court also held that mortgage interest constituted receipts from the use of intangible property, while mortgage sale gains constituted net gains from the sale of intangible property used in a trade or business rather than sales of inventory. Both were sourced to South Carolina because the mortgages were used at the location of the real property securing them. For credit card interest and fees, the court reclassified the receipts as service income rather than intangible-property income. Despite that change, the court upheld South Carolina sourcing because customers paid for the extension of credit and their in-state card use generated income, while activities such as administering rewards programs and facilitating balance transfers were preparatory or ancillary. Finally, the court upheld South Carolina sourcing of interchange and merchant fees because the initiation and ultimate funding of transactions at South Carolina merchants generated the bank's income, notwithstanding out-of-state routing, processing, and funding functions.

The court upheld the challenged penalties in both cases. In Mastercard, the taxpayer conceded that it had sufficient nexus with South Carolina to require filing returns, supporting the failure-to-file penalties regardless of whether its income was earned in the state. The ALC had already waived penalties for failure to pay due to the taxpayer's good faith reliance on DirectTV. In U.S. Bank, the court upheld the remaining substantial-understatement penalties because excluding the disputed receipts did not reasonably approximate the bank's South Carolina business activity and the bank failed to establish substantial authority or reasonable cause, as acting in good faith did not constitute reasonable cause. Please contact [Jeana Parker](#) with questions about [Mastercard Int'l Inc. v. Dep't of Rev.](#) and [U.S. Bank N.A. v. Dep't of Rev.](#)

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