



This Week in State Tax (TWIST)

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South Carolina: New Legislation Would Adopt Combined Reporting Standards

Legislation that sets forth standards for when corporate taxpayers can be required to file a unitary combined return has passed both houses of the South Carolina legislature. Recall, in the 2014 *Media General* case, the South Carolina Supreme Court held that unitary combined reporting was an apportionment methodology that could be used to equitably apportion a taxpayer's income to the state. Just this past year, the state's Administrative Law Court upheld forced combination as a means of correcting what it viewed was a flawed transfer pricing methodology.

House Bill 298 would amend the section of the South Carolina Code that allows a taxpayer to petition for, or the Department to require, the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income. Under the bill, the first step toward combination is that the Department must have "reason to believe" that a corporation's tax return does not accurately reflect South Carolina income due to transactions that lack economic substance or are not at fair market value. What it means to have a "reason to believe," or the level of certitude in that belief, is not addressed in the bill. However, if the Department determines that it has the appropriate "reason to believe," it may request additional information from the taxpayer so that it may determine whether the taxpayer's intercompany transactions have economic substance and are conducted at fair market value. The taxpayer has 90 days to provide the requested information. The bill does provide some guidance for determining whether the taxpayer's intercompany transactions fail either of these tests. Most of the guidance addresses whether a transaction has economic substance. In determining whether transactions are not at "fair market value," House Bill 298 simply states that the Department shall apply the standards contained in the IRC section 482 regulations. While the mere reference to the IRS section 482 regulations appears sparse on its face, one must remember that there is a large body of federal guidance interpreting IRC section 482 that would now be instructive in South Carolina. If the Department determines that the intercompany transactions lack economic substance or are not at fair value, then before it can require a combined return the Department must demonstrate that correction cannot be achieved by adding back, eliminating, or otherwise adjusting the intercompany transactions. It is not clear how it will be determined that these actions are insufficient to accurately reflect the taxpayer's net income. Finally, if the Department determines a combined return is required, it must provide notice to the taxpayer to submit the combined return within 90 days. The Department or the taxpayer may propose a combination of fewer than all members of the unitary group, provided,

however, the Department may not require a combination of fewer than all members of the unitary group without the taxpayer's consent. A combined return generally must include all members of the taxpayer's affiliated group that are conducting a "unitary business," which term is not defined in House Bill 298. Several types of entities would be statutorily excluded from the combined return including: (i) corporations not required to file federal income tax returns, (ii) certain non-captive insurance companies, (iii) exempt organizations, (iv) foreign corporations, and (v) corporations with at least 80 percent of their gross income being active foreign business income as defined in IRC section 861(c)(1)(B).

One important aspect in the bill is that the Department must provide a written statement of its findings to the taxpayer if it adjusts the taxpayer's income or requires a combined return. The written statement shall be provided no later than 90 days after the Department issues a proposed assessment.

House Bill 298 adopts provisions for taxpayers that wish to affirmatively obtain written advice as to whether the Department will require a redetermination of the corporation's income or whether combined reporting will be required. The guidance must be provided within 120 days of the receipt of any information that may be requested by the Department to make the requested determination. The revised law will take effect upon approval by the Governor and applies to all open tax periods excluding assessments under judicial review by the South Carolina Administrative Law Court, Court of Appeals, or Supreme Court. Please contact [Jeana Parker](#) with questions.

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