

Income/Franchise:

South Carolina ALJ Says Combined Reporting Corrects Distortion Resulting from Intercompany Transactions and East-West Structure

Case No. 21-ALJ-17-0182-CC, S.C. Admin. Law Ct. (8/15/24). In a case involving a national retailer and its various affiliates (including customer financing, trademark/tradename, back-office management, marketing, and real estate holding affiliates) whose overall organization included an “east-west structure” where the “East” taxpayer in this case challenged a South Carolina Department of Revenue (Department) audit assessment for fiscal years 2016 through 2018, the chief administrative law judge with the South Carolina Administrative Law Court (Court) continued to side with the Department in an amended order [see *State Tax Matters*, Issue 2024-29, for details on the original order] – concluding that separate reporting, along with South Carolina standard allocation and apportionment, failed to capture or correct resulting distortion from the taxpayer’s use of “intercompany transfer pricing and a partnership with an east-west structure” and that combined unitary reporting (“CUR”) constituted a reasonable and equitable alternative method to correct the distortion and result in a fair representation of the taxpayer’s in-state business activity. In doing so, the judge continued to note that the taxpayer’s intercompany transfer pricing and partnership with an east-west structure significantly distorted its in-state business activity and artificially lowered its tax burden in South Carolina “without reasonable and reliable justification,” and that, pursuant to state caselaw, CUR was an authorized alternative apportionment method. Accordingly, the judge upheld the Department’s application of the alternative apportionment method and ordered the “East” taxpayer to use combined unitary reporting on its South Carolina corporate income tax returns for fiscal years 2016 through 2018.

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Responding to one of the arguments made by the taxpayer against mandated combined reporting and requesting intercompany adjustments under “482-principles” be made instead, the judge noted that “although addressing intercompany issues with Section 482 powers may have allowed separate reporting to remain intact, as this case clearly demonstrates, utilizing Section 482 power is a complicated and fraught venture that takes enormous time and resources to ostensibly arrive at the same result as CUR achieves in this case: a fair representation of the taxable business activity in this state for a single taxpayer.” Please contact us with any questions.

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