



South Carolina Bar

Continuing Legal Education Division

2024 SC BAR CONVENTION

Tax Law Section

“Tax and Business Exit Planning for the
Generational Family Business: and
2024 Tax Update

Saturday, January 20

SC Supreme Court Commission on CLE Course No. 240034

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Continuing Legal Education Division

2024 SC BAR CONVENTION

Tax Law Section

Tax Update

Jason P. Luther

Adam J. Neil



State and Local Tax Update

South Carolina Bar Convention – January 20, 2024

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Disclaimer

The opinions expressed in this presentation are the authors' alone and should not be attributed to the South Carolina Department of Revenue.

Court of Appeals

Shirley Whitfield, Individually and as Personal Representative of the Estate of William Whitfield v. SCDOR, Appellate Case No. 2019-001748

- Filed tax return/claim for refund in 2017/2018 for taxes paid in 2012/2013
- Denied as untimely under section 12-54-85
- Taxpayer did not file written protest within 90 days
- Taxpayer appealed to ALC; dismissed for failure to exhaust administrative remedies

Shirley Whitfield, Individually and as Personal Representative of the Estate of William Whitfield v. SCDOR, Appellate Case No. 2019-001748

- Is the RPA confusing?
 - Section 12-60-20 – intended to provide the people of this State with a straightforward procedure to determine disputes with the Department
- Was the initial refund claim untimely?
 - Two-step analysis in Section 12-54-85
 - Timely filed, and taxes paid during look-back period
- **Court of Appeals (Jan. 25, 2023) – ALC properly dismissed Whitfield's action because she failed to exhaust her administrative remedies**

Jack's Custom Cycles, Inc. v. Dept. of Revenue, 18-ALJ-17-0393-CC



- *Issue:* Is an ATV/UTV a “motor vehicle” for purposes of the maximum motor vehicle sales tax?
- *ALC:* Yes.
- *Court of Appeals:* Yes

Jack's Custom Cycles, Inc. v. Dept. of Revenue, 18-ALJ-17-0393-CC

- “Max Tax” of \$300 on:
 - Aircraft
 - **Motor vehicle**
 - Motorcycle
 - Boat and watercraft motor
 - Trailer or semitrailer pulled by a truck tractor
 - Recreational vehicle (campers, motor homes, fifth wheel)
 - Self-propelled light construction equipment
- Motor Vehicle not defined for purposes of the Max Tax

Jack's Custom Cycles, Inc. v. Dept. of Revenue, 18-ALJ-17-0393-CC

- Title 56 – “all terrain vehicle” means a “motor vehicle . . . designed primarily for off-road recreational use.”
 - “Vehicle” means every device in which a person or property may be transported or drawn upon a highway.
 - ATVs not designed for highway use; DMV does not register or license ATVs
- SCDOR guidance in 2008 and 2018 (in conjunction with DMV)
 - ATVs are not required to be registered with DMV; subject to full sales tax

Jack's Custom Cycles, Inc. v. Dept. of Revenue, 18-ALJ-17-0393-CC

- Court of Appeals:
 - “The clear language of section 12-36-2110(A) does not restrict or condition the exemption to motor vehicles that are used on highways.”
 - ALC decision that ATVs and UTVs are motor vehicles under section 12-36-2110(A) is supported by substantial evidence.
- Opinion filed Feb 15, 2023; withdrawn, substituted, refiled Apr. 26, 2023

Revenue Ruling 23-3

The “max tax” applies to any motorized, self-propelled, wheeled vehicle (except trains).

LAW AND DISCUSSION:

The sales and use taxes are transactional taxes imposed upon the privilege of the business of selling at retail, or using, storing, or consuming personal property in South Carolina. The sales and use tax is imposed at a rate of 6% of “gross proceeds of sales” or “sales price,” plus any applicable local sales and use tax.³

The sale of any means of transportation that is enumerated in S.C. Code Ann. § 12-36-2110(A)(1) is subject to a partial sales or use tax exemption, which limits the tax rate to 5% of “gross proceeds of sales” or “sales price,” not to exceed \$500.⁴ Local sales and use taxes do not apply.

A “motor vehicle” is one such means of transportation.⁵ Historically, the Department of Revenue

Motor Vehicles. However, in its opinion in *Jack’s Custom Cycles*, the Court of Appeals held that the term “motor vehicle” does not “restrict or condition the exemption to motor vehicles that are used on highways.”⁶ Instead, the term includes “motorized, self-propelled, wheeled” vehicles that “do not run on rails.”⁷

CONCLUSION:

Effective April 26, 2023, for purposes of the maximum tax provisions of S.C. Code Ann. § 12-36-2110, the term “motor vehicle” includes any motorized, self-propelled, and wheeled vehicle that does not run on rails. Therefore, all-terrain vehicles, utility task vehicles, golf carts, and legend race cars are subject to the maximum tax provisions.

September 26, 2023
Columbia, South Carolina

³ See S.C. Code §12-36-910(A) for the 5% sales tax, S.C. Code § 12-36-1310(A) for the 5% use tax, and S.C. Code § 12-36-1110 for the additional 1% sales and use tax rate.

⁴ Effective after June 30, 2017, the maximum sales and use tax imposed pursuant to Chapter 36 of Title 12 on the sale, lease, or registration of an item enumerated in S.C. Code Ann. § 12-36-2110(A)(1) is increased from \$300 to \$500. S.C. Code Ann. § 12-36-2110(A)(4).

⁵ S.C. Code Ann. § 12-36-2110(A)(1)(b).

⁶ *Jack’s Custom Cycles, Inc. v. S.C. Dep’t of Revenue*, 439 S.C. 35, 47, 885 S.E.2d 433, 440 (Ct. App. 2023), [reh’g denied](#) (Apr. 26, 2023).

⁷ *Id.* at 47, 885 S.E.2d at 440.

Lowe's Home Center, LLC v. South Carolina Dep't of Revenue, Docket No. 14-ALJ-17-0552-CC (Dec. 11, 2020)



Issue: Is Lowes required to pay sales tax on the retail price of the materials it sells to installed sales contract customers?

ALC: Yes.

Court of Appeals: Oral argument on Nov. 6

Lowe's Home Center, LLC v. South Carolina Dep't of Revenue, Docket No. 14-ALJ-17-0552-CC (Dec. 11, 2020)

- Home Depot case (2018)
- **Installed Sales Contracts**
- Lowe's purchases all materials at wholesale using resale certificate
- For installation contracts, Lowe's remitted *use tax* on the wholesale price it paid for materials

Lowe's Home Center, LLC v. South Carolina Dep't of Revenue, Docket No. 14-ALJ-17-0552-CC (Dec. 11, 2020)

S.C. Code Ann. § 12-36-90 – Gross Proceeds of Sales

S.C. Code Ann. § 12-36-110 – Sale at Retail

- (1)(a) – building materials to contractors
- (1)(c) – withdrawal for use/consumption by anyone who purchased wholesale
- (1)(e) – sales to contractors for use in construction contracts

Reg. 117-309.17. Withdrawals From Stock, Merchants

Reg. 117-324 – Dual Business

Lowe's Home Center, LLC v. South Carolina Dep't of Revenue, Docket No. 14-ALJ-17-0552-CC (Dec. 11, 2020)

ALC: taxable retail sale occurs when the installation contract customer purchases the materials to be installed. No need for “deemed sale” of materials from Lowe’s to itself.

Tractor Supply Company v. SCDOR, Docket No. 19-ALJ-17-0416-CC



- *Issue:* Does separate entity reporting fairly represent TSC's business activity; if not, is combined unitary reporting a reasonable and equitable alternative apportionment method?
- *ALC:* Amended Final Order, Dec. 4, 2023

Combined Reporting - Refresher

- Allocation and apportionment seeks to impose income tax on a base that “reasonably represents the proportion of the [taxpayer’s] trade or business carried on within this State.” *See* Section 12-6-2210(B).
- If the standard apportionment formula does not fairly represent the taxpayer’s business activity in SC, Department can require other methods “to effectuate an equitable allocation and apportionment of the taxpayer’s income.” *See* Section 12-6-2320.
- *Media General* (2010) – DOR may use combined entity apportionment
- *Carmax Auto Superstores* (2014) and *Rent-A-Center West* (2016) – DOR has burden to prove that standard method does not fairly represent TP’s business activity in SC, and that alternative method was reasonable

Combined Reporting - Refresher

- S.C.
-
-

Under combined unitary reporting, taxpayers apportion their income to a state based on a unitary business with multiple entities rather than on a separate entity basis. In very general terms, a unitary business group is one in which the members of the group all contribute to income through functional integration, centralization of management, and economies of scale. *Container Corp. of America v. Franchise Tax Bd. of California*, 463 U.S. 159, 181 (1983). These contributions are evidenced by a flow of value (not necessarily a flow of goods) between the components of the business operation. *Id.* at 178.

Combined unitary reporting essentially treats the income of a parent corporation and the other members of the unitary business group as one entity for state apportionment purposes. The unitary business group's nationwide ("water's edge") or worldwide¹¹ income is combined and the state taxes a share of that combined income. The share is calculated by a formula that takes into account the combined unitary members' level of activity in the state as compared to the members' level of activity in all states.



STATE OF SOUTH CAROLINA
DEPARTMENT OF REVENUE
300A Outlet Pointe Blvd., Columbia, South Carolina 29210
P.O. Box 12265, Columbia, South Carolina 29211

SC REVENUE RULING #15-5

SUBJECT: Use of Alternative Apportionment Methods - Including Combined Unitary Reporting (Income Tax)

EFFECTIVE DATE: Applies to all periods open under the statute.

SUPERSEDES: All previous advisory opinions and any oral directives in conflict herewith.

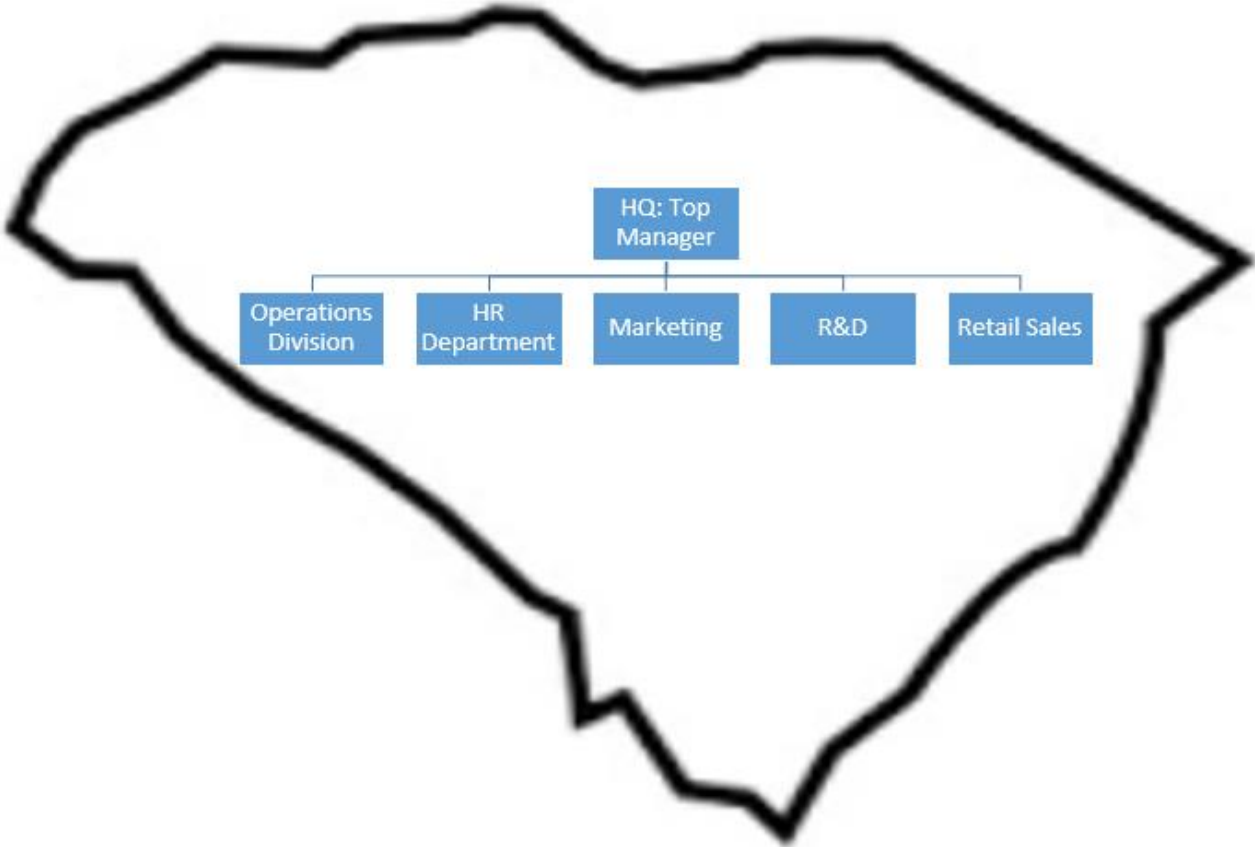
REFERENCES: S. C. Code Ann. Section 12-6-2220(4) (2014)
Section 12-6-2252(A) (2014)
Section 12-6-2280 (2014)
Section 12-6-2290 (2014)
Section 12-6-2295 (2014)
Section 12-6-2310 (2014)
Section 12-6-2320 (2014)
Section 12-54-85 (2014)
Section 12-54-155 (2014)

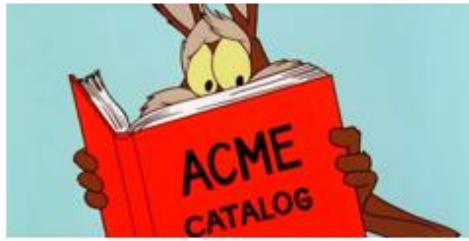
Section 12-4-320 (2014)
Section 1-23-10(4) (2005)
Revenue Ruling #09-3

Revenue Ruling is to provide guidance to the public. This opinion issued to apply principles of tax law to a set category of taxpayers. It is the Department's opinion unless superseded or modified by a change in statute, decision, or another Departmental advisory opinion.

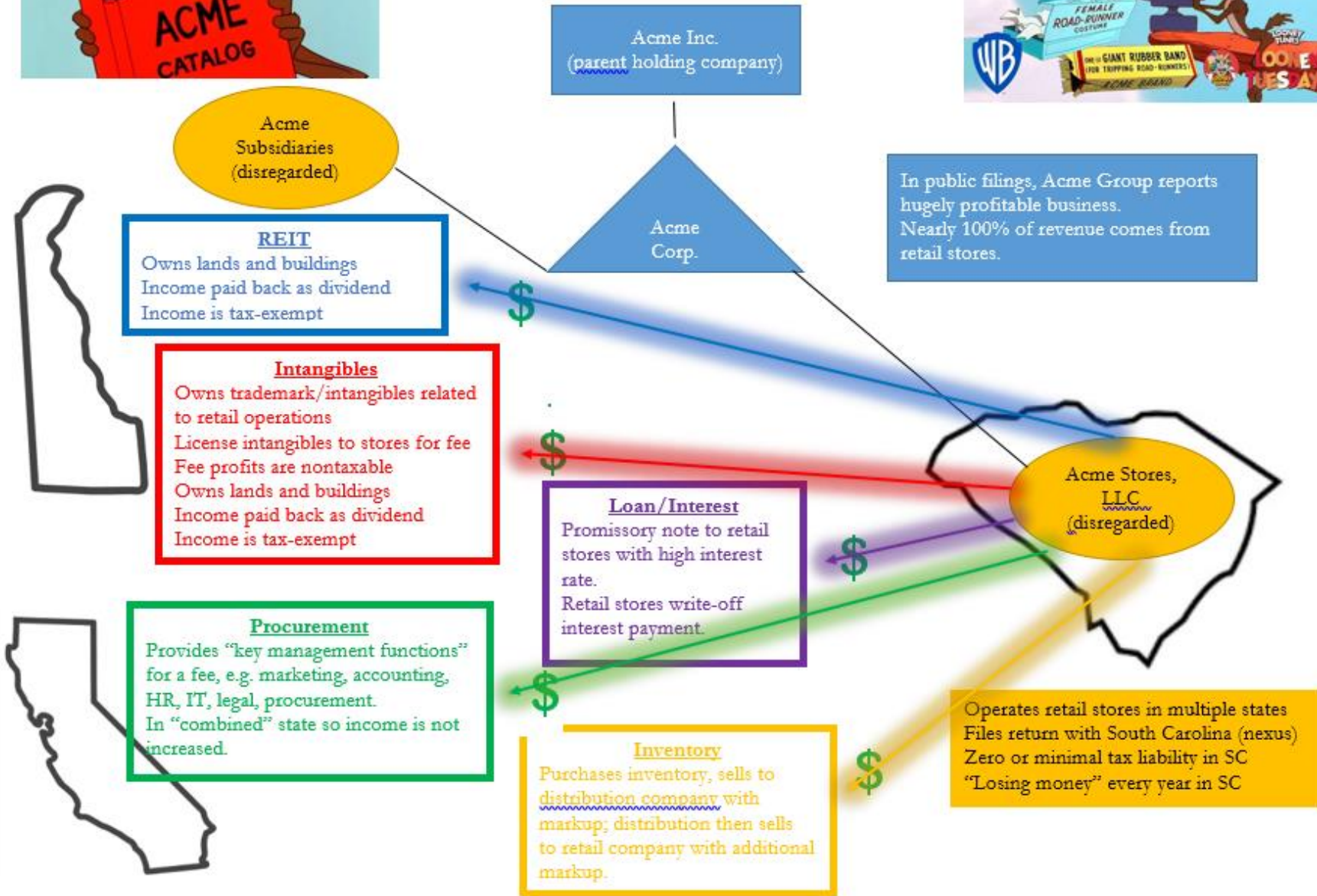
Some states are required to determine the amount of income is generally done through allocation and income is allocated to a specific state for taxation. In other states, the remaining income is apportioned to the business on a formula basis. Apportionment formulas vary. For example, some states adopt a three factor formula that double weights the sales factor. Some states adopt a three factor formula that double

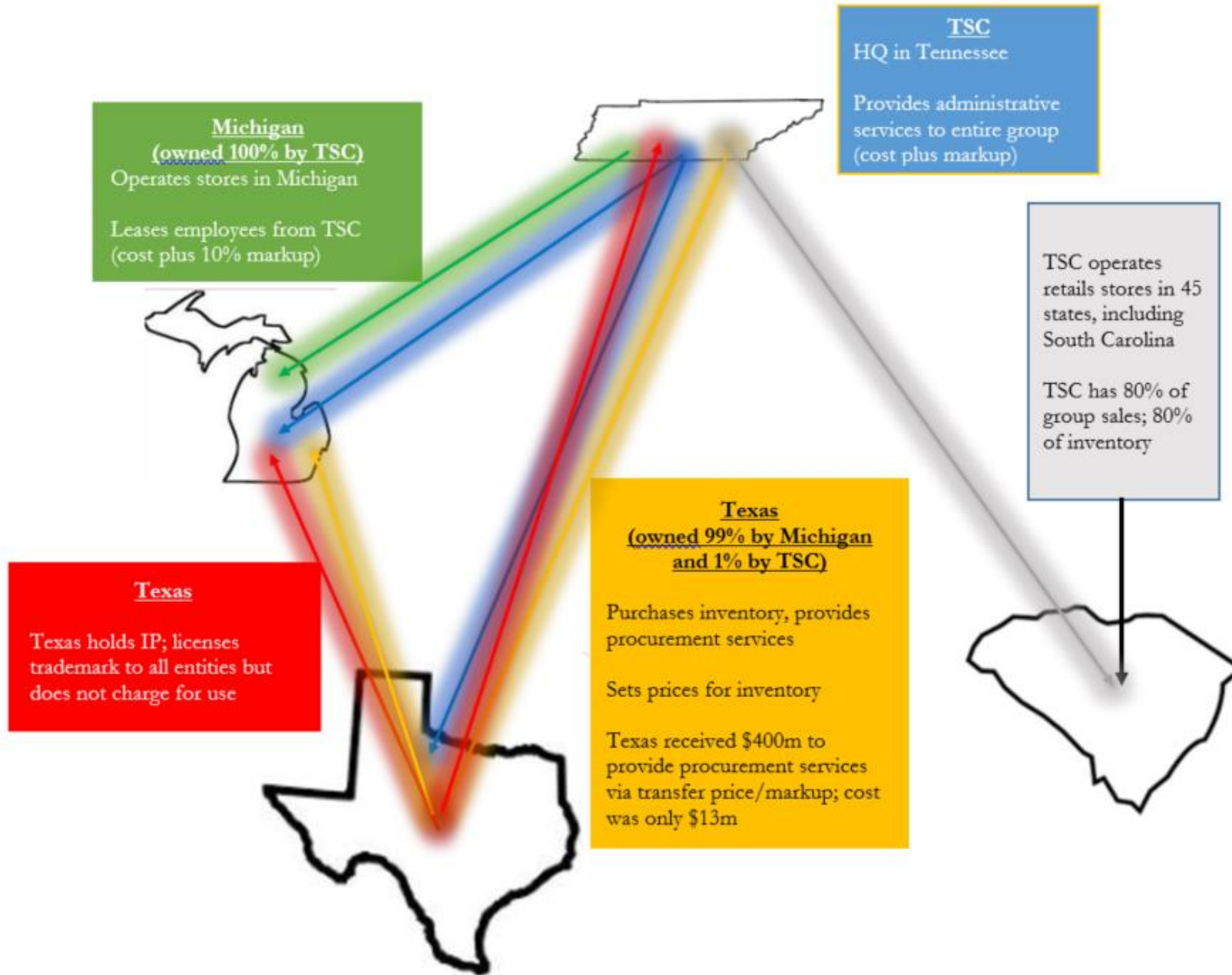
CLASSIC CORPORATE ORGANIZATIONAL STRUCTURE





ACME INC. AND SUBSIDIARIES (ACME GROUP)





Tractor Supply Company v. SCDOR, Docket No. 19-ALJ-17-0416-CC

- 2014 PwC 482 Transfer Pricing Study – 9.7% markup
 - Experts agreed PwC’s study was flawed
- ALC: 9.7% markup did not meet arm’s length standard
 - Disproportionality -- \$400m income v. \$13m costs
 - TSC had 80% of group’s sales and 80% of group’s inventory. After transfer pricing, Texas had 71% of group’s taxable income.

Tractor Supply Company v. SCDOR, Docket No. 19-ALJ-17-0416-CC

ALC Conclusions:

- CUR is a valid apportionment method under section 12-6-2320(A)(4)
- TSC is part of unitary business (functional integration, centralized management, economies of scale, flow of value, interdependence)
- TSC's business activity in SC is retail sales; not fairly represented under separate reporting b/c it allows business structure to dilute TSC's income and activities in SC by shifting profits under Procurement Agreement
- DOR not required to make 482 adjustment; CUR is reasonable

Combined Reporting – upcoming cases

- *AutoZone Investment Corporation v. SCDOR* (trial conducted in Oct. 2022; awaiting final order)
- *CarMax Auto Super Stores, Inc. v. SCDOR* (trial conducted in May 2023; awaiting final order)
- *Proctor & Gamble Mfg. Co. v. SCDOR* (trial scheduled for Mar. 2024)
- *Home Depot USA v. SCDOR* (trial scheduled for April 2024)
- *Wal-Mart Stores v. SCDOR* (trial scheduled for Aug. 2024)
- *Best Buy Stores LLP v. SCDOR* (discovery phase)
- *Dollar Tree Stores, Inc. v. SCDOR* (discovery phase)

Supreme Court

McEntire Produce, Inc. v. Dept. of Revenue, 17-ALJ-17-0060-CC



- *Issue:* Are items used in vegetable processing business exempt from sales tax under the Machine Exemption or the Pollution Control Exemption?
- *ALC:* Yes.
- *Court of Appeals:* No

McEntire Produce, Inc. v. Dept. of Revenue, 17-ALJ-17-0060-CC

- Machine Exemption and Pollution Control Exemption (Section 12-36-2120)
- Regulations require machine to be “integral and necessary” to manufacturing process
- Prevent/abate pollution of air, water, or noise (contaminating food products?)
- N.B. Regs specify that protective clothing, conveyances, chemicals, maintenance, storage, administrative items are not exempt

McEntire Produce, Inc. v. Dept. of Revenue, 17-ALJ-17-0060-CC

- ALC found majority of items at issue, including protective clothing, were exempt from sales and use tax
- Court of Appeals reversed
 - All items were subject to tax
 - SCDOR's interpretation was supported by statute and regulation
 - ALC broadened the exemptions beyond statute's plain meaning

McEntire Produce, Inc. v. Dept. of Revenue, 17-ALJ-17-0060-CC

- Petition for Writ of Certiorari:
 - Does unique nature of TP's food processing facility create a novel question of law?
 - Did CoA substitute its own view of the facts for that of ALC?
 - Did CoA interpretation of Machine Exemption create extra-statutory requirement that the machine be used continuously, year-round and without break in order to qualify for exemption?

Orthofix, Inc. v. Dept. of Revenue, Case No. 2021-CP-32-02752
KCI USA, Inc. v. Dept. of Revenue, Case No. 2021-CP-32-02753



- *Issue:* Does the sales tax exemption for durable medical equipment contain an unconstitutional “principal place of business” requirement?
- *Circuit Court:* Yes

Orthofix, Inc. v. Dept. of Revenue, Case No. 2021-CP-32-02752
KCI USA, Inc. v. Dept. of Revenue, Case No. 2021-CP-32-02753

Section 12-36-2120(74) - sales tax exemption for durable medical equipment and related supplies:

(c) sold by a provider who holds a South Carolina retail sales license and whose principal place of business is located in this State....

Orthofix, Inc. v. Dept. of Revenue, Case No. 2021-CP-32-02752
KCI USA, Inc. v. Dept. of Revenue, Case No. 2021-CP-32-02753

Circuit Court:

- Tax schemes favoring in-State activity over out-of-State activity are unconstitutionally discriminatory; PPOB requirement violates Commerce Clause
- The exemption provided by South Carolina Code § 12-36-2120(74) is severable and should continue in force and effect without the unconstitutional limitation

Note: Rule 203(d)(1)(A)(ii), SCACR – Supreme Court hears appeals of challenges to constitutionality of a state law

Columbia Fine Wine, Inc. et al. v. SCDOR; WSWA of SC,
Civil Action No. 2022-CP-40-04397

- Declaratory Judgment Action
 - Regulations exceed SCDOR power
 - Statutes and regulations are unconstitutional
 - Police powers v. economic protectionism
- General issues:
 - Ownership or financial interest in more than one tier
 - Retailer liquor dealer can only purchase from SC wholesaler
 - Liquors for exclusive use of specific retailer
 - Delivery – retailer or platform; no diverting in route or direct shipment
- Joint Petition for Original Jurisdiction – filed Nov. 17, 2023



Pending Appellate Cases (tax matters)

Court of Appeals

- *Amazon Services v. SCDOR* (2019-1706) – Decision Pending
- *Synovus Bank v. SCDOR* (2020-0999) – Oral Argument Feb 13, 2024
- *Colonial Pipeline Co. v. SCDOR* (2021-0219) – On Roster (Mar 2024)
- *Duke Energy Carolinas v. SCDOR* (2020-1542) – On Roster (Mar 2024)

Supreme Court

- *McEntire Produce, Inc. v. SCDOR* (2019-1933) – Ready for Consideration (Petition for Writ of Certiorari)
- *KCI USA, Inc. v. SCDOR* (2023-318); *Orthofix v. SCDOR* (2023-317) – Ready for Consideration

Administrative Law Court

Mastercard International, Inc. v. SCDOR, Docket No. 20-ALJ-17-0008-CC



- *Issue:* Does Mastercard have income-producing activities (IPA) in South Carolina subject to income tax in the State?
- *ALC:* (trial March 8-11, 2022)

Sourcing - Refresher

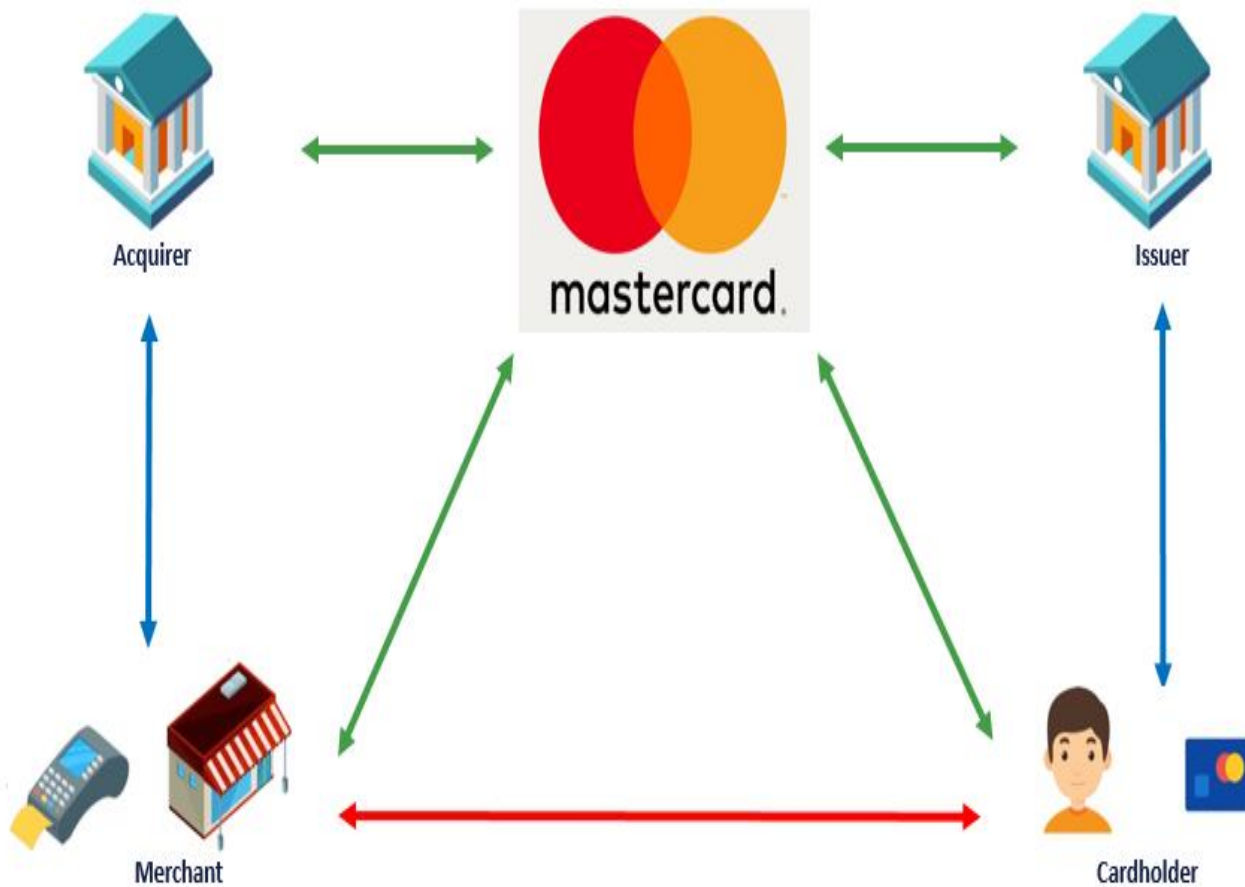
- Section 12-6-2210(B): if taxpayer is transacting business partly within and without the State, SC “income tax is imposed upon a base which *reasonably represents* the proportion of the trade or business carried on within this State.”
- Section 12-6-2290: apportion income using this fraction for each taxable year:

Gross receipts from within SC ÷ Total gross receipts from everywhere

Sourcing - Refresher

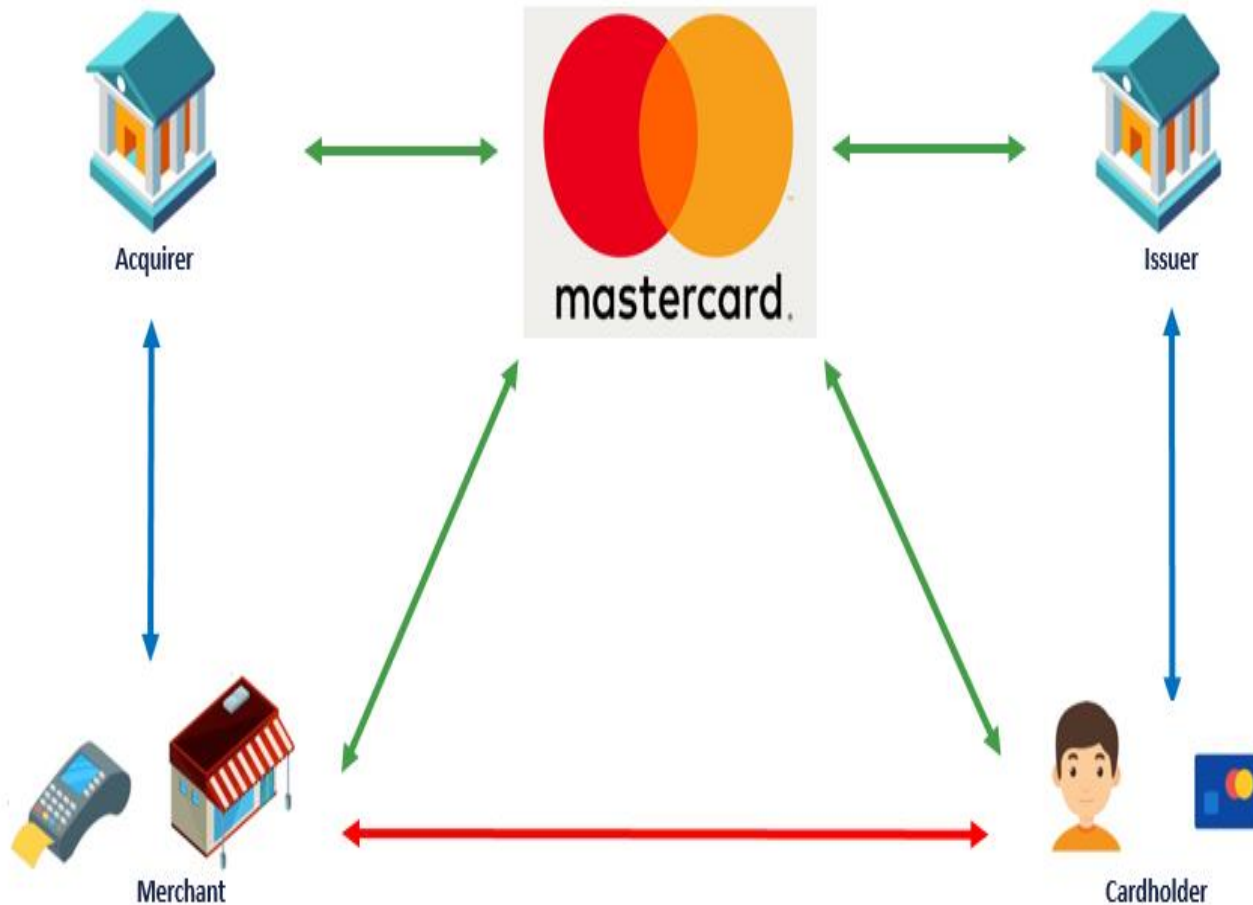
- Gross receipts for **service providers** – Section 12-6-2295(A)(5):
 - “If the income-producing activity is performed partly within and partly without this State, sales are attributable to this State to the extent the income-producing activity is performed within this State.”
- What is the income producing activity?

Mastercard International, Inc. v. SCDOR



- SCDOR: IPA is the provision of a credit card network that enables cardholders to purchase goods and services from merchants in South Carolina.
 - contracts with merchants and banks; advertises; maintains, operates, and regulates network
 - generates fees (from Acquirers and Issuers) when card is used in SC, based on quantity and \$ volume of transactions

Mastercard International, Inc. v. SCDOR



- Mastercard: business is to connect Issuers and Acquirers; customers are banks, not merchants or cardholders
- IPA cannot be based on purchases
- IPA must be Authorization and Clearing, which occurs only at central data centers (Missouri) or MIPs machines
- Neither the data centers nor MIPs machines are in SC

US Bank v. SCDOR, 20-ALJ-17-0008-CC



- US Bank's Income generated from:
 - Interest from residential mortgages and commercial/consumer loans
 - Credit card interest & fees + Fees from processing credit/debit transactions
 - Sale from stock
- 1. Longstanding DOR practice – income from loans sourced to location of borrower (reasonable proxy for location of debt, which is an intangible); IPA is loaning money to borrower, which occurs where borrower receives the loan
- 2. Purchase of good or service, which generates swipe fees, occurs when customer in SC accesses the network; Sourced to SC for SC transactions (same as MasterCard)
- 3. Gains from sale of stock are part of banking business, should be apportionable to SC

Advisory Opinions

Advisory Opinions

Formal Advice

- 4 Revenue Rulings
- 1 Revenue Procedure
- 18 Information Letters
- 6 Tax Policy Manuals
- 6 National Tax Surveys

Informal Advice

- 49 requests for guidance involving 89 distinct issues from the public
- 28 requests for guidance involving 53 distinct issues from within the Department

Tax Exemptions and Credits



"The most terrifying words in the English language are:

I'm from the government and I'm here to help."

Ronald Reagan



S.C.A.T.E. Cards



- Most of the supplies and equipment used by Farmers in commercial farming operations are exempt from sales tax.
- Previously a farmer was required to complete a form for every purchase that was maintained by the seller as proof of the exemption.
- DOR and Department of Agriculture cooperated in development of the SCATE card in place of using a form for each purchase.
- Because some items are still subject to sales tax and because the retailers still have record keeping requirements, DOR and AG developed guidelines that were published in Revenue Ruling 23-4

Income Tax Credits



- **Veterans Credit** is for hiring Veterans of the Armed Forces who have participated in a registered apprenticeship program (S.C. Code Ann. § 12-6-3720)
 - credit against an employer's income tax if employer hires a veteran who works at least 1 year and who completes an apprenticeship program validated by the US Department of Labor.
 - Veteran is someone who served in combat and, within 3 years of starting the apprenticeship, was honorably discharged

Income Tax Credits

- **Formerly Incarcerated Individual Credit** is for hiring ex-convicts who have participated in a registered apprenticeship program (S.C. Code Ann. § 12-6-3710)
 - credit against an employer's income tax if employer hires a formerly incarcerated individual who works at least 1 year and who completes an apprenticeship program validated by the US Department of Labor.
 - Formerly Incarcerated Individual is someone who served a sentence in a state prison or county jail for a non-violent crime, a crime in which the sentence was less than 10 years, or a crime for which the person has been pardoned. The person must have been released within 3 years of starting the apprenticeship

Income Tax Credits

- Revenue Ruling 23-1 (Veterans Credit) addresses topics like: can the apprentice participate remotely, can an employer hire 2 part-time veterans instead of 1 full-time veteran, and how does an employer screen the potential employee to ensure eligibility for the credit.
- Revenue Ruling 23-2 (Formerly Incarcerated Credit) address topics like: what is a violent crime, how does this credit interact with other available credits, and can an employer carry the credit forward to other tax years.

2024 Expectations

- Taxation of Partnerships including accounting for sale of a partnership interest
- Sourcing income for multistate taxpayers
- Comprehensive Guidance on the Max Tax/Infrastructure Maintenance Fee
- Variety of incentive credits, e.g. solar energy, abandoned buildings, etc.
- Sales tax on digital products
- Rolling a 529 education account into a Roth IRA



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South Carolina Bar

Continuing Legal Education Division

2024 SC BAR CONVENTION

Tax Law Section

Taxing Unrealized Income Under the 16th
Amendment

Clinton G. Wallace

The *Moore* Case and the Future of the Income Tax

SC Bar Convention
January 20, 2024

Clint Wallace



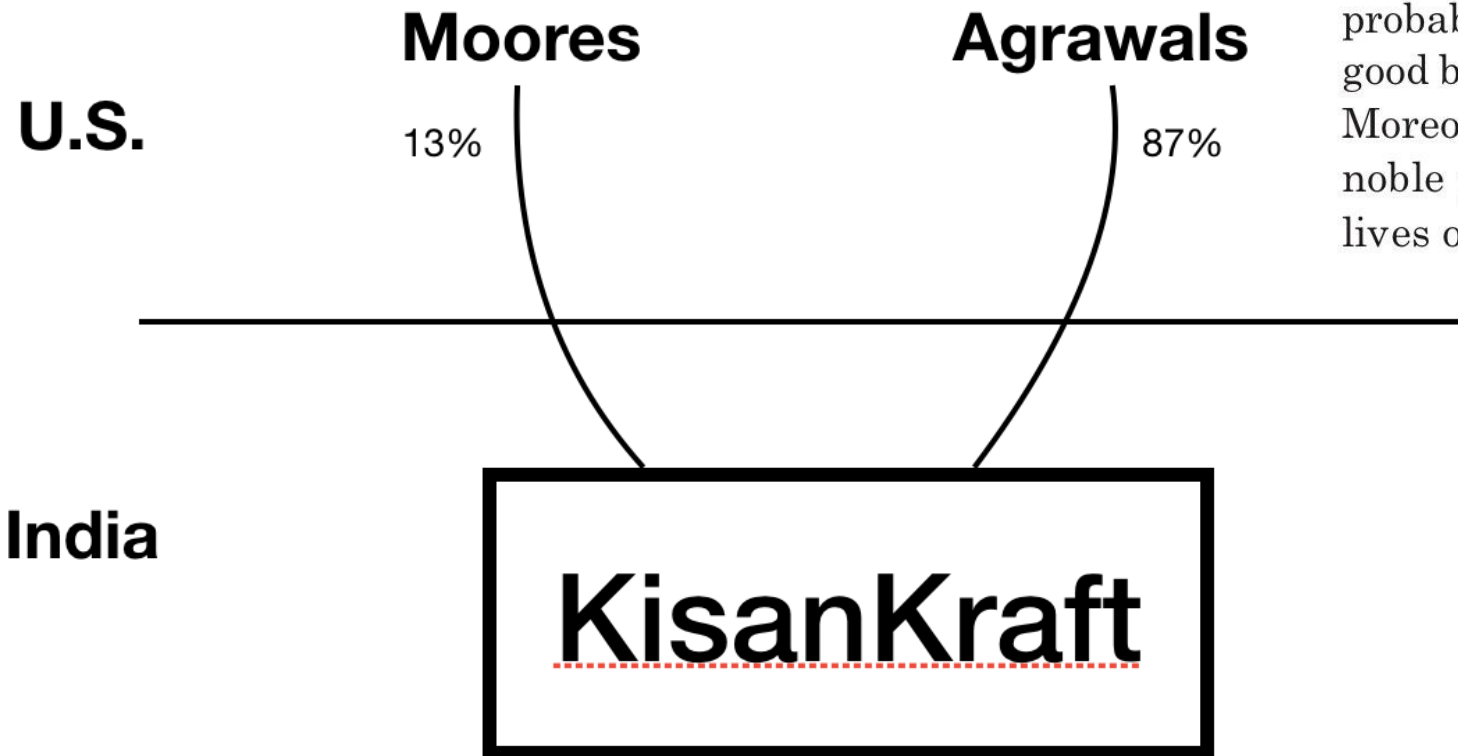
Charles Moore's Story

5. After one of Ravi's regular trips to India in the early 2000s, Ravi told me that he noticed that many small and marginal farmers in India used very simple and basic hand tools, ones that were far less efficient and effective than the tools available at Home Depot in the United States. In addition, Ravi noticed that people from the rural parts of India were increasingly leaving those areas and moving to cities, meaning there were fewer and fewer people available to perform farming and agricultural work, which drove up wages and farmers' operating costs.

6. Ravi shared with me his idea of starting a business to provide small and marginal farmers with more efficient and cost-effective tools and machines that would increase their productivity, help them better perform their jobs, and reduce their operating costs. Ravi's business plan was motivated by his



Moore's Story



When Ravi first approached me, I gave his business plan and investment proposal significant thought. We discussed the short-term, mid-term, and long-term goals of KisanKraft and agreed that **the best way for the business to succeed in its social and business missions would be for it to reinvest any earnings**, expand geographically, and, perhaps one day, experience a public offering or sale. I thought the probability of that happening was low, but Ravi had a good business plan and was someone whom I trusted. Moreover, I thought KisanKraft was formed for a noble purpose and had the potential to improve the lives of small and marginal farmers in India.

Background: 2017 “Tax Cuts and Jobs Act”

- Reduced corporate tax rate from 35% to 21%.
- Changed the US-International business tax rules from a “nominal” worldwide system to a “nominal” territorial system.
- Other tax cuts as well.
- Corporate tax cuts had a budget cost of \$1.3 trillion, plus other tax cuts added up to over \$2 trillion total.
- Using special budget rules, Trump White House + Republican majorities in House and Senate agreed: tax cuts could create \$1.5 trillion max additional debt
- Needed revenue to make up for these corporate (and other) tax cuts.



Background: the Transition Tax

§ 965 – Treatment of deferred foreign income upon transition to participation exemption system of taxation

\$\$

Provision	Effective	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
III. International Tax Reform													
A. Establishment of Participation Exemption System for Taxation of Foreign Income													
1. Deduction for dividends received by domestic corporations from certain foreign corporations.....	[22]	-17.8	-28.1	-20.1	-20.3	-20.8	-21.0	-22.1	-23.2	-24.3	-25.8	-107.2	-223.6
2. Special rules relating to sales or transfers involving certain foreign corporations.....	da 12/31/17 & Ta 12/31/17	0.1	0.2	0.5	0.8	1.2	1.4	1.7	1.6	1.8	2.4	2.9	11.8
3. Treatment of deferred foreign income upon transition to participation exemption system of taxation and mandatory inclusion at two-tier rate (8-percent rate for illiquid assets, 15.5-percent rate for liquid assets).....	[23]	78.6	49.6	16.5	15.6	15.7	27.2	47.5	64.4	33.0	-9.4	176.0	338.8

Source: JCX-67-17 (Dec. 18, 2017)

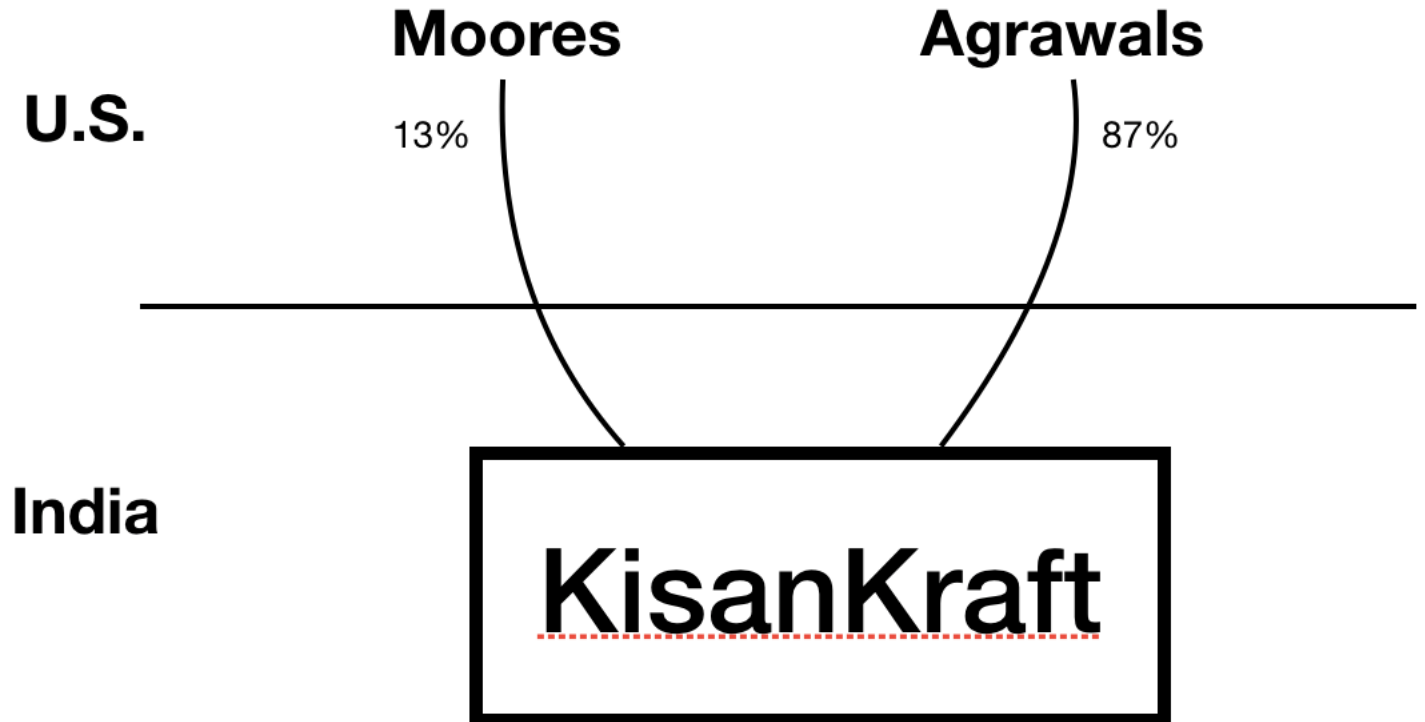
Background: Subpart F - §§ 951-965

Controlled Foreign Corporation (CFC)

- U.S. shareholders own >50% of stock, by vote or value
- U.S. shareholder is a U.S. person that owns 10% or more of stock

Historical precedents:

- Accumulated Earnings Tax - § 531
- Personal Holding Company Surplus - § 541
- Foreign Personal Holding Company regime
- PFIC regime (discuss later)



Details of the Transition Tax

- Previously untaxed (active) income of a CFC
- Rate of 15.5% (cash and cash equivalents) or 8% (other assets)
- Calculated as of November or December 2017 (two dates)
- Payable over time



Microsoft®



Background: Lower Courts

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

For the foregoing reasons, the
motion to dismiss (Dkt. No. 29) is DENIED, and the
motion (Dkt. No. 34) is
DISMISSED with prejudice.

DATED this 19th day of _____,

/s/ John C. Gould

John C. Gould
UNITED STATES DISTRICT COURT

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

Judge Bumatay, joined by Judges Ikuta, Callahan, and VanDyke, dissented from the denial of rehearing en banc. Judge Bumatay stated that the panel erred in disregarding the realization requirement of the Sixteenth Amendment, by allowing an unapportioned direct tax on unrealized income—undistributed earnings of a foreign corporation owned by a U.S. taxpayer—without offering any other limiting principle; and that the opinion opens the door to new federal taxes on other types of wealth and property being categorized as an “income tax” without the constitutional requirement of apportionment.

Before: Ronald M. Gould, Jacqueline H. Nguyen,
and Mark J. Bennett, Circuit Judges.

Opinion by Judge Gould

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miss
mary

Request for Certiorari

- Taxation without realization violates the 16th Amendment
- MRT is a “direct” tax that requires “apportionment”
- Direct / indirect tax distinction were intended to protect liberty interests against federal government
- 16th Amendment is a limited exception to direct / indirect framework

No. _____

IN THE
Supreme Court of the United States

CHARLES G. MOORE and KATHLEEN F. MOORE,
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

**On Petition for a Writ of Certiorari to the
United States Court of Appeals
for the Ninth Circuit**

PETITION FOR WRIT OF CERTIORARI

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Constitutional Background

Article I, § 2

Clause 3 Seats

Representatives and direct Taxes shall be apportioned among the several States which may be included within this Union, according to their respective Numbers, which shall be determined by adding to the whole Number of free Persons, including those bound to Service for a Term of Years, and excluding Indians not taxed, three fifths of all other Persons.

Article I, § 8

Clause 1 General Welfare

The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States;

Article I, § 9

Clause 4 Direct Taxes

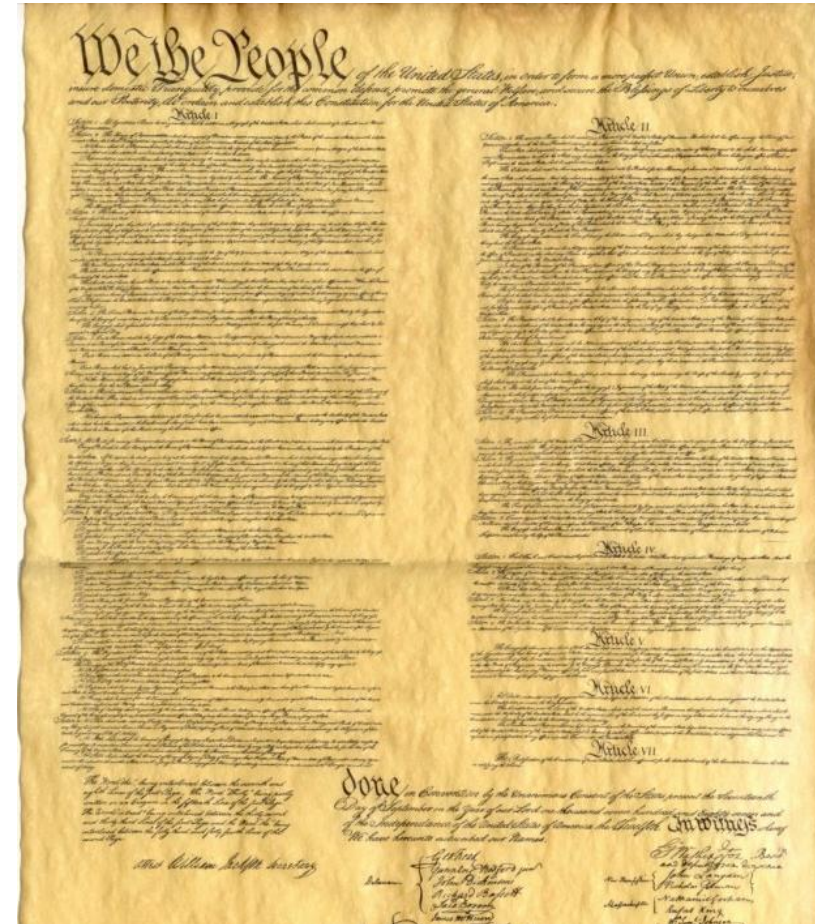
No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or enumeration herein before directed to be taken.

Sixteenth Amendment

The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.

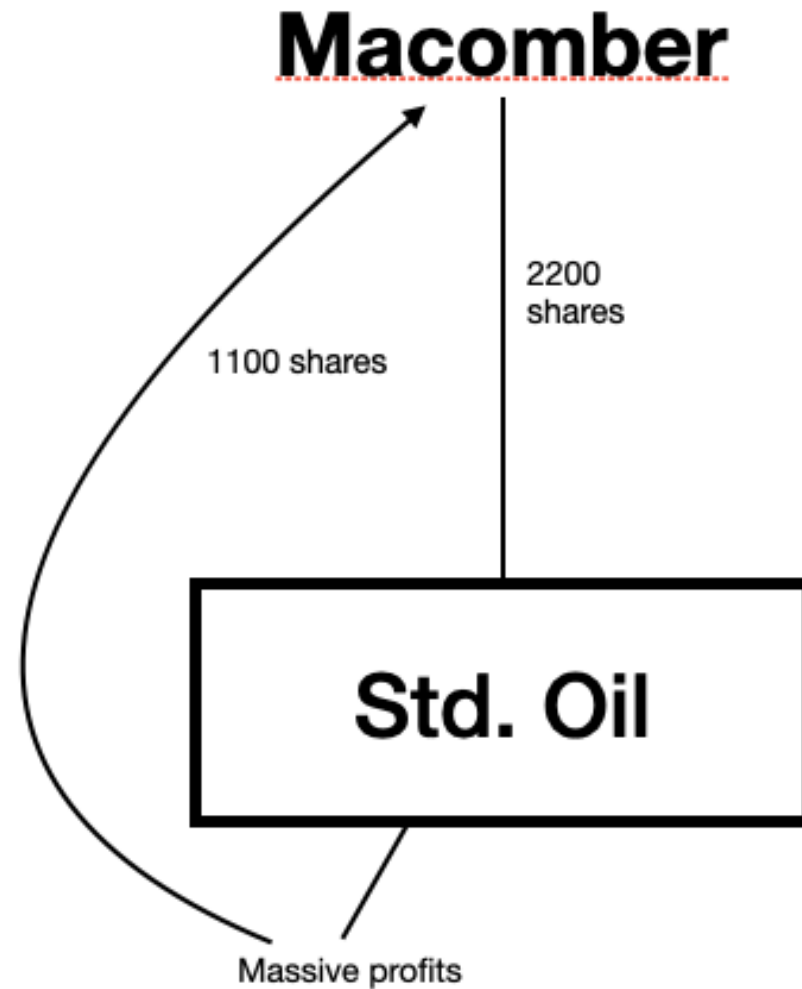
Petitioner's Argument

- “The Constitution’s Framers were wary of direct taxation because they knew it could be used to work “partiality or oppression” against disfavored persons and places. The Federalist No. 36 (Hamilton).”
- “Their solution was to align this dangerous mode of taxation with representation, ensuring that its burdens would be shared broadly, not imposed according to political power or caprice. The Sixteenth Amendment’s framers retained that vital protection, being no less wary than their predecessors of federal taxation of property.”



Petitioner's Argument

- Macomber & stock dividends
- Petitioner, quoting Macomber opinion: income is “a ‘gain,’ ‘profit,’ or other thing of value must be ‘received or drawn by the recipient (the taxpayer) for his separate use, benefit and disposal.’ 252 U.S. at 207 (emphases in original). Only ‘that is income derived from property. Nothing else answers the description.’ Id. (emphasis in original).”



Petitioner's Argument cont'd

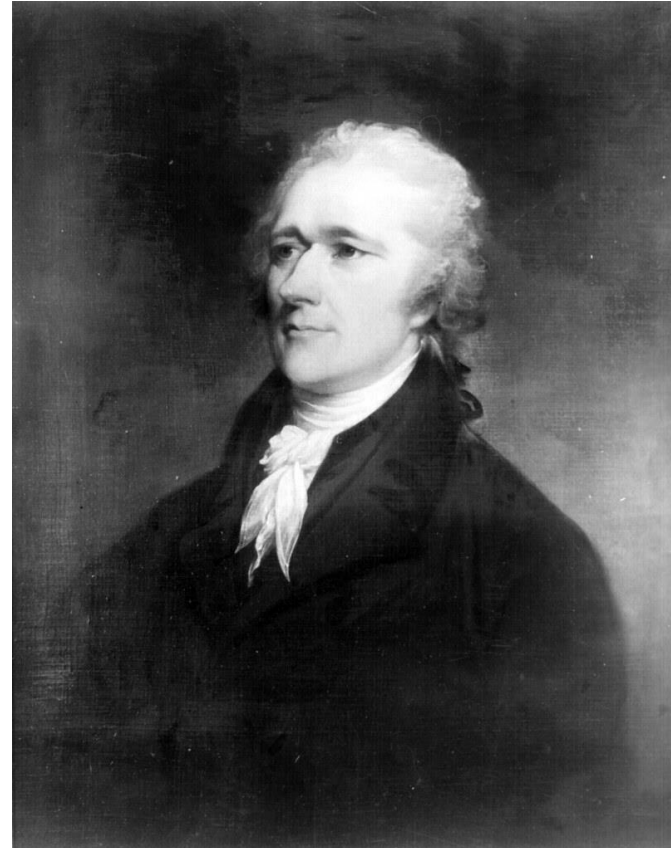
- “The Court has never retreated from Macomber’s core holding on realization; to the contrary, its precedent from that era to the modern day consistently observes the necessity of realization to income. Congress, too, has accepted that understanding, structuring federal income taxes to turn on taxpayer realization.”
- “The year after the decision Congress exempted all stock dividends from taxation, and ultimately limited taxation of stock dividends to that permitted under Macomber. 26 U.S.C. § 305.”

Government's Argument

- No realization requirement
- Excise tax alternative

Government's Argument cont'd

- History and tradition
 - Hylton
 - Civil War era taxes



Oral Arguments

- Battle of the dictionaries:
Sotomayor
- Compromise concepts:
Gorsuch
- Political constraints:
Kavanaugh
- Wealth taxes?: Alito, Gorsuch
- Cottage Savings skepticism:
Roberts

Implications of Realization

- Non-realization rules all over the Tax Code!
- Examples?
 - Example: Partnership taxation
 - Example: Mark to market
 - Example: OID
 - Example: Branch Profits Tax
 - Example: Expatriation Tax
 - Example: Grantor Trusts

Partnership Taxation

- Subchapter K, §§ 701-761
- If two individuals form a partnership and the partnership earns \$100 of income....
- *Heiner v. Mellon*, 304 U.S. 271 (1938)
- *Basye v. United States*, 410 U.S. 441 (1973)
- “Few principles of partnership taxation are more firmly established than that no matter the reason for nondistribution each partner must pay taxes on his distributive share.” Basye at 454.

Mark-to-Market

- § 1256 (straddles)
 - § 475 (dealers and traders in securities)
 - § 817A (assets held by life insurance companies);
 - § 1259 (other)
- Straddles example: if a taxpayer simultaneously enters into contract to (a) buy and (b) sell wheat in the future for \$100 when the current price is \$50, it will have a gain and a precisely offsetting loss on each of the two contracts depending on whether the future price exceeds \$100.

Original Issue Discount

- § 1272
- Example: A company that issues a bond that will pay out \$1,400 in 3 years, and that has an issue price of \$1,000.

Other Issues

- § 884 – Branch Profits Tax
- § 877A – Expatriation Exit Tax
- § 671 – Grantor trust rules
- Bottom Line: The absence – or even uncertainty around – each of these rules would effectively permit significant amounts of income to go untaxed.

Reading the Tea Leaves

- TBD

Clint Wallace

Thank You!



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Tax Law Section

Tax and Business Exit Planning for the
Generational Family Business

Phillip J. Martin
V. Verne McGough, Jr.
Robert T. Victor
R. Andrew Rogers

Tax and Business Exit Planning for the Generational Family Business
January 20, 2024

I. Hypothetical Sale / Transaction

- A. Typical transaction timeline
- B. Example transaction

II. Pre-Sale (1-2 Years Prior to Transaction)

A. Tax and Accounting

1. Before a decision has been made to sell the business. Proactively navigating through business life cycle with a team of advisors:
 - a. Quarterly business updates and tax planning meetings provide an opportunity to help drive longer-term planning.
 - b. Succession planning is an over-used term that pretty much every business advisor claims to be an “expert” in. However, it’s not always the top priority. When should it be? When should it start? All of that depends upon where a business is, where they are trying to get, and when do they desire to get there.
 - c. One of the most essential elements of a high-value advisory relationship is understanding where a business is in the business life cycle and where the owners are trying to go with it. This approach helps plan a roadmap for the future and outline what needs to be established. It also helps define priorities and encourages the owners to commit time and resources to take them to where they want to be.
2. Upon conclusion that a transaction will be the succession plan.
 - a. Ideally this decision is made is at least 18-24 months prior to a transaction.
 - b. The first step will be to have a roundtable meeting with a team of trusted advisors, including an attorney, a financial advisor, a CPA, and maybe others.
3. Process to determine goals, options and timeline.
 - a. Business valuation and value enhancement consulting.
 - b. Evaluate organizational structure and estate planning opportunities.
 - c. Value Enhancement:
 - i. Finance scorecard, assessment, roadmap
 - ii. Sell-side diligence / quality of earnings
 - d. Assessment of buyer-type alignment
 - e. Go-to market
4. Business valuation and value enhancement consulting.
 - a. Determine range of current value
 - b. Identification of value enhancement opportunities.
 - c. Assessment of management team impact on value
 - d. Benchmark metrics assessment
 - e. Action plan

5. Evaluate Organizational Structure and Estate Planning Opportunities.
 - a. Assess how company is currently capitalized and any potential benefits of recapitalization.
 - b. Along with roundtable of advisors, evaluate potential estate planning strategies that could be implemented pre-transaction.
 - c. Identify after-tax proceeds needed by current owners and feasibility prior to any substantial transfers.
6. Finance Scorecard, Assessment, Roadmap.
 - a. Assess current finance/accounting team, policies, procedures, and financial reporting.
 - b. Provide a scorecard on above items highlighting areas that need improvement.
 - c. Provide a Roadmap to assist management in addressing critical areas in an effort to improve operations and enhance enterprise value.
7. Sell-Side Diligence / Quality of Earnings.
 - a. Identify potential add-backs and subtractions to EBITDA.
 - i. Make appropriate adjustments.
 - ii. Clean up ongoing business practices to eliminate need for adjustments.
 - b. Identify any potential unrecorded tax liabilities so they can be cleaned up prior to a transaction.
 - i. Sales tax and other state/local tax liabilities are common in many businesses and can negatively impact deals.
 - ii. State income tax nexus
 - c. Other tax diligence
 - i. State income tax nexus
 - ii. Payroll compliance
 - iii. COVID related programs (ERC claims, excessive PPP loans, etc.)
 - iv. Related party transactions
8. Assessment of Buyer-type Options and Alignment.
 - a. Strategic Buyers
 - i. Known / Unknown
 - b. Financial Buyers
 - c. Management Team Buyers
9. Go-To-Market Process.

B. Planning

1. Identify Key Employees.
 - a. Consider putting a deferred compensation plan in place for key employees and leadership
 - b. Ensure key people are insured against loss
2. Do you know your wealth gap?
 - a. Identify the Ring Fence number needed to live off of post-sale
 - b. Calculate true monthly spending number by analyzing personal spending along with what is run through the business.

3. Evaluate One-Off Expenses to Plan for Post-Sale:
 - a. Second home
 - b. Vehicles
 - c. Education
 - d. Renovations
 - e. Consider your personal desire for charitable & family gifting

C. Legal

1. Review Shareholder's Agreement.
 - a. Buy-Sell Language or Cross Purchase Agreement?
 - b. Review funding options if there is an unexpected buy-out pre-transaction.
 - c. Are any amendments required?
2. Ownership of Shares.
 - a. Revocable Trust for Probate Avoidance/Future-Generation Asset Protection
 - b. Consider estate tax mitigation options requiring transfer of ownership pre-transaction
 - i. Appraisal discounts (lack of marketability/lack of control)
 - ii. Recapitalization plan (if transferring assets for estate planning/tax mitigation/estate exemption preservation)
 - iii. Spousal lifetime access trusts
 - iv. Dynasty trusts
 - v. Intentionally defective grantor trusts
 - vi. Family limited partnerships (strategic gifting)
 - c. Consider transactions with income tax benefits
 - i. Charitable trusts
 - ii. Donor advised fund

III. Immediate Pre-Sale

A. Tax and Accounting

1. Evaluation of Tax Structuring
 - a. Asset vs. stock sale
 - b. Installment sales
 - c. Earn-outs and terms
2. Review income tax mitigation opportunities for year of transaction

B. Planning

1. Identify appreciated stock to gift in the year of transaction
2. Develop an investment strategy for sale proceeds & ten year runway for post-sale withdrawals
3. How much to allocate to:
 - a. Alternative investments
 - b. Income producing investments
 - c. Tax savings
 - d. Charitable contributions (bunch future giving - Donor Advised Fund)
 - e. Education funding - consider super funding 529 Plan for state tax savings (up to \$85,000 for 2023)
4. Finalize monthly expense needs

C. Legal

1. Confirm proper completion of pre-closing transactions
 - a. Recapitalization
 - b. Trust funding
 - c. Estate and income tax motivated transactions

IV. During the Transaction

A. Tax and Accounting

1. Letter of Intent Review and Comments.
 - a. Deal structure
 - i. Stock / asset sale and related implications
 - ii. Structuring equity rollovers tax efficiently
 - iii. Defining any earnout terms
 - iv. Evaluate escrow terms
 - b. Evaluate valuation determination / terms
 - c. Net working capital provision review
 - d. Update tax and cash-flow model to evaluate if deal structure meets seller's needs prior to going to next step
2. Diligence Support.
 - a. Provide support to internal accounting team
 - b. Utilize sell-side diligence knowledge to push back on negative adjustments
 - c. Address questions related to tax and other accounting matters
3. Purchase Agreement Review and Comments.
 - a. Evaluate tax provisions
 - b. Evaluate and provide support on Net Working Capital provisions.
 - c. Evaluate escrow and any earnout provisions
 - i. Assist in modeling earnout provisions as needed
 - d. Operating/Shareholder Agreement review and comments (in event of rollover equity)

B. Planning

1. Due diligence support

C. Legal

1. Letter of Intent
2. Transaction negotiation and document drafting
 - a. Asset Purchase Agreement / Stock Purchase Agreement
 - b. Schedules
3. Due diligence – monitoring, responsiveness, and integration with schedules
4. Post-transaction document drafting
 - a. Employment Agreement(s)
 - b. Lease Agreement(s)
 - c. Earn-Out Agreement
 - d. Rollover equity documents

V. Post-Transaction

A. Tax and Accounting

1. Support final Net Working Capital reconciliation
2. Seller side tax compliance
3. Additional support to be determined
4. Evaluate use of one-time tax strategies in year of sale (Charitable Giving Strategies, Tax Credits, Private Placements, etc.)
5. Annual Income Tax Planning/Deferral or Mitigation opportunities

B. Planning

1. Continue to revise investment and withdrawal strategy annually
 - a. Review monthly expenses regularly to ensure needs are planned for
 - b. Use any additional proceeds or earn-outs to replenish withdrawal strategy as needed
2. Look for appreciated stock annually for charitable giving purposes
3. Analyze tax loss harvesting opportunities annually
4. Build out a replacement of income strategy using alternative investments

C. Legal

1. Develop a comprehensive annual gifting plan
 - a. Intentional dilution of remaining taxable estate
 - b. Tax-efficient charitable giving
 - c. Lifetime bracket-shifting opportunities
2. Explore additional estate planning concepts as needed
3. If there will be a “second or third bite”:
 - a. Review of negotiated agreements and vesting schedules, if applicable
 - b. Develop estate and income tax mitigation plan regarding future sale proceeds

VI. Transaction Comparison