

1980 S.C. Op. Atty. Gen. 129 (S.C.A.G.), 1980 S.C. Op. Atty. Gen. No. 80-81, 1980 WL 81963

Office of the Attorney General

State of South Carolina

Opinion No. 80-81

July 28, 1980

**\*1 SUBJECT: License Fee on Domestic Insurance Companies**

(1) A domestic insurance company which computes its license fee under the maximum limitation of five percent of net income is subject to the allocation and apportionment statutes in Chapter 7 of Title 12, known as the Income Tax Act of 1926.

(2) Tabular interest is a related expense deductible against investment income.

TO: Mr. C. H. Brooks  
Director  
Income Tax Division  
South Carolina Tax Commission

**QUESTIONS:**

1. Under the provisions of § 38-5-410 and § 38-5-420, is the 'net income' limitation on license fees of a domestic insurance company doing business both within and without South Carolina determined by use of the applicable allocation and apportionment provisions of Chapter 7 of Title 12, known as the Income Tax Act of 1926?

2. Is 'tabular interest' allocated as an expense of investment income?

**APPLICABLE LAW:**

§§ 38-5-410, 38-5-420, 38-5-460, Chapter 7 of Title 12, known as the Income Tax Act of 1926, with specific reference to Article 9, Allocation or Apportionment of Income.

**DISCUSSION:**

Question 1. Sections 38-5-410 and 38-5-420 both impose a two percent (2%) graded license fee on domestic insurance companies doing business in South Carolina. Section 38-5-410 pertains to life insurance companies and Section 38-5-420 pertains to other insurance companies. Each section places the following limitation on the license fee:

'The additional and graded license fee imposed in this section shall not exceed five percent of the net income of the company as determined under the provisions of Chapter 7 of Title 12, \* \* \*.'

Section 38-5-460 incorporates by reference the provisions of Chapter 7 of Title 12 for purposes of computing net income. This section provides:

'For the purposes of the computation of net income \* \* \* all the provisions of Chapter 7 of Title 12, insofar as they may be applicable, are hereby adopted and made a part of §§ 38-5-410 to 38-5-450.'

One of the provisions found in Chapter 7 of Title 12 which relates to the computation of net income is that of § 12-7-250 which says:

'If a taxpayer \* \* \* is transacting or conducting his business partly within and partly without this State, the income tax as provided in this chapter shall be imposed upon a base which reasonably represents the portion of the trade or business carried on within this State. \* \* \*.'

In determining the 'base which reasonably represents' South Carolina income, § 12-7-1120 provides specific allocations of income and § 12-7-1190 provides apportionment of the remaining net income computed on the basis of gross receipts from within the State to the total gross receipts.

Thus, since § 12-7-250 requires that a taxpayer transacting business partly within and partly without this State apportion its income and since § 38-5-460 incorporates 'For the purposes of computation \* \* \* all the provisions of Chapter 7 of Title 12, \* \* \*', it is the opinion of this office that the provisions of Chapter 7 of Title 12 dealing with allocation and apportionment of income apply to domestic insurance companies.

**\*2** Question 2. A question is presented as to whether tabular interest is an investment expense specifically allocated to investment income.

Tabular interest is part of the computation made in determining the additions to reserves. Section 38-5-410 provides as follows: '\* \* \* that in addition to the deductions allowed by [Chapter 7 of Title 12] there shall be allowed in computing net income any addition to policy reserves as may be required by the Commissioner, \*\*\*.'

Section 12-7-1120 specifically allocates certain elements of income and related expenses are offset against these elements. Thus, if tabular interest is an expense related to investment income which is specifically allocated under § 12-7-1120, then tabular interest is deducted against investment income.

An insurance company has income from two primary sources: investment income and underwriting income. Investment funds come from premium payments held in reserve and unused funds of operation. The company uses these funds to derive investment income. However, the company must satisfy obligations due upon the death of the policyholders. In order to satisfy these obligations the company in effect 'pays interest' into the reserve account for the reserve funds it 'borrowed' for making investments. In this manner the reserve account consists of the premium reserve and interest added to the premium reserve so that the reserve is sufficient to satisfy obligations due upon the death of the policyholder. The interest element in the reserve account is in effect the cost incurred by the company in deriving investment income. This interest element is in essence the tabular interest.

Thus, it is the opinion of this office that tabular interest is an expense related to investment income and is deducted against investment income.

#### CONCLUSIONS:

1. A domestic insurance company which computes its license fee under the maximum limitation of five percent of net income is subject to the allocation and apportionment statutes in Chapter 7 of Title 12, known as the Income Tax Act of 1926.
2. Tabular interest is a related expense deductible against investment income.

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