

THE STATE OF SOUTH CAROLINA
In The Supreme Court

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APPEAL FROM LEXINGTON COUNTY
Court of Common Pleas

S.C. SUPREME COURT

William P. Keesley, Circuit Court Judge

CASE NO. 2021-CP-32-02752

Orthofix, Inc., Respondent,

v.

South Carolina Department of Revenue, Appellant.

NOTICE OF APPEAL

The South Carolina Department of Revenue appeals the order of the Honorable William P. Keesley, dated and filed February 2, 2023.

{Signature on Following Page}

March 2, 2023



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STATE OF SOUTH CAROLINA
COUNTY OF LEXINGTON

IN THE CIRCUIT COURT
ELEVENTH JUDICIAL CIRCUIT

Orthofix Inc.

Plaintiff,

vs.

South Carolina Department of Revenue,

Defendant.

Case No. 2021-CP-32-02752

ORDER

This matter came before the Court on a hearing addressing cross motions for summary judgment on November 2, 2022. Present before the Court were counsel for Plaintiff, Michael J. Hilkin, Esq. and Rick Reames, III, Esq., and counsel for Defendant, Marcus D. Antley, III, Esq. The record before the Court included Stipulations of Fact as further described herein, along with pre-trial briefs and oral arguments of each party.

Having heard the arguments of counsel and weighing all of the evidence in the record, the Court concludes that Plaintiff is entitled to declaratory relief against Defendant.

STATEMENT OF THE CASE

Plaintiff filed this action on August 20, 2021, seeking declaratory relief in the form of a judgment that: (1) declares facially unconstitutional that portion of South Carolina Code § 12-36-2120(74)(c), as it requires that a seller must have its principal place of business in South Carolina in order to be eligible for a sales tax exemption provided for certain sales of “durable medical equipment and related supplies”; and (2) Plaintiff is entitled to a refund of South Carolina sales tax plus any applicable interest, on its sales of durable medical equipment and related supplies, which would have qualified for the exemption as written in South Carolina Code

§ 12-36-2120(74) if it did not require Plaintiff to have its principal place of business in South Carolina in order to qualify for the exemption.

As reflected in the pleadings and the Stipulation of Facts filed in this case, and further addressed in briefing, Plaintiff Orthofix Inc. is a Delaware corporation with its principal place of business in Texas. Defendant South Carolina Department of Revenue is a State agency created under Title 12, Chapter 4 of the South Carolina Code, and has offices throughout the State.

Following Plaintiff's service of a Complaint for Declaratory Relief, the parties filed cross Motions for Summary Judgment under Rule 56 of the South Carolina Rules of Civil Procedure, along with subsequent briefs responding to those cross motions.

FACTUAL STIPULATIONS

In conjunction with the motions for summary judgment filed by both parties, the Court was directed to a Stipulation of Facts filed on May 6, 2022, in which the parties agreed to a number of material facts that were not in dispute. These stipulated facts are restated below and are taken as true for purposes of this action:

1. Plaintiff, referred to by Defendant¹ in its Determination as "Taxpayer," is a Delaware corporation with its principal place of business in Texas.
2. Plaintiff holds a South Carolina retail sales license and sells tangible personal property at retail, including durable medical equipment and related supplies in South Carolina.
3. Plaintiff timely remitted South Carolina sales tax to Defendant on the durable medical equipment and related supplies sales to customers in South Carolina.

¹ Note that the Stipulation of Facts refers to Plaintiff as "Petitioner" and Defendant as "Respondent" or the "Department."

4. On June 1, 2020, Petitioner submitted refund claims totaling \$351,790.00 for sales tax paid on durable medical equipment and related supplies sold to customers in South Carolina during the period of March 1, 2017 through March 31, 2020.

5. On August 27, 2020, Defendant denied the refund claims for sales tax paid on durable medical equipment and related supplies sold to customers in South Carolina on the basis that Plaintiff's principal place of business is not located in South Carolina.

6. Plaintiff timely protested the denial. Plaintiff only disputed the constitutionality of the sales tax exemption statute. Specifically, Plaintiff asserts that the sales tax exemption provided in Title 12 for retail sales of durable medical equipment is facially unconstitutional because it discriminates against out-of-State businesses and violates the dormant Commerce Clause of the United States Constitution.

7. On November 16, 2020, Defendant's Appeals Section held a teleconference with Plaintiff. Defendant and Plaintiff were unable to resolve the protest, leading to Defendant's issuance of the Determination on July 22, 2021 in which Defendant denied the refund claim.

8. Plaintiff timely filed its request for contested case hearing in the Administrative Law Court on August 20, 2021 to review Defendant's Determination.

9. On August 20, 2021, Plaintiff also filed an action in the Lexington County Court of Common Pleas challenging the constitutionality of the sales tax exemption's discrimination against otherwise qualified taxpayers doing business in South Carolina that do not have a principal place of business in South Carolina.

10. The parties do not dispute that retail sales of durable medical equipment and related supplies are subject to sales tax in South Carolina. The parties also do not dispute that South

Carolina law provides for an exemption from sales tax paid on durable medical equipment and related supplies at South Carolina Code § 12-36-2120(74).

11. Plaintiff sold durable medical equipment and related supplies, as defined under federal and State Medicaid and Medicare laws, to customers in South Carolina. Plaintiff only seeks a refund of sales tax for those sales of durable medical equipment and related supplies.

12. The durable medical equipment and related supplies sold to customers in South Carolina for which Plaintiff seeks a refund of sales tax were paid for directly by funds of South Carolina or the United States under the Medicaid or Medicare programs, where State or federal law or regulation authorizing the payment prohibited the payment of the sale or use tax.

13. The parties do not dispute that Plaintiff holds a South Carolina retail sales license.

14. There is no other basis for denial of Plaintiff's refund claim addressed in Defendant's Determination other than a statutory requirement of the sales tax exemption as written that the taxpayer's principal place of business must be located in South Carolina in order to qualify for the exemption.

DISCUSSION

Plaintiff and Defendant agree that Plaintiff's challenge to the constitutionality of the sales tax exemption set forth in South Carolina Code § 12-36-2120(74) is ripe for adjudication. Summary judgment is proper when there is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law. Rule 56(c), SCRCF; *Young v. S.C. Dep't of Disabilities & Special Needs*, 374 S.C. 360, 365, 649 S.E.2d 488, 490 (2007).

South Carolina Code § 12-36-2120(74) provides an exemption for gross proceeds from sales of "durable medical equipment and related supplies":

(a) as defined under federal and state Medicaid and Medicare laws;

(b) which is paid directly by funds of this State or the United States under the Medicaid or Medicare programs, where state or federal law or regulation authorizing the payment prohibits the payment of the sale or use tax; and

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

(Emphasis added).

This case deals with the final requirement of the exemption, i.e., that a seller must have its “principal place of business . . . located in” South Carolina.

The Limitation of the Exemption in South Carolina Code § 12-36-2120(74) to Sellers with a “Principal Place of Business” in South Carolina Violates the Commerce Clause of the U.S. Constitution.

Plaintiff asserts that to disallow an exemption from sales tax to an out-of-State company simply because it is an out-of-State company is a violation of the Commerce Clause of the U.S. Constitution. Plaintiff further maintains that the exemption set forth in South Carolina Code § 12-36-2120(74) violates the Commerce Clause because it limits the availability of the exemption to sellers “whose principal place of business is located in” South Carolina.

The Commerce Clause of the U.S. Constitution affirmatively grants Congress the power “[t]o regulate Commerce with foreign Nations, and among the several States.” U.S. Const. art. I, § 8, cl. 3. Additionally, the U.S. Supreme Court recognizes the Commerce Clause has a “negative implication . . . driven by concern about economic protectionism—that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors.” *Dep’t of Revenue v. Davis*, 553 U.S. 328, 337-38 (2008) (internal quotations omitted). This “negative implication,” commonly referred to the “dormant Commerce Clause”:

effectuates the Framers' purpose to prevent a State from retreating into economic isolation or jeopardizing the welfare of the Nation as a whole, as it would do if it were free to place burdens on the flow of commerce across its borders that commerce wholly within those borders would not bear.

Fulton Corp. v. Faulkner, 516 U.S. 325, 330-31 (1996) (internal quotations omitted).

Fundamentally, the Commerce Clause prohibits a State from “impos[ing] a tax which discriminates against interstate commerce . . . by providing a direct commercial advantage to local business.” *Nw. States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 458 (1959). Consistent with this prohibition, the U.S. Supreme Court, in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 278-79 (1977), established a four-prong test to be used in determining whether a State tax on an out-of-State business violates the Commerce Clause. In order to comply with Commerce Clause requirements, a State tax: (1) must be applied to an activity with a substantial nexus with the taxing state; (2) must be fairly apportioned; (3) must not discriminate against interstate commerce; and (4) must be fairly related to services provided by the taxing State. *Id.* The limitation of the exemption at South Carolina Code § 12-36-2120(74) to sellers “whose principal place of business is located” in South Carolina violates the prohibition against taxes that discriminate against interstate commerce.

Tax schemes favoring in-State activity over out-of-State activity are unconstitutionally discriminatory. A tax discriminates against interstate commerce in violation of the dormant Commerce Clause “if it is facially discriminatory, has a discriminatory intent, or has the effect of unduly burdening interstate commerce.” *Amerada Hess Corp. v. Dir., Div. of Tax'n*, 490 U.S. 66, 75 (1989). Discriminatory tax schemes that favor in-State activity over out-of-State activity violate the dormant Commerce Clause. *See, e.g., Fulton Corp.*, 516 U.S. at 333 (striking a North Carolina tax imposed on stockholders that was measured on the value of stock, reduced by the

portion of the issuer's income taxable in North Carolina, holding that the tax scheme was facially discriminatory because it served "at least, to discourage [North Carolina] corporations from plying their trades in interstate commerce"); *Westinghouse Elec. Corp. v. Tully*, 466 U.S. 388, 406 (1984) (striking a New York corporate tax credit that increased or decreased depending on whether a taxpayer's subsidiary conducted more or less of its export activities in New York, ruling that the credit "foreclose[d] tax-neutral decisions and . . . create[d] . . . an advantage for firms operating in New York") (internal quotations omitted); *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 337 (1977) (striking amendments to New York's tax on stock transfers that provided tax benefits to stock transfers made through a New York-based exchange, to the exclusion of stock transfers on out-of-state exchanges, holding that the amendments "discriminatorily tax[ed] . . . business operations performed in [an]other State") *Shasta Beverages (Div. of Consol. Foods Corp.) v. S.C. Tax Comm'n*, 280 S.C. 48, 54, 310 S.E.2d 655, 658 (1983) (concluding that, under the Commerce Clause of the U.S. Constitution, "a state cannot impose a tax which would require an interstate commerce business to transfer a part of its business operations to the taxing state in order to receive equal tax treatment").

Applying the language on the face of South Carolina Code § 12-36-2120(74), Defendant denied Plaintiff's refund claim for the sole reason that Plaintiff does not have its principal place of business in South Carolina. The language of the statute on its face discriminates against interstate commerce. The limitation of the exemption at South Carolina Code § 12-36-2120(74) to companies with a principal place of business in South Carolina has "the same economic effect as a state tariff, the quintessential evil targeted by the dormant Commerce Clause." *Comptroller of the Treasury v. Wynne*, 575 U.S. 542 (2015).

Defendant argues that the limitation in South Carolina Code § 12-36-2120(74) is constitutional because it “encourages economic development in South Carolina by encouraging more corporate executives to locate in South Carolina and more businesses to conduct the bulk of their corporate activities in South Carolina.” But the means by which the statute encourages such activity – providing a tax exemption for a specific in-State activity based on the other in-State versus out-of-State activity of a taxpayer – has repeatedly been held to be unconstitutionally discriminatory even if those means were intended to promote in-State economic development. *See, e.g., Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 273 (1984) (finding “unpersuasive the State’s contention that there was no discriminatory intent on the part of” the Hawaii legislature when it passed tax exemptions for certain liquors primarily produced in Hawaii in order “to promote a local industry,” stating that if the Court “were to accept that justification, [it] would have little occasion ever to find a statute unconstitutionally discriminatory”); *Boston Stock Exchange*, 429 U.S. at 326-28 (striking New York State tax benefits provided for purposes of “encouraging” stock transactions on the New York Stock Exchange instead of out-of-State exchanges).

A taxing statute that discriminates against interstate commerce must “pass the strictest scrutiny,” and “[t]he State’s burden of justification is so heavy that facial discrimination by itself may be a fatal defect.” *Or. Waste Systems, Inc. v. Dep’t of Env’tl. Quality*, 511 U.S. 93, 101 (1994) (internal quotations omitted). In this case, Defendant’s primary justifications for the limitation in South Carolina Code § 12-36-2120(74) are that the limitation was intended to promote economic development and that the limitation had a mere incidental impact on interstate commerce. No justification that Defendant has provided satisfies the “strictest scrutiny” burden of justification for a facially discriminatory statute. *See, e.g., Fulton Corp.*, 516 U.S. at 333 n.3 (stating that the

U.S. Supreme Court has “never recognized a ‘*de minimis*’ defense to a charge of discriminatory taxation under the Commerce Clause”); *Bacchus Imps.*, 486 U.S. at 272-73 (discussed above, rejecting an argument that a discriminatory tax may be excused because the statute is intended to support economic development); *Boston Stock Exch.*, 429 U.S. at 326-28 (same).

Therefore, the limitation of the exemption in South Carolina Code § 12-36-2120(74) to sellers with a “principal place of business” in South Carolina must be held to be unconstitutionally discriminatory in violation of the Commerce Clause of the U.S. Constitution.

The Unconstitutional Limitation of the Exemption in South Carolina Code § 12-36-2120(74) May be Severed from the Rest of the Exemption.

“[E]stablished principles of construction” permit this Court to conclude that, even if a portion of a taxing statute “is constitutionally invalid,” that “the remainder of the statute” may be “severable” so that it may “continue in force and effect.” *Shasta Beverages*, 280 S.C. at 57, 310 S.E.2d at 660.

Plaintiff asserts that the doctrine of severance should be applied in this case, so that the unconstitutionally discriminatory limitation of South Carolina Code § 12-36-2120(74) is eliminated and the rest of the statutory language as written by the South Carolina General Assembly is preserved.

The South Carolina Supreme Court has stated that “[t]he test for severability is whether the constitutional portion of the statute remains complete in itself, wholly independent of that which is rejected, and is of such a character as that it may fairly be presumed that the Legislature would have passed it independent of that which is in conflict with the Constitution” *Thayer v. S.C. Tax Comm’n*, 307 S.C. 6, 13, 413 S.E.2d 810, 814-15 (1992) (internal quotations omitted).

In this case, the test for severability supports a conclusion that the exemption provided by South Carolina Code § 12-36-2120(74) is severable and should continue in force and effect without the unconstitutional limitation. First, the exemption within South Carolina Code § 12-36-2120(74) remains complete itself, wholly independent of the language which is unconstitutional. With the removal of the unconstitutional limitation, South Carolina Code § 12-36-2120(74) will only provide an exemption to sellers meeting the other requirements of the statute – specifically, the exemption will be available for sales of “durable medical equipment and related supplies”:

- (a) as defined under federal and state Medicaid and Medicare laws;
- (b) which is paid directly by funds of this State or the United States under the Medicaid or Medicare programs, where state or federal law or regulation authorizing the payment prohibits the payment of the sale or use tax; and
- (c) sold by a provider who holds a South Carolina retail sales license.

The requirement in South Carolina Code § 12-36-2120(74) that a product must be sold by a seller “whose principal place of business is located in this State” would be eliminated, and no additional language is necessary to make the exemption workable and complete in itself.

Further, this Court finds that it may fairly be presumed that the South Carolina General Assembly would have passed the exemption in South Carolina Code § 12-36-2120(74). The South Carolina Supreme Court has applied the doctrine of severance to preserve tax benefits provided within statutes that included discriminatory limitations. *See Shasta Beverages*, 280 S.C. 57, 310 S.E.2d at 660. The South Carolina Supreme Court has also applied the doctrine of severance to preserve sales tax exemptions contained in paragraphs with unconstitutional elements. *Thayer*, 307 S.C. at 12-13, 310 S.E.2d at 814-15. On balance, this Court concludes that a similar solution to the constitutional infirmity presented by South Carolina Code § 12-36-2120(74) is proper here.

As such, this Court rejects Defendant's argument that, if the limitation of the exemption in South Carolina Code § 12-36-2120(74) to sellers with a principal place in South Carolina is unconstitutional, that the entirety of the statute must be declared void. While numerous States provide sales tax exemptions for durable medical equipment, this Court has found no state with such an exemption that was limited to sellers having a principal place of business in the taxing State – and Defendant could not identify a single state with such a limitation. Notably, if this Court were to accept Defendant's argument, Plaintiffs may still be entitled to a remedy in the form of a refund of sales tax under the Due Process Clause of the U.S. Constitution, requiring this Court to consider yet another constitutional problem. *McKesson Corp. v. Div. of Alcoholic Beverages & Tobacco*, 496 U.S. 18, 36 (1990).

But a consideration of a remedy under the Due Process Clause is unnecessary here, because this Court has determined that severability will preserve most of the statutory language added by the South Carolina General Assembly in South Carolina Code § 12-36-2120 – without requiring any additional language to be added to the statute. Therefore, the sales tax exemption provided within South Carolina Code § 12-36-2120(74) must be provided to all sellers that qualify for the exemption, regardless of the location of the seller's principal place of business in South Carolina or another State. *See Thayer*, 307 S.C. at 12-13, 413 S.E.2d at 814-15 (holding that one portion of a paragraph of South Carolina Code § 12-36-2120 was severable and that the exemptions provided for in the rest of the paragraph may remain in place).

THEREFORE, it is hereby ORDERED that:

1. That portion of South Carolina Code § 12-36-2120(74), as it requires that a seller must have its principal place of business in South Carolina in order to be eligible for a sales tax

exemption provided for certain sales of “durable medical equipment and related supplies,” violates the Commerce Clause of the U.S. Constitution;

2. Applying the doctrine of severability, because Plaintiff would be eligible for the sales tax exemption provided by South Carolina Code § 12-36-2120(74) without the unconstitutional limitation, Plaintiff is hereby eligible for such exemption on the sales at issue in this matter; and

3. Plaintiff is entitled to a refund of sales tax paid, plus any applicable interest, on its sales of durable medical equipment and related supplies for the period of March 1, 2017 through March 31, 2020. The parties are directed to reach agreement on the exact amount of sales tax to be refunded (and applicable interest due) based on this ruling, and are further directed to report to this Court if they are unable to reach such an agreement.

[Judge’s electronic signature follows on separate page]



Lexington Common Pleas

Case Caption: Orthofix, Inc. VS Department Of Revenue South Carolina

Case Number: 2021CP3202752

Type: Order/Summary Judgment

Circuit Judge (Code #2050)

s/ William P. Keesley

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