THE STATE OF SOUTH CAROLINA
In The Supreme Court

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S.C. SUPREME COURT

ON APPEAL FROM LEXINGTON COUNTY
Court of Common Pleas
William P. Keesley, Circuit Court Judge

CASE NO. 2021-CP-32-02753
Appellate Case No. 2023-000318

KCI USA, Inc., ... Respondent,

v.

South Carolina Department of Revenue, ... Appellant.

KCI USA, INC.'S INITIAL BRIEF

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STATEMENT OF ISSUES ON APPEAL

I. DID THE CIRCUIT COURT CORRECTLY DETERMINE THAT THE LIMITATION OF THE SALES TAX EXEMPTION, AS PROVIDED BY S.C. CODE ANN. § 12-36-2120(74)(C), TO SELLERS WITH A "PRINCIPAL PLACE OF BUSINESS" IN SOUTH CAROLINA DISCRIMINATES AGAINST OUT-OF-STATE SELLERS IN VIOLATION OF THE DORMANT COMMERCE CLAUSE OF THE U.S. CONSTITUTION?

II. IF THE ANSWER TO THE FIRST QUESTION IS YES, DID THE CIRCUIT COURT CORRECTLY DETERMINE THAT THE UNCONSTITUTIONAL LIMITATION OF THE SALES TAX EXEMPTION MAY BE SEVERED TO PRESERVE THE REST OF THE EXEMPTION AS WRITTEN BY THE SOUTH CAROLINA LEGISLATURE?

STATEMENT OF THE CASE

Respondent KCI USA, Inc. adopts the Statement of the Case set forth in Appellant's Initial Brief insofar as it sets forth a concise history of the proceedings as necessary to an understanding of the appeal in accordance with Rule 208(b)(1)(C) of the South Carolina Appellate Court Rules. To the extent relevant to the Court's consideration of this appeal, Respondent further states that simultaneous with the filing of its Complaint in the Circuit Court on August 20, 2021, Respondent also filed a Request for Contested Case Hearing in the South Carolina Administrative Law Court (ALC) in accordance with S.C. Code Ann. § 12-60-460. Given that the constitutional questions raised in Respondent's Request are outside the jurisdiction of the ALC and were instead within the jurisdiction of the Circuit Court, the contested case has been stayed by agreement of the parties.

STANDARD OF REVIEW

"On review from a grant of summary judgment, the Court applies the same standard applied by the circuit court pursuant to Rule 56(c), SCRCP." *Stevens & Wilkinson of S.C., Inc. v. City of Columbia*, 409 S.C. 568, 576, 762 S.E.2d 696, 700 (2014). "'[W]hen the evidence is susceptible of only one reasonable interpretation, summary judgment may be granted.'" *Bell v. Progressive Direct Ins. Co.*, 407 S.C. 565, 576, 757 S.E.2d 399, 404 (2014) (quoting *Brooks v. Northwood Little League, Inc.*, 327 S.C. 400, 403, 489 S.E.2d 647, 648 (Ct. App. 1997)). As to the issues before this Court, both Respondent and Appellant agree that there is no genuine issue of material fact in dispute. (**R. pp. ----**).

"[I]n cases involving a constitutional challenge to a statute" Respondent agrees that the statute will be "presumed constitutional and, if possible, will be construed to render [the statute] valid," *Retail Servs. & Sys., Inc. v. S.C. Dep't of Revenue*, 419 S.C. 469, 472, 799 S.E.2d 665, 666 (2017) (internal quotations omitted). Nevertheless, when a statute's "invalidity appears so clearly

as to leave no room for reasonable doubt that it violates a provision of the constitution," the statute "will be declared unconstitutional." *Joytime Distribs. & Amusement Co. v. State*, 338 S.C. 634, 640, 528 S.E.2d 647, 650 (1999); *see also Knotts v. S.C. Dep't of Nat. Res.*, 348 S.C. 1, 6, 558 S.E.2d 511, 513 (2002).

But just because a statute has unconstitutional language does not mean that the entire statute must be classified as unconstitutional in whole – instead, "a statute may be constitutional and valid in part and unconstitutional and invalid in part." *Shumpert v. S.C. Dep't of Highways and Pub. Transp.*, 306 S.C. 64, 68-69, 409 S.E.2d 771, 774 (1991).

FACTS

Respondent adopts the Facts set forth in Appellant's Initial Brief insofar as it sets forth a concise recitation of the facts necessary to an understanding of the appeal in accordance with Rule 208(b)(1)(C) of the South Carolina Appellate Court Rules. The relevant facts in this appeal are undisputed and were stipulated before the Circuit Court. *See* Stipulation of Facts (**R. pp. ----**).

To the extent relevant to the Court's consideration of this appeal, Respondent adds that the Stipulation of Facts entered into by the parties confirms that: (1) Respondent sold durable medical equipment and related supplies, as defined under federal and state Medicaid and Medicare laws, to customers in South Carolina; (2) the durable medical equipment and related supplies sold to customers in South Carolina for which Respondent 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; and (3) Respondent holds a South Carolina retail sales license. Stipulation of Facts, ¶¶ 11-13 (**R. pp. ----**). As such, the parties stipulated that there is no basis for denial of Respondent's refund claim addressed in Appellant's Determination other than a statutory

requirement that the taxpayer's principal place of business must be located in South Carolina in order to qualify for the Exemption. Stipulation of Facts ¶ 14 (**R. pp. ----**).

The federal Medicare website defines durable medical equipment "that Medicare covers" to include canes, hospital beds, walkers, and wheelchairs.[1] As stipulated by the parties, the definition of durable medical equipment and related supplies as defined under federal and state Medicaid and Medicare laws also includes the products sold by Respondent for which it claimed the Exemption. Those products are "V.A.C. Therapy" mechanisms, which are used to assist in the healing of patients who have suffered traumatic injuries resulting in deep wounds that otherwise would be difficult to get to close on their own.[2]

ARGUMENTS

The multi-part Durable Medical Equipment Exemption statute as written contains a limitation preventing any seller from claiming the Exemption if its principal place of business is not located in South Carolina. This limitation facially discriminates against out-of-State sellers to the advantage of in-State sellers, thereby necessitating consideration of whether the Exemption's limitation to in-State sellers ***is unconstitutionally discriminatory*** under the dormant Commerce Clause of the U.S. Constitution.

Appellant attempts to overcome the facially discriminatory nature of the Exemption by (1) relying on the presumption that a South Carolina statute is constitutional and (2) claiming that the burden for overcoming such presumption would require Respondent to "negate every conceivable basis that might support" the discriminatory statute. App. Brief at 6. But this

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[1] Durable medical equipment (DME) coverage, U.S. Centers for Medicare and Medicaid Services, available at https://www.medicare.gov/coverage/durable-medical-equipment-dme-coverage (last accessed June 2, 2023).

[2] *See, e.g.*, V.A.C.Ulta Negative Pressure Wound Therapy System, 3M/KCI, available at https://www.acelity.com/healthcare-professionals/global-product-catalog/catalog/vaculta-negative-pressure-wound-therapy-system (last accessed June 2, 2023).

disregards the fact that, when a state's statute is facially discriminatory, the burden shifts to the state to defend such statute under a standard the U.S. Supreme Court has labeled as "strictest scrutiny." *Or. Waste Sys., Inc. v. Dep't of Env't Quality of State of Or.*, 511 U.S. 93, 101 (1994). Such burden does not allow Appellant to merely come up with any "conceivable basis" to defend its discriminatory statute (App. Brief at 6) – instead, the burden on Appellant is so high that the U.S. Supreme Court has concluded that "State laws discriminating against interstate commerce on their face are 'virtually *per se* invalid.'" *Fulton Corp. v. Faulkner*, 516 U.S. 325, 331 (1996) (quoting *Or. Waste Sys.*, 511 U.S. at 99) (emphasis in original). The Circuit Court rightly concluded that Appellant could not overcome this virtually impossible burden and held that the Durable Medical Equipment Exemption unconstitutionally discriminates against out-of-State sellers including Respondent in violation of the dormant Commerce Clause.

Appellant next claims that the remedy to the unconstitutional limitation within the Durable Medical Equipment Exemption is to declare the entire Exemption void, even though this Court's historic application of the doctrine of severance to unconstitutional state tax laws would preserve the vast majority of the Exemption language as written by the South Carolina Legislature without requiring this Court to add any additional language to the South Carolina Code. The Circuit Court rightly concluded that the better option in this case is to keep the Exemption intact without its current unconstitutional limitation – especially as, under the Due Process Clause of the U.S. Constitution, Appellant's proposed elimination of the Exemption would nevertheless necessitate Respondent receive the refunds requested to be made equal with any in-State seller who has (1) already received the Exemption and (2) by application of the State's tax statutes of limitations cannot be required to pay tax on its exempted sales on a retroactive basis.

Therefore, Respondent respectfully requests that the Order issued by the Circuit Court in this case be upheld.

I. The Limitation of the Durable Medical Equipment Exemption to Sellers with a "Principal Place of Business" in South Carolina Plainly Discriminates Against Out-of-State Sellers in Violation of the Dormant Commerce Clause of the U.S. Constitution.

The Durable Medical Equipment Exemption as written provides that in-State sellers are eligible for the Exemption while all out-of-State sellers are not. In the face of such clear language, Appellant makes no attempt to argue in its opening brief that the Exemption's limitation to in-State sellers is not discriminatory. Instead, to support an argument that the discriminatory nature of the Exemption is excusable under the U.S. Constitution, Appellant relies on (1) the general presumption that a statute is constitutional and (2) an incorrect legal standard that disregards the "strictest scrutiny" burden it must carry when a statute facially discriminates against out-of-State sellers. *Or. Waste Sys.*, 511 U.S. at 101.

Appellant ignores the U.S. Supreme Court's standard of 'virtually *per se* invalid[ity]'" that applies when a statute facially discriminates against out-of-State sellers such as Respondent – and when the correct standard is applied, there is no reasonably conceivable basis to maintain that the discriminatory language of the Exemption is constitutional. *Fulton*, 516 U.S. at 331 (quoting *Or. Waste Sys.*, 511 U.S. at 99) (emphasis in original).

A. *Any General Presumption that the Durable Medical Equipment Exemption as Written is Constitutional is Overcome by Facially Discriminatory Language Within the Exemption.*

Regardless of any general presumption of constitutionality applicable to a South Carolina statute, the Durable Medical Equipment Exemption's requirement that a seller have its principal place of business in South Carolina is unconstitutionally discriminatory and has the economic effect of a tariff. While Appellant's Motion for Summary Judgement before the Circuit Court

established the discriminatory nature of the Exemption's limitation to in-State sellers,[3] this Court's own analysis of when a statute is discriminatory under the dormant Commerce Clause of the U.S. Constitution is worth review.

In *Shasta Beverages (A Division of Consolidated Foods Corp.) v. S.C. Tax Commission*, 280 S.C. 48, 310 S.E.2d 655 (1983), this Court held that provisions of South Carolina's since-repealed soft drink tax were unconstitutionally discriminatory. At the time, South Carolina's soft drink tax was "assessed on the volume of the product sold." *Id.*, 280 S.C. at 51, 310 S.E.2d at 656. South Carolina statutes provided a tax discount and exemption as long as the bottler "market[ed] its goods on its own . . . leased or owned soft drink truck . . . in the normally accepted store-door delivery method" – meaning that a bottler was required to conduct South Carolina soft drink deliveries on its own trucks. *Id.*, 280 S.C. at 51, 310 S.E.2d at 656-57 (internal quotations omitted). The South Carolina soft drink statutes also provided an alternative (and less burdensome) method of reporting the tax, but only to bottlers qualifying for the tax discount and exemption (based on the South Carolina delivery of soft drinks using the bottler's own trucks) or having "their plants . . . located in" South Carolina. *Id.*, 280 S.C. at 52, 310 S.E.2d at 657.

The Court concluded that the statutory provisions limiting the availability of the tax discount and exemption were unconstitutionally discriminatory because they "forced" soft drink bottling companies "to conduct store-door delivery in South Carolina in order to receive" the benefits – thereby forcing companies "to give up their right to conduct their business solely in interstate commerce in order to receive the same tax advantage available to local bottlers." *Id.*. And the Court found "the discrimination" caused by the statutory provision limiting the availability of the alternative tax reporting method was "even clearer." *Id.*

[3] Respondent's Motion for Summary Judgment (filed July 8, 2022) (**R. pp. ----**).

Interpreting U.S. Supreme Court case law, this Court stated:

> The [State] is arguing that the Bottlers could avoid discrimination against their interstate commerce business by ceasing to do a part of their business in interstate commerce. The fundamental point of the Commerce Clause . . . is that a company has a constitutional right to conduct its business entirely in interstate commerce, and it cannot be subjected to discriminatory taxation by virtue of that choice. The United States Supreme Court has made it clear that 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.

Id., 280 S.C. at 53-54, 310 S.E.2d at 658.

The constitutional infirmity embedded within the Durable Medical Equipment Exemption parallels that in *Shasta*. Just as in *Shasta*, Respondent is required by South Carolina law to relocate into South Carolina for its sales to receive the Exemption available to sellers with a principal place of business in South Carolina. The Court in *Shasta* concluded that the offending provisions "constitute[] a clear violation of the [dormant] Commerce Clause." *Id.*, 280 S.C. at 52, 310 S.E.2d at 657. While South Carolina statutes like the Exemption may enjoy a general presumption of constitutionality, *Shasta* establishes that such general presumption is overcome when a statute on its face provides a tax benefit to in-State sellers that is not available to out-of-State sellers.

B. As the Durable Medical Equipment Exemption is Facially Discriminatory Against Out-of-State Sellers, the Appellant Has the Burden of Strictest Scrutiny to Defend the Constitutionality of the Exemption.

Implicitly conceding the discriminatory nature of the Durable Medical Equipment Exemption, Appellant argues that the Exemption is not unconstitutionally discriminatory as long as there is some "reasonable hypothesis" to justify discrimination. App. Brief at 6. However, Appellant has misconstrued the burden shift that applies when "the discrimination against interstate commerce is apparent from the statute[]" itself. *Shasta*, 280 S.C. at 53, 310 S.E.2d at 658. As repeatedly stated by the U.S. Supreme Court, "State laws discriminating against interstate

commerce on their face are 'virtually *per se* invalid.'" *Fulton*, 516 U.S. at 331 (quoting *Or. Waste Sys.*, 511 U.S. at 99) (emphasis in original).

Contrary to Appellant's claim that any "conceivable basis" may establish the constitutionality of a discriminatory statute (App. Brief at 6), the U.S. Supreme Court's standard of *per se* invalidity is exceedingly high – if a statute is discriminatory in nature, the burden shifts to the State, and any "justifications for discriminatory restrictions on commerce [must] pass the 'strictest scrutiny.'" *Or. Waste Sys.*, 511 U.S. at 101. The State's burden of justification is so heavy that "facial discrimination by itself may be a fatal defect, ***regardless of the State's purpose***, because 'the evil of protectionism can reside in legislative means as well as legislative ends.'" *Hughes v. Oklahoma*, 441 U.S. 322, 337 (1979) (quoting *Philadelphia v. New Jersey*, 437 U.S. 617, 624 (1978)) (emphasis added).

C. Any Intent to Encourage South Carolina Industry Cannot Excuse the Discriminatory Nature of the Durable Medical Equipment Exemption's Limitation to South Carolina-Based Companies.

Appellant appears to believe that a taxing statute may be discriminatory in nature as long as the discrimination is justified by the purpose of in-State economic development. For this proposition, Appellant cites the U.S. Supreme Court's decision in *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 271 (1984) as stating "that a state may enact laws pursuant to its police powers that have the purpose and effect of encouraging domestic industry" (quoted in App. Brief at 6).

But Appellant fails to acknowledge the very next sentence of the U.S. Supreme Court's *Bacchus* decision, which states that "the Commerce Clause stands as a limitation on the means by which a State can constitutionally seek to achieve that goal." *Id.* In *Bacchus* the U.S. Supreme Court held that a statutory taxing scheme intended to support economic development by providing preferential tax treatment under Hawaii's liquor excise tax to certain in-State liquors was

unconstitutional. The outcome of *Bacchus* is consistent with the conclusion reached by the Circuit Court below.

In *Bacchus*, the U.S. Supreme Court evaluated a Hawaiian statute that exempted locally produced alcoholic beverages – okolehao and pineapple wine – from the state's excise tax on wholesale liquor sales "to subsidize" either "nonexistent" or "financially troubled . . . liquor industries peculiar to Hawaii." *Id.* at 272. The Court found that such exemption was unconstitutionally discriminatory, stating that "the legislation constitutes 'economic protectionism' in every sense of the phrase,'" and pointing out that "[i]t has long been the law that States may not 'build up [their] domestic commerce by means of unequal and oppressive burdens upon the industry and business of other States." *Id.* at 272-73 (quoting *Guy v. Baltimore*, 100 U.S. 434, 443 (1880)).

The conclusion in *Bacchus* is consistent with other U.S. Supreme Court decisions. For example, a New York stock transfer tax incentive struck down in *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318, 323-24 (1977) (which provided a lower stock transfer tax if a stock transfer was made through a New York-based exchange) was passed in response to a "concern" that the stock transfer tax "created a competitive disadvantage for New York trading and was thus responsible for the growth of out-of-state exchanges." While the New York State Court of Appeals held that the stock transfer tax incentive was "a nondiscriminatory, and therefore constitutionally permissible, means of 'encouraging' sales on the New York Stock Exchange," the U.S. Supreme Court struck it down on the basis that it "discriminate[d] against interstate commerce in violation of the [dormant] Commerce Clause." *Id.* at 328. In doing so, the Court flatly rejected the promotion of economic development as an acceptable justification for discriminatory tax provisions.

Appellant seems to believe that applying the principles present in *Bacchus* would cause "all economic development exemptions [to] be unconstitutional," including a list of exemptions that are not at issue in this case. App. Brief at 7. While Respondent has not raised any challenge in this case other than a challenge to the discriminatory limitation within the Durable Medical Equipment Exemption, Appellant notes that there is a straightforward way to distinguish between constitutional and unconstitutional state tax incentives under U.S. Supreme Court precedent, and such approach would not cause "all economic development exemptions" to be declared unconstitutional.

In his seminal state and local tax treatise, University of Georgia tax law professor Walter Hellerstein analyzes U.S. Supreme Court case law addressing the constitutionality of state tax incentives under the dormant Commerce Clause and contrasts tax exemptions that are, and are not, unconstitutionally discriminatory. Jerome R. Hellerstein, Walter Hellerstein & Andrew Appleby, *State Taxation* ¶ 4.14[3][b][v] (Thomson Reuters/Tax & Accounting, 3rd ed. 2001, with updates through May 2023) (online version accessed on Checkpoint (www.checkpoint.riag.com) June 2, 2023).[4]

Professor Hellerstein provides two scenarios where tax exemptions are used to incentivize in-State activity. In his first scenario, an exemption is constitutionally sustainable when it does not "rely on the coercive power of the state to compel a choice favoring in-state investment." *Id.* Such an exemption says, in effect, "Come to our state and we will not saddle you with any additional

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[4] The U.S. Supreme Court regularly cites Professor Hellerstein's articles and his treatise in support of the conclusions reached in their decisions applying the dormant Commerce Clause to U.S. state and local tax issues. *See, e.g.*, *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080, 2092 (2018); *Comptroller of the Treasury of Md. v. Wynne*, 575 U.S. 542, 561 (2015) (citing Professor Hellerstein's treatise); *Ala. Dep't of Revenue v. CSX Transp., Inc.*, 575 U.S. 21, 28 (2015) (citing Professor Hellerstein's treatise); *MeadWestvaco Corp. v. Ill. Dep't of Revenue*, 553 U.S. 16, 25, 27, 29, 31 (2008) (citing Professor Hellerstein's treatise).

property or sales tax burdens. Moreover, should you choose not to accept our invitation, nothing will happen to your tax bill – at least nothing that depends on our taxing regime." *Id.*

In Professor Hellerstein's second scenario, the U.S. Supreme Court has consistently found unconstitutional exemptions where a state said, in effect:

> You are already subject to our taxing power because you have engaged in taxable activity in this state. If you would like to reduce those burdens, you may do so by directing additional business activity into this state. Should you decline our invitation, we will continue to exert our taxing power over you as before, and your tax bill might even go up.

Id.

Here, the Durable Medical Equipment Exemption clearly falls under Professor Hellerstein's second scenario. There is no dispute that Respondent is generally subject to South Carolina sales tax because it sells durable medical equipment to customers in the State. Stip. ¶ 2 **(R. pp. ----)**. With the Exemption's requirement that a seller have its "principal place of business" in South Carolina to qualify, the State is in effect offering to reduce a preexisting tax burden to taxpayers that direct additional business activity to South Carolina. Thus, the Exemption's language imposes the very type of discriminatory requirement that the U.S. Supreme Court consistently strikes down as unconstitutional.

D. Appellant's Other Purported Justifications to Defend the Durable Medical Equipment Exemption Do Not Withstand Constitutional Scrutiny.

Appellant also claims that the discriminatory nature of the Durable Medical Equipment Exemption is excusable because the exemption could have been intended "to shorten the supply chain to ensure South Carolina's most vulnerable populations have access to durable medical equipment," or "to pre-empt potential supply shortages like those experienced during the COVID-19 pandemic." App. Brief at 8. Appellant cannot cite any basis as to how these hypothetical justifications for the Exemption's discriminatory limitation overcomes the "strictest scrutiny" burden applicable to it under U.S. Supreme Court precedent. *See Or. Waste Sys.*, 511 U.S. at 101.

II. The Circuit Court Properly Applied the Doctrine of Severance to Preserve Most Language of the Durable Medical Equipment Exemption as Written by the Legislature Without Adding Any Additional Language to the South Carolina Code.

The Circuit Court properly applied "established principles of construction" to conclude that, even though the 11 words of the South Carolina Code limiting the Durable Medical Equipment Exemption to sellers with a principal place of business in South Carolina were "constitutionally invalid," nevertheless "the remainder of the statute" was "severable" so that it could "continue in force and effect." *See Shasta*, 280 S.C. at 57, 310 S.E.2d at 660.

Appellant, however, proposes a more radical solution to the Durable Medical Equipment's constitutional infirmity – the wholesale elimination of all 78 words of the Exemption on a retroactive basis. Appellant's preferred course of action fails to properly apply the severance doctrine as outlined by this Court, and would nevertheless require the payment of the refund requested by Respondent to avoid a violation of the Due Process Clause of the U.S. Constitution.

A. This Court's Precedent Establishes that Severing the Exemption's Unconstitutional Language is the Best Cure to Preserve the Constitutional Elements of the Exemption.

While Appellant broadly claims that the unconstitutional limitation of the Durable Medical Equipment Exemption to in-State sellers is not severable from the constitutional elements of the Exemption, this Court's case law establishes otherwise. "The 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).

Applying this test, the exemption within S.C. Code Ann. § 12-36-2120(74) remains complete itself, wholly independent of the language which is unconstitutional. With the removal of the unconstitutional limitation, S.C. Code Ann. § 12-36-2120(74) only provides 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.

No additional language is necessary to be added by this Court to make the Exemption workable and complete in itself – while application of Appellant's preferred remedy would eliminate an otherwise constitutional exemption statute as written by the South Carolina Legislature.

Further, it may fairly be presumed that the South Carolina Legislature would have passed the Exemption without the discriminatory limitation because this Court has made such an assumption in a similar situation in the past. In *Shasta*, after this Court determined that the two statutes within South Carolina's (since repealed) soft drink tax discussed above were unconstitutionally discriminatory, the Court next considered the proper remedy to the constitutional infirmities. Most notably, this Court held that the alternative reporting method "should simply be made available to the claimants here and to all other bottlers in their circumstances who are paying soft drink taxes to the State of South Carolina." 280 S.C. at 57, 310 S.E.2d at 660. To provide the alternative method to all bottlers, the Court excised only the unconstitutionally discriminatory language from the statute providing the alternative method and left the rest of the statute intact. *Id.* The Court determined that the South Carolina Legislature "would not have intended ***all*** bottlers to return" to the general method for reporting tax. *Id.* (emphasis added).

The same logic applies here. The "vast majority" of states do not subject durable medical equipment to sales tax.[5] And of those states that specifically exempt durable medical equipment paid for by Medicare and Medicaid programs, South Carolina is the only State that includes the extra requirement that such equipment must be purchased from a company having its "principal place of business" in the State to qualify for the exemption. Hrg. Tr. 39:2-4 (**R. pp. ----**).

B. It May Be Presumed that the South Carolina Legislature Would Have Adopted the Sound Tax Policy of Preserving the Durable Medical Equipment Exemption for Sales to Medicare and Medicaid Recipients Rather than Eliminate the Exemption Altogether.

Appellant relies on general standards of interpretation of sales tax exemptions as support for the conclusion that the unconstitutional limitation in the Durable Medical Equipment Exemption may not be severed. But Appellant reaches this conclusion without analysis of facts at issue in this case, which establish that keeping durable medical equipment sales to beneficiaries of Medicare and Medicaid out of the sales tax base is sound policy that is more than fair to presume the South Carolina Legislature would adopt.

As the vast majority of states exempt from sales taxation durable medical equipment for beneficiaries of these federal and state programs aimed to protect and preserve the health of the most vulnerable populations,[6] it is difficult to imagine that, if faced with the choice of severing the unconstitutional portion of the Durable Medical Equipment Exemption so that all sellers benefit from transacting with South Carolina's elderly and poor residents or instead eliminate the Exemption entirely, the South Carolina Legislature would choose to expand the tax burden on such

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[5] Nevada Secretary of State Barbara K. Cegavske, *State of Nevada Statewide Ballot Questions 2016* at 44, available at https://web.archive.org/web/20161110005645/https://www.nvsos.gov/Modules/ShowDocument.aspx?documentid=4434 (last accessed June 2, 2023) (explaining that a subsequently passed constitutional amendment to exempt durable medical equipment from Nevada sales tax would "help[] sick, injured, and dying patients and their families" and "bring Nevada in line with the vast majority of states which do not tax this type of equipment for home use").

[6] *Id.*

transactions in a step out of line with the vast majority of other states. This fact alone should allow for this Court to "fairly . . . presume[]" that the Legislature "would have passed" the Exemption "independent of" the language "which conflicts with the Constitution." *Joytime Distrib.*, 338 S.C. at 648-49, 528 S.E.2d at 654.

On the other hand, there was no specific legislative intent or purpose set forth in the text or title of the legislation adding the Exemption that would suggest it should be eliminated in whole if the unconstitutional limitation to in-State sellers is not preserved. 2007 Act No. 99 (enacted June 19, 2007); *see also Joytime Distrib.*, 338 S.C. at 649, 528 S.E.2d at 655 ("it is proper to consider the title or caption of an act in aid of construction to show the intent of the legislature"). Appellant ignores that its suggested course of action ***would fully eliminate*** the Exemption currently available to taxpayers the Legislature undeniably intended to receive the Exemption, i.e., those taxpayers making sales that satisfy every element of the Exemption's test including the requirement that the seller have its principal place of business in South Carolina. On balance, erasing the entirety of the Exemption's language is a radical and unnecessary step as opposed to the mere removal of the 11 words currently causing the Exemption to be unconstitutional.

C. Appellant Misconstrues this Court's Analysis in **Thayer** *to Get Around the Severance Doctrine.*

While Appellant appears to believe that this Court's determination in *Thayer* dictates against the application of the severance doctrine here, a close read of the decision establishes the opposite. In *Thayer*, this Court applied the doctrine of severance to preserve sales tax exemptions contained in paragraphs of the South Carolina Code that contained unconstitutional elements. In that case, this Court faced a constitutional challenge under the First Amendment to a sales tax exemption under S.C. Code Ann. § 12-36-2120(8), which stated (and notably, still states to this day) that an exemption from sales tax is provided for "newsprint paper, newspapers, and religious

publications, including the Holy Bible." The taxpayer was a publisher of a publication that collected "advertisements placed by real estate brokers to publicize homes available for purchase." *Thayer*, 307 S.C. at 8, 413 S.E.2d at 812. The taxpayer alleged, and the Court held, that the exemption given to religious publications violated the Establishment Clause of the First Amendment – even though the Court rejected an allegation that the exemption given to newspapers violated the Free Press Clause of the First Amendment. *Id.*, 307 S.C. at 9-10, 413 S.E.2d at 813.

This left open the question of severability. While the statute at hand broadly provided an exemption for newspapers and religious publications, the Court's determination that the exemption for religious publications was unconstitutional ***did not*** cause the Court to throw out the exemption in total. Instead, this Court allowed the constitutional portion of S.C. Code Ann. § 12-36-2120(8) (during the years at issue in *Thayer* numbered as section 12-35-550(7)) applicable to newspapers to remain in place (as it does to this day) on the basis that the "constitutional portion of the statute remain[ed] 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." 307 S.C. at 13, 413 S.E.2d at 814-15 (internal quotation omitted). This is exactly what the Circuit Court did in this case – eliminate the unconstitutional portion of the Durable Medical Equipment Exemption statute and keep the rest of the statute in place. For the reasons outlined above, on balance a similar solution to the constitutional infirmity presented by S.C. Code Ann. § 12-36-2120(74) is proper here.

D. Appellant's Preferred Remedy Would Nevertheless Necessitate Payment of Respondent's Requested Refunds.

Separately, Appellant's assertion that the cure for the Exemption's constitutional infirmity is to eliminate it in whole, thereby foreclosing Respondent from the tax benefit that had been afforded to in-State taxpayers for which Respondent properly asserted claims for refund, creates

yet another constitutional infirmity. As stated by the U.S. Supreme Court, "[b]ecause exaction of a tax constitutes a deprivation of property, the State must provide procedural safeguards against unlawful exactions in order to satisfy the commands of the Due Process Clause." *McKesson Corp. v. Div. of Alcoholic Beverages & Tobacco*, 496 U.S. 18, 36 (1990). In other words, the Due Process Clause of the U.S. Constitution requires a taxpayer wrongly subjected to a discriminatory tax scheme to be provided ***actual*** relief. Here, eliminating the Durable Medical Equipment Exemption does not cure the discriminatory treatment of Respondent and similarly situated out-of-State sellers as compared to competing sellers of durable medical equipment whose principal place of business were in South Carolina during the Period at Issue (October 1, 2014 through September 30, 2017).

When a taxpayer has been subjected to a discriminatory tax regime violating the dormant Commerce Clause, the U.S. Supreme Court has identified three potential remedies: (1) the State may refund the "difference between the tax [a taxpayer] paid and the tax it would have been assessed were it extended the same rate reductions that its competitors actually received"; (2) "the State may assess and collect back taxes from [the taxpayer's] competitors who benefited from the rate reductions during the contested tax period"; or (3) the State may provide a "combination of a partial refund to [the taxpayer] and a partial retroactive assessment of tax increases on favored competitors, so long as the resultant tax actually assessed during the contested tax period reflects a scheme that does not discriminate against interstate commerce." *Id.* at 40-41.

The Period at Issue in this case ended September 30, 2017, and the statute of limitations for assessing favored in-State competitors has now passed.[7] It is impossible for Appellant to

[7] Under South Carolina law, generally "taxes must be determined and assessed within thirty-six months [i.e., three years] from the date the return or document was filed or due to be filed, whichever is later." S.C. Code Ann. § 12-54-85(A). A typical taxpayer must file its sales tax returns monthly. *See* S.C. Code Ann. § 12-36-2580 (only allowing quarterly returns when a taxpayer's sales tax liability "does not exceed one hundred dollars for any month"). Therefore, the statute of limitations for most (if not all) of Respondent's competitors elapsed in 2020.

"assess and collect back taxes from [Respondent]'s competitors who benefited from the [Exemption] during the contested tax period, calibrating the retroactive assessment to create in hindsight a nondiscriminatory scheme." *McKesson Corp.*, 496 U.S. at 40. Consequently, the only constitutionally adequate option is a refund of sales tax paid by Respondent on sales during the Period at Issue that would have qualified for the Durable Medical Equipment Exemption if the Exemption did not have the unconstitutional requirement that a taxpayer have its "principal place of business" in South Carolina. This outcome is also consistent with South Carolina's tax scheme and the handling of refund claims for taxpayers that prevail on claims that a tax has been imposed wrongfully as a matter of law. *See* S.C. Code Ann. § 12-60-480. Based on the foregoing, Appellant's claim that Respondent is not entitled to a refund, even if the Exemption is unconstitutional, is erroneous as a matter of law.

Appellant attempts to get around this additional constitutional infirmity by quoting *Thayer* for the conclusion that "*McKesson* requires relief as a matter of federal law only when taxpayers involuntarily pay a tax that is unconstitutional under existing precedents." 307 S.C. at 13, 413 S.E.2d at 815. But the next sentence of *Thayer* confirms what was meant by that sentence, stating that "*McKesson* is inapplicable when . . . taxpayers have been subjected to a constitutional tax."

Perhaps Appellant believes this is not an obstacle based on their claim that "Respondent offers no authority directly on point that the [] Exemption was unconstitutional when the Legislature passed it over fifteen years ago." App. Brief at 12. But to reach the question of severance in the first place, this Court will presumably rely on the voluminous case law cited in the first section of this brief to conclude that there is significant authority from both the U.S. Supreme Court and this Court establishing that the Exemption's limitation to sellers with a

principal place of business in South Carolina unconstitutionally discriminates against out-of-State based sellers.

Further, as Appellant quotes in its own brief from the U.S. Supreme Court decision *American Trucking Associations, Inc. v. Smith*, 496 U.S. 167, 181 (1990) (*American Trucking II*), *McKesson* "hold[]s that a ruling that a tax is unconstitutionally discriminatory under the Commerce Clause places ***substantial obligations on the States to provide relief*** . . . ." (emphasis added). App. Brief at 12. *American Trucking II* addressed the question of whether a (at the time recent) decision of the U.S. Supreme Court, *American Trucking Associations, Inc. v. Scheiner*, 483 U.S. 266 (1987) (*American Trucking I*), applied on a retroactive basis when such case "established a new principle of law in the area of our dormant Commerce Clause jurisprudence." In holding that *American Trucking I* did not apply retroactively to overturn taxes similar to those at issue in *American Trucking I*, the Court pointed out that precedents of the U.S. Supreme Court issued prior to *American Trucking I* gave state legislators "good reason to suppose that enactment of the [tax at issue] would not violate their oath to uphold the United States Constitution." *American Trucking II*, 496 U.S. at 180, 182.

But *American Trucking II* confirms "[i]t is important to distinguish the question of retroactivity at issue in" that case "from the distinct remedial question at issue in [the] *McKesson*" decision (which was issued on the same day as *American Trucking II*); according to the Court, *McKesson* holds that "[w]hen taxpayers involuntarily pay a tax that is unconstitutional under existing precedents . . . . federal law sets certain minimum requirements that States must meet . . . in providing appropriate relief," i.e., the three potential remedies outlined above. *Id.* at 178-79. This is the case because "[w]here a State can easily foresee the invalidation of its tax statutes, its reliance interests may merit little concern." *Id.* at 182 (citing *McKesson*).

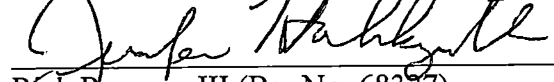
Here, case law from the U.S. Supreme Court and this Court overwhelmingly establishes that the Durable Medical Equipment's limitation to sellers principally located in South Carolina was unconstitutional under precedents existing decades before the Exemption was enacted. *See* 2007 Act No. 99 (enacted June 19, 2007, which introduced the Durable Medical Equipment Exemption). At most, Appellant may argue that such precedent is not relevant because it does not specifically address a sales tax exemption applicable to durable medical equipment sales.

But taking such a constrained approach to determining when *McKesson* applies would allow state legislatures to play a game of discriminatory whack-a-mole, whereby a state would be allowed to pass inventive but unambiguously discriminatory statutes that remain in effect for years until a court finally overturns them, as long as the exact same discriminatory statute hasn't been addressed by the U.S. Supreme Court or a state court in the past. Such an approach would lead to chaos, essentially allowing states to create the very type of tax burdens that the dormant Commerce Clause is intended to prevent – an outcome not intended by the U.S. Supreme Court in *American Trucking II*.

CONCLUSION

For the reasons stated above, this Court should uphold the Circuit Court's well-reasoned decision that the Durable Medical Equipment Exemption as written unconstitutionally discriminates against sellers with a principal place of business outside of South Carolina, and that the proper remedy is to strike down the unconstitutional requirement in the Exemption and thereby allow an exemption for gross proceeds from sales of durable medical equipment that otherwise meet the constitutional statutory requirements.

Respectfully submitted,



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ON APPEAL FROM LEXINGTON COUNTY
Court of Common Pleas
William P. Keesley, Circuit Court Judge

CASE NO. 2021-CP-32-02753
Appellate Case No. 2023-000317

KCI USA Inc.,... Respondent,

v.

South Carolina Department of Revenue, ... Appellant.

PROOF OF SERVICE

I certify that I have served the Respondent, KCI USA Inc.'s, Initial Brief via U.S. Postal Service, postage prepaid on June 2, 2023 at the following address:

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