

THE STATE OF SOUTH CAROLINA

In the Court of Appeals

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APPEAL FROM THE ADMINISTRATIVE LAW COURT

SC Court of Appeals

Milton G. Kimpson, Administrative Law Judge

Case No. 20-ALJ-17-0008-CC

Appellate Case No. 2024-001252

Mastercard International Incorporated,Appellant,

v.

South Carolina Department of RevenueRespondent.

RESPONDENT SOUTH CAROLINA DEPARTMENT OF REVENUE'S FINAL BRIEF

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INTRODUCTION

Mastercard operates a global payments network that connects cardholders, merchants, and banks to facilitate cashless payments for goods and services. For decades, Mastercard has marketed its services using the ubiquitous, recognizable refrain: “There are some things money can’t buy; for everything else, there’s Mastercard.” As Mastercard acknowledges, these advertisements are not directed to banks, but to cardholders and merchants. What service is Mastercard advertising? The provision of a payment processing network designed to enable cardholders to purchase the “everything else” by using their Mastercard branded card at millions of merchant locations around the world. Every time a Mastercard is used, wherever it is used, Mastercard produces income.

South Carolina law requires multistate corporations that conduct business or have income in South Carolina to pay an annual corporate income tax on the proportion of their income that is reasonably attributable to their business activities in this state. For service providers like Mastercard, that proportion is determined using a fraction (or ratio) based on the gross receipts generated from the corporation’s “income-producing activity” that occurs in South Carolina versus everywhere else.

Mastercard is ubiquitous in South Carolina. South Carolina banks offer Mastercard branded credit and debit cards. The Mastercard logo appears at point-of-sale systems in retailers, offices, and other businesses across the state. Mastercard advertises and markets its network here through television, social media, and printed materials, as well as promotions and sponsorships and at sporting and entertainment events. Cardholders and merchants can buy and sell goods and services in South Carolina using electronic payment instead of cash only because the Mastercard network exists here.¹

Although Mastercard markets its network as “Priceless,” its services come with a price tag. Whenever a Mastercard cardholder makes a purchase or accesses an ATM in South Carolina,

¹ Mastercard even enables South Carolina taxpayers to pay their tax obligations to the State using a Mastercard. *See* <https://dor.sc.gov/iit-filing> (last accessed Jan. 7, 2025).

Mastercard generates fees from the transaction. It assigns fees to various discrete functions within its overall payment processing services, which it charges directly to its network banks. But Mastercard has chosen to structure its fee-based revenues to be wholly dependent upon the participation of cardholders and merchants, not just banks. Mastercard does not earn any income unless these customers—cardholder and merchant—use a Mastercard branded card in a cashless transaction. The amount of its fees is directly determined by the number and dollar volume of those transactions. If no merchants accept its cards or no cardholders use them, Mastercard’s network generates no income.

During the tax years at issue (2006–2017), Mastercard cardholders and merchants engaged in 1.39 billion credit and debit card transactions for the purchase and sale of goods and services in South Carolina. The dollar volume of those transactions totaled \$83.2 billion. Every transaction was facilitated by Mastercard via its network. Each transaction produced income for Mastercard.

Notwithstanding Mastercard’s business activity in this state, prior to this litigation “the company didn’t feel” like it had any connection (nexus) with South Carolina whatsoever. So it never filed a South Carolina corporate income tax return, and never paid any corporate income taxes to the State. Mastercard maintains it has no corporate tax obligations in South Carolina, arguing its network does not exist here, it has no income-producing activities here, and it does not earn income here. It narrowly defines its income-producing activity as only the transmission of 0s and 1s between data centers and processing machines that are located outside South Carolina. And despite operating a self-described “four party” payments network and promoting Mastercard usage and acceptance to cardholders and merchants throughout South Carolina and beyond, it makes the extraordinary claim those cardholders and merchants are not included among its customers.

The Administrative Law Court correctly rejected Mastercard’s argument, and did not err in upholding the Department’s determination that Mastercard owes corporate income tax to South Carolina. Respectfully, this Court should affirm.

COUNTER-STATEMENT OF THE ISSUES ON APPEAL

- I. Does substantial evidence support the ALC's findings that Mastercard's income-producing activity is the provision of its payment processing network in South Carolina?
- II. Did the ALC correctly conclude the Department's proposed gross receipts ratio for sourcing Mastercard's income to South Carolina reasonably approximated Mastercard's business activity here, as required under section 12-6-2295(A)(5)?
- III. Did the ALC abuse its broad discretion to qualify Professor Hawkins as an expert in "consumer credit markets" and admit his testimony, which was consistent with and supported by substantial record evidence?
- IV. Did the ALC err by declining to waive the statutorily mandated penalties for Mastercard's failure to file, where Mastercard conceded income tax nexus with the state and did not prove its failure to file was reasonable?

STATEMENT OF THE CASE

This matter came before the ALC in accordance with the Administrative Procedures Act, S.C. Code Ann. § 1-23-310 et seq., and the Revenue Procedures Act, S.C. Code Ann. § 12-60-10 et seq. Mastercard International Incorporated (Mastercard) requested a contested case hearing to challenge a final agency Determination issued by the South Carolina Department of Revenue (Department) on December 19, 2019. (R. pp. 207–29). The Determination found that Mastercard had income tax nexus with South Carolina and was required to source to South Carolina a portion of its income related to the payment network services it provides in this state. The Department assessed Mastercard corporate income taxes, license fees, penalties, and interest for tax years 2006 through 2017 (Audit Period). (R. p. 207). Following a contested case hearing on March 8–11, 2022, the ALC entered a Final Order and Decision (Final Order) on June 3, 2024, upholding the Department's Determination in all respects except that the ALC partially waived the penalties for Mastercard's failure to timely pay its taxes. (R. p. 53). The case was reassigned to a different administrative law judge that, after reviewing the record evidence, reached the same findings and conclusions and therefore denied Mastercard's Motion for Reconsideration on July 2, 2024. (R. pp. 1–3). Mastercard filed its Notice of Appeal on July 30, 2024.

STATEMENT OF THE FACTS

1. Mastercard's business operations.

Mastercard is a “leading global payments company” that “connects consumers, financial institutions, merchants, governments and businesses worldwide, enabling them to use electronic forms of payment instead of cash and checks.” (R. pp. 4562, 5342). Mastercard operates the “MasterCard Worldwide Network” (Network), a proprietary, global telecommunications network that facilitates the authorization, clearing and settlement of cashless transactions. (R. p. 4249). By providing these transaction processing services through its Network, Mastercard enables its cardholders to use their Mastercard branded cards at millions of acceptance locations worldwide. *Id.*

The Network uses a “four party” model for payment processing, which includes Mastercard and four other parties:

- **Cardholder:** an individual or business authorized to use a Mastercard branded card to pay for goods or services.
- **Merchant:** a seller of goods and services who is authorized to accept Mastercard branded cards as payment.
- **Acquirer:** the “merchant’s bank” or the financial institution used by a merchant to process credit/debit transactions.
- **Issuer:** the “cardholder’s bank” or the financial institution that issues a Mastercard branded credit or debit card, authorizes payment on the cardholder’s behalf, and allows the cardholder to carry a credit balance.
- **Mastercard:** the “fifth party” that owns and operates the payment network.

(R. pp. 271–72, 790); (R. p. 4562) (“A typical transaction processed over our network involves four parties in addition to us.”); (R. p. 2758) (providing definitions).

a. The typical Mastercard transaction.

There are three basic steps to a transaction on the Network: authorization, clearing, and settlement. Mastercard controls and facilitates each step. In a typical transaction, a Cardholder

purchases goods or services from a Merchant using a Mastercard branded card. (R. p. 4877). Mastercard's authorization process begins when a cardholder presents a Mastercard as payment for a transaction and ends when the Merchant and the Cardholder are advised if payment is approved. (R. p. 2883). Through the Network, Mastercard delivers an authorization request from the Acquirer bank, on behalf of the Merchant, to the Issuer. (R. pp. 4249, 5346). The Issuer approves or denies the request and the process is reversed. Mastercard delivers the Issuer's response back through the Network directing the Acquirer and Merchant how to proceed with the transaction. (R. pp. 2934, 441).

The Network includes Mastercard Interface Processors (MIP) that perform various functions including delivering transaction authorization request and response messages. A MIP is a server that runs Mastercard proprietary software; it is owned by Mastercard and leased to the Acquirers and Issuers. (R. pp. 301–02, 442, 486–91, 2928–36). A MIP is typically located at a bank's facility; there are no MIPs in South Carolina. (R. p. 330). Mastercard's authorization platform also extends to the "point of interaction" (POI), meaning the location at which a transaction occurs, and Mastercard controls various aspects of the Network's operation at the POI. (R. pp. 1400–01, 2918).²

Mastercard divides the authorization process into twelve distinct steps, but in most instances authorization takes less than seven seconds and as little as 130 milliseconds. (R. pp. 478, 908). Mastercard operates its authorization platform "on a continuous basis," providing access to "All Customers 24 Hours a Day, 365 Days a Year," which "ensur[es] that cardholders can use a Mastercard card anytime." (R. p. 2920) (emphasis added).

In the clearing process, Mastercard facilitates the exchange of financial transactional information between Issuers and Acquirers for transactions that are authorized and completed. (R. p. 5346). Mastercard analyzes and processes financial transaction information it receives from the banks

² Mastercard dictates the use of the Mastercard acceptance mark at the POI, requirements for ATMs and POI terminals, discounts and other benefits that may be applied at a POI, and whether and how Merchants may apply surcharges to Cardholders at the POI. (R. pp. 1497, 1572).

and provides Acquirers and Issuers regular reports detailing their net settlement position (i.e. what each bank owes or is owed). (R. pp. 319, 519) (testimony of Mastercard's senior executives). Issuers often use this information to bill Cardholders. *Id.* Transactions are not "relayed for clearing" unless they were "previously authorized." (R. p. 2894).

Finally, Mastercard provides settlement services to facilitate the exchange of funds (and associated fees) between banks in the Network based on their net settlement position as determined in the clearing stage. (R. pp. 539, 543, 5346). Settlement occurs within days of clearing and allows Acquirers to collect funds from Issuers and reimburse Merchants. (R. pp. 323, 3415). Mastercard guarantees the settlement of many Network transactions to "ensure the integrity of [the Mastercard Network]." (R. p. 4245).

b. Mastercard governs all aspects of a transaction on its Network through formal, mandatory Standards that apply to all transaction participants.

Mastercard has established and enforces a comprehensive framework of written requirements that govern each step of the transaction and regulate the interconnected relationships of all five Network participants. (R. pp. 290–91, 4245). These "Standards," as Mastercard describes them, consist of thousands of pages of rules, manuals, guides, bulletins, and policies, as updated. (R. p. 2487).³ The Standards "enable the seamless acceptance and processing of Mastercard transactions" at a global and local level so that consumers, businesses, and merchants will choose to use Mastercard's products. (R. pp. 327, 407–08). These Standards are so critical to the viability and profitability of the Network that Mastercard believes "failure to comply with any Standard(s) may cause damage to [Mastercard] in an amount difficult to calculate." (R. p. 1430).

³ The record contains other documents that are also incorporated into the Standards, such the GCMS Reference Manual, Mastercard Settlement Manual, and the Expert Monitoring System Product. (R. pp. 3402–4206).

The Mastercard Rules are the “backbone” of Mastercard’s Standards. (R. pp. 372–73, 2487). Acquirers and Issuers are required to follow the Mastercard Rules to ensure the integrity and reliability of the Network; a safe and secure Network benefits all five participants in a transaction. (R. pp. 327, 407–08). Acquirers must have a Merchant Agreement with any Merchant that accepts Mastercard; the terms and substance of which are dictated by the Mastercard Rules and cannot conflict with the Standards. (R. p. 1723). Mastercard imposes daily fines on any Acquirer that uses the Network for a Merchant that does not have a Merchant Agreement. (R. p. 1725).

By prescribing the terms of the Merchant Agreement, Mastercard controls the Merchant’s use of the Network and dictates what the Merchant must (and must not) do when a card is presented for payment. For example, Mastercard imposes requirements on how a Merchant interacts with the Cardholder at the POI, including on the Merchant’s web site. (R. p. 1734). Merchants can use the Mastercard logo only in accordance with the Mastercard Rules and must “prominently display the MasterCard Acceptance Mark at the point of interaction to indicate the Merchants accepts Cards.” (R. pp. 1735–36). Merchants must honor all valid Mastercard branded cards when presented for payment, cannot require Cardholder identification beyond what the Rules provide, are prohibited from charging Cardholders certain transaction surcharges or requiring a minimum/maximum transaction amount, and are prohibited from any practice that discriminates against or discourages the use of a Mastercard branded card in favor of any other brand. (R. pp. 1738–41, 421–22). If a Merchant fails to comply with the Standards, Mastercard fines the Acquirer. *Id.*

Mastercard also uses a Mastercard License Agreement (MLA) to govern each licensee’s use of Mastercard’s “marks” in connection with authorized payment and merchant-acceptance programs. (R. pp. 290–92, 2824–30). Mastercard’s marks have value in facilitating transactions between Cardholders and Merchants, so the MLA requires licensees to abide by the Standards, including the Mastercard Rules. (R. pp. 839–40). By displaying the Mastercard logo, a Merchant demonstrates the transaction is

governed by the Standards, which allows Cardholders to trust the security of the transaction. *Id.* Only Merchants who accept a Mastercard payment brand are authorized to display the Mastercard trademark. (R. pp. 838–39).

The Mastercard Authorization Manual covers the minutia of the Authorization Platform. The Manual contains “instructions, directives, [and] requirements” for the Acquirers and Issuers to “set their policies to be compliant with Mastercard.” (R. pp. 490–91, 2896). Like the Mastercard Rules, the Authorization Manual also directs the conduct of Merchants by requiring various terms in the contracts between Acquirers and Merchants. (R. pp. 830, 2953). Merchants must inform and obtain a Cardholder’s consent related to processing an estimated preauthorization request. (R. p. 3092). When Mastercard delivers an authorization response it “always prompts” the Merchant to take one of the following actions: approve, decline, refer card to issuer, capture card, or valid (not declined). (R. p. 2934) (emphasis added). Merchants are even required to use their best efforts to “retain” an invalid Mastercard branded card by “reasonable and peaceful means.” (R. pp. 491, 2935).

The Authorization Manual also details various measures Mastercard takes to protect Cardholder integrity, such as fraud alerts, expert monitoring, and real time fraud scoring. To provide these Cardholder services, Mastercard maintains data for each card, including a Cardholder’s account number, card number, and purchase history, and analyzes this card account data to alert Acquirers, Issuers, and Merchants about fraud risk associated with a particular card/transaction. (R. pp. 493–98, 3158–64). These services are designed to ensure Cardholders trust—and therefore use—the Network. (R. pp 500–01).

- c. **Mastercard’s derives its income from fees it generates for providing a Network that facilitates cashless transactions between Cardholders and Merchants.**

Mastercard generates revenues from fees it charges for “providing transaction processing and other payment-related services (operations fees) and by assessing our customers based primarily on

the dollar volume of activity on the cards that carry our brands (assessments).” (R. pp. 395–96, 818, 2811–2818, 4245). Mastercard classifies its revenue streams into five categories, each of which are based either on the number or gross dollar volume of Mastercard branded transactions (or a combination of the two): domestic assessment fees; cross border volume fees; transaction processing fees; other income; and rebates and incentives. (R. pp. 578, 4574).⁴ Mastercard’s Summary of Costs contains its fee structure and a detailed list of the “major fees”⁵ that its member banks are expected to pay, which it identifies generally as licensing fees, assessment fees, and transaction and network interface fees. (R. pp. 332, 819, 2779–823).

Mastercard acknowledges each of these fee-based revenue streams are directly impacted by the use of cards carrying the Mastercard brand and the number/gross dollar volume of transactions Mastercard processes. (R. pp. 4248, 4764). For example, Mastercard reported that in 2010 and 2011 its gross revenues increased 12.5% (\$841 million) and 18.2% (\$1.4 billion), respectively, “primarily due to the increased dollar volume of activity on cards carrying our brands and increased transactions.” (R. p. 4770). Consequently, Mastercard generates fees from South Carolina transactions in direct proportion to the number of Merchants here and the number and dollar volume of Cardholder transactions here. (R. pp. 25, 826). As those metrics increase, so does Mastercard’s income. (R. pp. 395–96, 824).

2. The Department’s audit

The Department initiated an audit of Mastercard in 2017. Prior to the audit, Mastercard had never paid South Carolina corporate income taxes or filed a corporate income tax return with the

⁴ “Other income” is a catchall and smallest of the revenue streams; it is based on the dollar amount of Mastercard’s assessment fees, cross border dollar volume fees, and transaction processing fees. Rebates and incentives are a contra-revenue stream. (R. pp. 581–82, 4574).

⁵ These major fees include items like annual license fees, initiation fees, merchant location fees, issuer assessments, brand volume fees, quarterly assessment fees, domestic/international settlement fees, authorization-processing fees, access fees, and ATM switch fees, to name a few. (R. pp. 332, 818–19, 848–49, 2779–823).

Department. (R. pp. 575, 692, 700, 6494–517). Because Mastercard had never filed returns or paid income tax, the Department was authorized to extend the audit beyond the typical 36-month period to include tax years 2007–2016. (R. p. 571); *see* S.C. Code § 12-54-85.

On March 26, 2018, the Department issued its Proposed Assessment to Mastercard. (R. p. 5533). The Proposed Assessment concluded Mastercard was doing business in the state during the Audit Period and therefore had income tax and license fee nexus in South Carolina. (R. p. 5548); *see* S.C. Code Ann. § 12-3-530. Specifically, Mastercard had employees in the state, licensed intangibles (its trademarks and brands) for use in the state, contracted with businesses that operate in the state, and generated substantial income in the state from fees based on transactions initiated in South Carolina. (R. pp. 576, 5548).

The Proposed Assessment determined Mastercard's business in South Carolina is its provision of a credit card network that allows Cardholders and Merchants to consummate card purchases in South Carolina. *Id.* Mastercard earns income from the fees it receives for the services it provides through the Network; those fees are generated when a transaction is initiated over the Network. The Proposed Assessment found that Mastercard's major revenue streams are directly and wholly generated from its Network. It concluded that because Mastercard's income producing activity (providing a payment systems network) is performed partly in South Carolina, it should have sourced to South Carolina the gross receipts it earned from fees generated by transactions that occurred in South Carolina. (R. pp. 576–84, 5533–6282, 6602).

Because Mastercard did not offer any data to establish the actual income it generated from transactions initiated in the state, the Proposed Assessment used other data obtained from Mastercard to calculate a proxy for the gross receipts generated from transactions in South Carolina. That data included the total number of Mastercard transactions in South Carolina and the United States for each year of the audit, as well as the annual gross dollar volume (GDV) for those transactions. (R. pp. 585–

86, 6183–202). The gross receipts ratio varied each year of the Audit Period, ranging from 0.4948% to 0.6227%. (R. pp. 574, 5538–43, 6613). Using these gross receipts ratios, the Department assessed Mastercard total income tax and license fees of \$6,126,142.07, penalties of \$2,594,336.56, and interest of \$851,026.98 for the Audit Period. Mastercard did not dispute the Department’s calculations in the proposed assessment; rather, Mastercard only disputed the sourcing methodology. (R. pp. 600–01, 624, 645).

STANDARD OF REVIEW

The Administrative Procedures Act governs appellate review of decisions from the ALC. This Court may not substitute its judgment for that of the ALC as to the weight of the evidence on questions of fact, and may reverse the ALC only if its finding, conclusion, or decision was:

- (a) in violation of constitutional or statutory provisions;
- (b) in excess of the statutory authority of the agency;
- (c) made upon unlawful procedure;
- (d) affected by other error of law;
- (e) clearly erroneous in view of the reliable, probative, and substantial evidence on the whole record; or
- (f) arbitrary or capricious or characterized by an abuse of discretion or clearly unwarranted exercise of discretion.

S.C. Code Ann. § 1-23-610(B); *DIRECTV, Inc. & Subsidiaries v. S.C. Dep’t of Revenue*, 421 S.C. 59, 68, 804 S.E.2d 633, 638 (Ct. App. 2017).

Judicial review of the ALC’s findings of fact is limited to determining if the findings are supported by “substantial evidence.” *MRI at Belfair, LLC v. S.C. Dep’t of Health & Envtl. Control*, 379 S.C. 1, 6, 664 S.E.2d 471, 474 (2008). Substantial evidence is evidence which, when considering the record as a whole, would allow reasonable minds to reach the conclusion that the ALC reached. *Books-A-Million, Inc. v. S.C. Dep’t of Revenue*, 430 S.C. 388, 391, 844 S.E.2d 399, 400–01 (Ct. App. 2020). When the evidence conflicts on an issue, the court’s substantial evidence standard of review defers to the findings of the fact-finder, and the mere possibility of drawing two inconsistent conclusions from the

evidence does not prevent a finding from being supported by substantial evidence. *Risher v. S.C. Dep't of Health & Envtl. Control*, 393 S.C. 198, 210, 712 S.E.2d 428, 435 (2011).

The admission of nonscientific expert testimony is within the sound discretion of the ALC and will not be reversed absent a prejudicial abuse of discretion. *State v. White*, 382 S.C. 265, 269, 676 S.E.2d 684, 686 (2009). If the record reflects the ALC exercised its discretion according to law, the appellate courts “will almost always affirm the ruling,” even if a witness’s qualifications as an expert “present a close question.” *State v. Wallace*, 440 S.C. 537, 541, 892 S.E.2d 310, 312 (2023).

ARGUMENT

This Court should affirm the ALC’s decision because the applicable standards of review compel it. What Mastercard’s income-producing activity is, and where it occurs, is a question of fact. *DIRECTV, Inc. & Subsidiaries v. S.C. Dep’t of Revenue*, 421 S.C. 59, 80–81, 804 S.E.2d 633, 644, (Ct. App. 2017). In light of the evidence, the ALC found Mastercard’s arguments unpersuasive and that Mastercard had failed to satisfy its burden to prove the Department’s assessment was incorrect. *Id.* Conversely, the ALC found the preponderance of the evidence supported the Department’s position that Mastercard’s income-producing activity is the provision of a payment processing network, which it provides—in part—in South Carolina, and that its gross receipts attributable to South Carolina are reasonably represented by a ratio of transactions/volume in South Carolina versus everywhere else. Mastercard asks this Court to view the evidence differently than the ALC, but this Court should defer to the ALC’s findings because they are supported by substantial evidence. *Id.* at 78, 804 S.E.2d at 643.

Further, the ALC’s decision to qualify and admit Professor Hawkins’s expert testimony is not grounds for reversal. As the record demonstrates, the ALC “thoughtfully appl[ied] the correct law to the information and evidence before it” with respect to its decision to qualify Hawkins and allow him to testify. *Wallace*, 440 S.C. at 543, 892 S.E.2d at 313. This Court “almost always” affirms the trial court’s exercise of its discretion in ruling on the admissibility of evidence, and there is no reason for

this Court to depart from that deferential standard in this case. *Id.* Even if Professor Hawkins’s qualifications as an expert “present a close question,” it was not an abuse of discretion to qualify him, and this Court should not disturb that decision. *Id.* (citation omitted).

Finally, the ALC did not err by declining to waive penalties for Mastercard’s failure to file corporate income tax returns because the law mandates the assessment of penalties when, as here, the taxpayer fails to file. The ALC found Mastercard had failed to prove its failure to file was reasonable, and this Court should affirm the ALC’s decision under the substantial evidence standard of review.

I. Substantial evidence supports the ALC’s findings that Mastercard’s income-producing activity is the provision of its payment processing network in South Carolina.

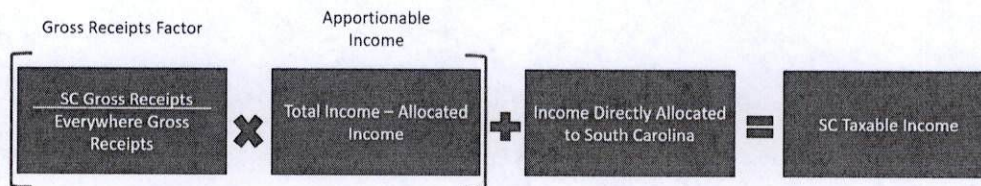
The South Carolina Income Tax Act (Act), S.C. Code Ann. § 12-6-10 et seq., provides the statutory framework for determining whether, and how, to tax the income of multistate corporations like Mastercard.

A. South Carolina imposes a corporate income tax on a fraction of a multistate corporation’s total income that reasonably represents the proportion of its business activities that occur in this State.

The Act imposes a five percent corporate income tax on the taxable income of every corporation that transacts, conducts, does business, or has income within this State, regardless of whether these activities are carried on in intrastate, interstate, or foreign commerce. *See* S.C. Code Ann. § 12-6-530. For taxpayers that do business in more than one state, Article 17 of the Act sets forth the rules for allocation and apportionment to determine the proper share of the taxpayer’s income that may be taxed by South Carolina. *See* S.C. Code Ann. § 12-6-2210 to -2320. Certain types of income are statutorily allocated to a specific state to be taxed by that jurisdiction. *See* S.C. Code Ann. § 12-6-2220. The remaining income is apportioned among the states in which the taxpayer does business.

As the Supreme Court has previously held, “the apportionment formula is a reasonable basis for establishing the income tax of corporations [that] . . . do business on a multistate level.” *Eastman Kodak Co. v. S.C. Tax Comm'n*, 308 S.C. 415, 419, 418 S.E.2d 542, 544 (1992). The purpose of Article 17 is to ensure South Carolina imposes the tax upon a base that “reasonably represents the proportion of the trade or business carried on within this State.” S.C. Code Ann. § 12-6-2210(B) (emphasis added); *see also Hertz Corp. v. S.C. Tax Comm'n*, 246 S.C. 92, 95, 142 S.E.2d 445, 446 (1965) (noting the legislative purpose). Although apportionment seeks to be as exact as possible, “all that is required is a reasonable approximation.” *Covington Fabrics Corp. v. S.C. Tax Comm'n*, 264 S.C. 59, 66, 212 S.E.2d 574, 577 (1975). This method is consistent with constitutional requirements for taxing corporations engaged in interstate commerce. *See Geoffrey, Inc. v. S.C. Tax Comm'n*, 313 S.C. 15, 23, 437 S.E.2d 13, 18 (1993).

For most businesses,⁶ South Carolina apportions a taxpayer’s income using a single factor apportionment formula based on either its sales or gross receipts, depending on the nature of the taxpayer’s business. If a taxpayer is principally in the business of providing services, its South Carolina taxable income is calculated by multiplying its apportionable income by the gross receipts factor (i.e. gross receipts from within South Carolina sales, divided by gross receipts from everywhere), plus any income directly allocated to the State:



See S.C. Code Ann. §§ 12-6-2252, -2280.

The Act defines “gross receipts” from services to mean “Receipts from services if the entire income-producing activity is within this State. If the income-producing activity is performed partly

⁶ S.C. Code Ann. § 12-6-2310 requires an industry-specific apportionment formula for certain taxpayers.

within and partly without this State, sales are attributable to this State to the extent the income-producing activity is performed within this State.” S.C. Code Ann. § 12-6-2295(A)(5).

Thus, for multistate taxpayers that receive income from providing services, the receipts from those services are attributed (i.e. “sourced”) to South Carolina for income tax purposes based on a reasonable approximation of the proportion to which the income-producing activity related to those services is performed in South Carolina. The statutory policy for sourcing income in section 12-6-2295(A) is designed to apportion to South Carolina a fraction of the taxpayer’s total income that is “reasonably attributable to its business activity in this State.” *DIRECTV, Inc. & Subsidiaries v. S.C. Dep’t of Revenue*, 421 S.C. 59, 70, 804 S.E.2d 633, 639 (Ct. App. 2017); *Hay v. S.C. Tax Comm’n*, 273 S.C. 269, 255 S.E.2d 837 (1979).

B. A service provider’s income-producing activity is the service that participants in a transaction (if that transaction produces the taxpayer’s income) want in exchange for payment.

The Act does not define “income-producing activity.” Section 12-6-2295(A)(5) applies to a wide range of different and often diverse service industries and taxpayers. What the income-producing activity is and where it occurs may vary from one case to the next. The statute does not require the income-producing activity to be measured using any particular method or proxy. Therefore, consistent with this flexible approach adopted by the General Assembly, the Department’s practice is to examine the unique nature and nuances of each taxpayer’s industry/business to determine the relative amount of a taxpayer’s income-producing activities in this state. (R. p. 670). As the ALC noted, this approach is also consistent with this Court’s precedent. *See DIRECTV*, at 71, 804 S.E.2d at 639 (“In South Carolina, the nature of the taxpayer’s business in the state determines the method of apportionment a taxpayer must use.”); *Lockwood Greene Engineers, Inc. v. S.C. Tax Comm’n*, 293 S.C. 447, 450, 361 S.E.2d 346, 348 (Ct. App. 1987) (noting with approval that the statute permits different methods for different industries when determining where to source gross receipts from services).

Generally, income-producing activity is the purpose or reason that participants pay to enter a transaction (or combination of transactions), which produces income for the service provider (taxpayer). That is, with respect to the transactions that provide the taxpayer's income, the income-producing activity is what participants in that transaction(s) want in exchange for payment.

For example, in *Mercury Motor Exp., Inc. v. S.C. Tax Comm'n*, 244 S.C. 134, 135 S.E.2d 756 (1964), the Supreme Court examined the income-producing activity of a Florida interstate motor carrier that transported freight to, from, and through South Carolina. The taxpayer admitted it was liable for tax on a portion of its income (1%) using an apportionment ratio based on its revenue from freight originating in or delivered to South Carolina versus elsewhere. The Tax Commission's ratio used the taxpayer's total mileage in South Carolina/everywhere, resulting in a tax on 17% of its income. The taxpayer objected to the mileage formula, claiming that *delivering to* South Carolina was a taxable event, but *driving through* it was not, so the Commission was unconstitutionally taxing income it earned beyond the borders of South Carolina. *Id.* at 137, 135 S.E.2d at 757–58.

In affirming the Tax Commission's position, the Supreme Court anchored its analysis in a series of non-South Carolina cases. *Id.* at 139–42, 135 S.E.2d at 759–60. Importantly, in each of those cases the state used a different method of apportionment, based on the unique activities of the taxpayer. The Supreme Court examined the unique facts of the taxpayer's freight hauling business, noting that it consisted of a series of discreet transactions such as solicitation; pick up, hauling, and deliver; and collecting the hauling charges. Although each of those transactions contributed to produce the taxpayer's income, the hauling of the freight as its trucks traversed South Carolina roads was the activity that ultimately produced income. That is, the service the freight's owners wanted in exchange for payment was for the freight to be hauled from one location to another. To the extent that hauling was done in South Carolina, the taxpayer had income-producing activity in this state. *Id.*

Similarly, in *Lockwood Greene Engineers, Inc. v. S.C. Tax Comm'n*, 293 S.C. 447, 361 S.E.2d 346 (Ct. App. 1987), the issue was whether “gross receipts from within this State” (under the then-applicable sourcing statute for service providers) looked to where the taxpayer’s customers were located and payments made or where the services were performed. This version of the sourcing statute did not include the term “income-producing activity,” but the Court’s analysis focused on what services the engineering firm provides and, conversely, the services (or activity) for which a client pays an engineering firm (the expertise and time of its employees) that produces income for the firm. With a view of the purpose and policy of the sourcing statute—to tax the income that reasonably reflects taxpayer’s business in South Carolina—the Court concluded the firm’s income should be sourced to the location where the engineer provided those services, i.e. the location of the engineer. *Id.* at 447, 361 S.E.2d at 346.

Importantly, as was true in *Mercury Motors*, the holding in *Lockwood Greene* presumes the necessity of examining the nuances of specific industries and the unique activity that produces income for each taxpayer, and it approved the use of different sourcing methods for different industries. For example, the Court of Appeals noted the sourcing method—where the services are performed—for an engineering firm was analogous to the way income is sourced for similar personal professional service firms (e.g. law firms, accounting firms, entertainment and sports companies, and hospitality management companies). *Id.* at 450, 361 S.E.2d at 348. But it was permissibly different from the method used for other businesses that were not comparable to the engineering firm (e.g. finance companies and media broadcasters). *Id.*

In *DIRECTV, Inc. v. S.C. Dep’t of Revenue*, 421 S.C. 59, 804 S.E.2d 633 (Ct. App. 2017), the Court of Appeals again premised its sourcing analysis on an evaluation of the nature of DIRECTV’s business, before determining the method by which its income should be attributed to South Carolina. The Court found DIRECTV is in the business of providing access to digital television entertainment

to customers across the United States, in exchange for a subscription fee. *Id.* at 64; *see also id.* at 77. Its subscribers pay DIRECTV primarily for the equipment to access the satellite signal/network to receive the television content it delivers. *Id.* Importantly, the Court distinguished DIRECTV from the taxpayer in *Lockwood Greene*, noting that the “service DIRECTV provides is entirely different from *Lockwood Greene* and DIRECTV’s source of income does not derive from its engineers, but rather from subscriptions to its programming packages.” *Id.* at 75–76. Thus, the Court determined that DIRECTV’s income producing activity was “the delivery of its programming signal to its customers across the country and in South Carolina.” *Id.*

Critically, the Court found DIRECTV’s income-producing activity was the delivery of the satellite signal because that was the activity that actually generates income for DIRECTV in the form of subscriptions. *Id.* at 75–76, 78. In other words, the income-producing activity was what the participants in the transaction (monthly subscribers) want in exchange for paying the monthly subscription fee—television programming. And providing access to that satellite signal both in South Carolina and elsewhere produced the subscription fees that were DIRECTV’s income.

These decisions are informative because they recognize the General Assembly has provided a flexible sourcing standard that is based upon the income-producing activity for a given industry or taxpayer. But these decisions, including *DIRECTV*, are not dispositive and do not announce a one-size-fits all rule that is binding on the unique facts of this case because none of them analyze the payment processing industry or the nuances of Mastercard’s particular business.

The ALC’s decision, by contrast, did analyze Mastercard’s payment processing network. The ALC’s 50-page Final Order exhaustively examined the evidence and testimony, properly considered the credibility of each witness, and made extensive factual findings based on a thorough examination of Mastercard’s business model, the manner in which transactions facilitated on the Network, and Mastercard’s role in providing the Network. The ALC correctly identified Mastercard’s income-

producing activity under section 12-6-2295(A)(5): providing a payment system (the Mastercard network) to Cardholders, Merchants, and Issuing and Acquiring Banks so that these parties can exchange goods and services “without simultaneous payment by cash or check.” (R. p. 30). It then correctly determined that income-producing activity occurs, in part, in South Carolina, and that a reasonable approximation of that activity performed here is measured by the number and dollar volume of transactions that occur here.

C. Mastercard’s income-producing activity is the provision of its network to facilitate cashless transactions, including in South Carolina.

At its core, every business exists because it has identified a problem and found a way to charge for the solution. Mastercard’s business solves the problem of the two-sided market, in which buyers and sellers meet to exchange a good or service. (R. pp. 793, 800–01). Its solution is the Mastercard Network, a global payment system that “connects consumers, financial institutions, merchants, governments and businesses worldwide, enabling them to use electronic forms of payment instead of cash and checks.” (R. p. 5342); *see also* *Ohio v. Am. Express Co.*, 585 U.S. 529, 534–35, 138 S. Ct. 2274, 2280 (2018) (noting Mastercard is one of the four dominant credit card companies that operate a “two-sided platform,” i.e. credit card network, that brings together cardholders and merchants to enable them to make a transaction).

By creating and maintaining the Network’s physical and relational infrastructure, developing and enforcing a single set of rules that apply to all participants in the Network, and providing a safe and reliable Network that efficiently processes transactions, Mastercard provides a service that Merchants, Cardholders, and banks alike can trust. The participants can trust that a card issued in one state can be used to complete a transaction in another. Merchants can trust the bill will be paid because the card bears the Mastercard mark. Customers know where their card is accepted and can trust the Network will protect them against fraudulent charges when their account is accessed. All parties can

trust the transaction will be processed quickly and correctly. *Am. Express Co.*, 585 U.S. at 535, 138 S. Ct. at 2281 (“[T]he value of the services that a two-sided platform provides increases as the number of participants on both sides of the platform increases. A credit card, for example, is more valuable to cardholders when more merchants accept it and is more valuable to merchants when more cardholders use it.”). Because they trust the Network, they use it. And every time they use it, whether in South Carolina or elsewhere, the Network produces income for Mastercard.

Just as this Court found that DIRECTV’s income-producing activity was the delivery of its television programming to its subscribers, the ALC relied on a record “replete with evidence” to find that Mastercard’s income-producing activity is the delivery or provision of a worldwide payment Network that facilitates cashless transactions between Merchants, Cardholders, Issuers, and Acquirers. (R. pp. 31, 33, 39, 41, 44, 48, 54).

This Network existed and operated in South Carolina during the Audit Period. Mastercard had employees here. (R. p. 576). It licensed its marks for use here, and its logo was displayed at Merchant locations and banks across the state. *Id.* It contracted with at least a dozen banks here, requiring them to issue a certain number of cards, follow the Standards (and ensure Merchants do too), and pay fees to Mastercard whenever those cards were used. Mastercard marketed and advertised its Network here, with the primary goal of inducing Cardholders and Merchants to use Mastercard branded cards for transactions throughout the state. It worked: during the Audit Period, those cards were used over a billion times in South Carolina.

Mastercard paints an overly narrow picture of its Network in order to claim that it has no (or miniscule) income-producing activity in South Carolina. It characterizes the Network as only its machines (hardware, software, MIPs, and data centers) and members (Issuer and Acquirer banks), and claims that its income-producing activity only occurs where those members and machines are physically located. (Appellant Br. at 19). The ALC was right to reject this distorted view because it

understates the comprehensive nature of the service the Network provides and completely ignores the two essential participants in every transaction, without whom Mastercard would generate no income.

1. Mastercard's network is more than just MIPs and data centers.

There is no doubt Mastercard built, maintains, and manages the Network infrastructure that connects Issuer and Acquirer banks—but that system also includes Cardholders and Merchants wanting to transact business without using cash. Thus, Mastercard's contention that it generates revenue only at the MIPs or data centers (because that is where it transmits data for authorization, clearance, and settlement) grossly oversimplifies Mastercard's role in overseeing and operating the entire Network and ignores the realities of what actually produces Mastercard's income for facilitating “the routing and processing of financial transactions.” (R. p. 2919).

Long before a Mastercard computer transmits data, Mastercard developed and implemented Standards to “provide a framework under which we operate” and “clear direction” about the responsibilities of all four parties in the Network. (R. p. 1487). It is impossible to overstate the comprehensive nature of the Standards. Through thousands of pages of rules and requirements, many of which are updated and revised annually, Mastercard controls every aspect of the Network to ensure its integrity—and value. The Standards' far-reaching requirements belie Mastercard's litigation position that its worldwide Network ends at the MIPs machines or that its income-producing activity is limited to delivering messages between the MIPs and data centers.

For example, Mastercard generates revenue by charging fees for authorization, which it describes as a 12-step process (a process Mastercard created). Mastercard claims its role is limited to only half of those steps and its only act that entitles it to authorization fees is delivering a message to an Issuer bank at step 10. (Appellant Br. 7–8, 22). But the Standards include a host of requirements that govern every step in the process. As Mastercard's witnesses testified and its Authorization Manual

explains, its Authorization Platform is intentionally designed to transmit authorization validation among Issuers, Acquirers, and the “points of interaction” (the point of sale where the transaction occurs) (emphasis added). (R. pp. 441, 478–79, 2771, 2918). The Authorization Platform must necessarily be accessed at the Merchant level in order to initiate (and consummate) a transaction. Thus, the Standards impose requirements on Merchants and POIs, including the information the terminals display and retain, how Merchants authenticate Cardholder data, and the process for reporting suspected fraud at the POI. (R. pp. 2954, 3151, 3171, 3263). Mastercard even publishes an *Installment Payment Service—Point of Interaction Eligibility and Enablement: Implementation Guide*. (R. p. 3231).

It makes sense for Mastercard to manage and control all 12 steps. Mastercard describes the Network as a “payments network,” not a “MIP network” or “message delivery service.” (R. p. 5342). The Network would have no utility if the authorization information was never communicated to the Merchant and Cardholder so that the transaction could proceed. It is precisely because Mastercard designed its Network to enable a Merchant and Cardholder to complete a transaction (not just convey approval or declining messages between banks) that Mastercard’s Network extends to the Merchant’s location.

2. Mastercard’s Network provides a service to more than just the member banks.

There is nothing in the plain language of section 12-6-2295(A)(5) that limits sourcing a taxpayer’s income-producing activities only by considering its “direct customers.” See, e.g., *Humana MarketPoint, Inc. v. Comm’r of Revenue*, 2024 WL 4997432, at *17 (MN Tax Court, Nov. 21, 2024) (rejecting argument that receipts from services must be sourced to the location of the “direct recipient/customer” and upholding a “look-through” sourcing approach that considered the “indirect beneficiaries” and “customer’s customer”). Even if section 12-6-2295(A)(5) required this analysis, the ALC correctly rejected Mastercard’s efforts to minimize its relationship with Cardholders and

Merchants in the payment processing ecosystem by hyper-focusing on only the “paying customers” (i.e. banks with whom it enters contracts) as the relevant parties to the income-producing activity analysis. (R. p. 38); (Appellant Br. at 19).

Undoubtedly, Mastercard’s member banks are necessary and important parties in the Network, but even those relationships exist for the purpose of serving the Network’s primary customers: Cardholders and Merchants. *Am. Express Co.*, 585 U.S. at 535, 138 S. Ct. at 2280 (“The key feature of transaction platforms is that they cannot make a sale to one side of the platform without simultaneously making a sale to the other. For example, no credit-card transaction can occur unless both the merchant and the cardholder simultaneously agree to use the same credit-card network.”).

The record supports the ALC’s conclusion that there is a customer relationship between Mastercard and the Cardholders/Merchants. Mastercard exercises significant control over how Merchants can participate in the Network, primarily by dictating specific terms in the Merchant Agreements. *See supra* p. 7. The terms are all-encompassing: they require Merchants to “prominently display” the Marks in “preferred locations”; limit how Merchants may use the Marks in advertising and point of interaction materials; dictate the wording, type size, color, and location of the mark on direct mail Cardholder solicitations by certain Merchants; mandate how and what they communicate to Cardholders regarding pre-authorization and authorization responses; and provide that Merchants must “honor all valid [Mastercards] without discrimination.” (R. pp.409–12, 831, 1738).⁷ Merchants must follow the Standards to remain in the Network, and Mastercard will penalize the Acquirers for the Merchant’s noncompliance. (R. p. 833). Notably, Mastercard groups noncompliance with the

⁷ Notably, Merchants have spent millions of dollars fighting whether they are required to comply with all of Mastercard’s mandates. (R. pp. 833–34); *see also In re Visa Check/Mastermoney Antitrust Litigation*, 297 F.Supp.2d 503 (E.D.N.Y. 2003) (awarding hundreds of millions of dollars in attorneys fees and costs to approximately five million merchants in antitrust class action, which alleged Mastercard illegally used its power in credit card services to force merchants to accept Mastercard debit cards).

Standards into three categories, one of which it describes as noncompliant conduct that is “visible to customers,” meaning Cardholders. (R. pp. 1431, 1484) (“A Merchant must maintain a policy that does not discriminate among customers seeking to make purchases with a Card.”) (emphasis added).

In South Carolina, Mastercard used its contracts with its member banks here (e.g. Summerville, Charleston, and Conway) to incentivize them to promote and issue Mastercard branded cards to Cardholders in this state. (R. pp. 2831–2879). In those agreements, Mastercard agreed to provide these South Carolina banks with various benefits, including card issuance support and a marketing signing or sign-on bonus. (R. pp. 2854, 2857). It agreed to reimburse them for expenses they incurred in marketing and promoting Mastercard issuance, activation, and usage in South Carolina. (R. pp. 2831–35). Mastercard provided monetary incentives to the banks based on the annual volume (dollar amount) generated by transactions for the purchase of goods and services using a Mastercard branded card in South Carolina. (R. p. 2849). In return, the South Carolina banks committed to issue and maintain Mastercard branded cards exclusively and not to be associated with or issue a card for any company Mastercard determines is its competitor, including Visa, Discover, American Express, and PayPal. (R. p. 2846). Mastercard does this because it earns no fees without Cardholders and Merchants using Mastercard branded cards.

Mastercard also offers a variety of services to its Cardholder customers in South Carolina. (R. pp. 852–56). Mastercard offers Cardholders the ability to pre-set spending limits (Spend Control Programs). (R. p. 3223). In emergencies, Mastercard provides Cardholders an Emergency Cash Advance or a replacement card. (R. pp. 2798–99). The Mastercard website provides a global ATM locator. (R. pp. 3201). The Merchant Data Cleansing Suite enables Cardholders to more easily identify potential fraud when reviewing their billing statements. (R. p. 3486). Mastercard controls elements of the communications from Issuer to Cardholder. (R. p. 1494). And it mines Cardholder data to capture their typical transactional behavior for use in programs like its Expert Monitoring Systems Real-time

Fraud Scoring, which is designed to detect and reduce fraud with the goal of increasing Cardholder satisfaction. (R. p. 4126). In fact, a portion of its “other revenues” are generated from “Cardholder services fees” for providing benefits to Cardholders. (R. p. 4770).

Mastercard admits its revenues are impacted by the Cardholder’s and Merchant’s use of its cards, but it contends this fact is irrelevant because they are not Mastercard’s “paying customers” and therefore, according to Mastercard, are not its customers at all. (Appellant Br. at 19, 22). This ignores a critical half of the participants that Mastercard’s four-party Network exists to serve. It is also inconsistent with Mastercard’s annual reporting that its “customers encompass a vast array of entities,” including financial institutions (like Issuers and Acquirers) “as well as merchants, governments and other businesses” (emphasis added). (R. pp. 5403, 5346) (describing how Mastercard grants licenses to and enforces participation standards on issuers, acquirers, and “other customers”).

The substantial evidence supports the ALC’s finding that Mastercard’s customer base is much broader than just Issuers and Acquirers. Each of these programs and services are specifically designed to benefit both Merchants and Cardholders, including those in South Carolina, because Mastercard’s four-party Network is effectively worthless if two of the four parties are absent.⁸ Mastercard may have direct contracts only with the member banks, but that does not change the fact that Cardholders and Merchants are beneficiaries of Mastercard’s services and necessary parties with respect to how

⁸ Mastercard claims it “doesn’t care” about where a Cardholder makes a purchase, nor does it “care about information regarding the merchant” because—in its view—none of that information is important for purposes of providing its services. (R. pp. 308–09, 351, 492). Yet Mastercard keeps and maintains data documenting the states where Merchants are located, the annual number of transactions by Merchants in each state, the value of those transactions, and the percentage allocation of those transactions in each state relative to the total country. (R. pp. 352–55, 6183). It also keeps certain data on Cardholders, including purchase history. (R. pp. 492–93). Why? Because without this information Mastercard could not provide the various services to Cardholders and Merchants outlined above. More importantly, Mastercard could not determine whether the South Carolina banks with whom it contracts had met their volume quotas unless Mastercard had information detailing transactions attributable to a certain card account during a specified period, and whether that card was issued by a specific South Carolina bank.

Mastercard produces income for purposes of the Act.⁹ No matter how “unequivocal” the self-serving testimony of Mastercard’s witnesses may be, the record evidence is clear that Mastercard’s day-to-day operations treat Merchants and Cardholders as a *sine qua non* of its Network. See Adam J. Levitin, PRIVATE DISORDERING? PAYMENT CARD FRAUD LIABILITY RULES, 5 Brook. J. Corp. Fin. & Com. L. 12 (2010) (discussing how payment card networks are “two-sided networks” with “four different types of customers” and categorizing them as “end customers” (merchants and consumers) and “intermediate customers” (acquirers and issuers)).

II. The ALC correctly concluded the Department’s proposed gross receipts ratio for sourcing Mastercard’s income to South Carolina reasonably approximated Mastercard’s business activity here, as required under section 12-6-2295(A)(5).

The ALC upheld the Department’s method for allocating and sourcing Mastercard’s income to South Carolina because it was a reasonable approximation of the income Mastercard earns from its income-producing activity here. (R. p. 50). The method is consistent with the statutory language and policy in section 12-6-2295(A)(5), and this Court should affirm it. See *DIRECTV*, 421 S.C. at 77, 804 S.E.2d at 642–43 (noting fees paid by subscribers in South Carolina should be included in the numerator of the gross receipts ratio because they reasonably represented the extent of DIRECTV’s income-producing activity in this state).

⁹ Mastercard makes much ado about the ALC’s statement that the “actual payors” of Mastercard’s fees are the Merchants and Cardholders. (Appellant Br. at 33). The ALC understood that the technical payor of the fees are the banks with whom Mastercard has a contractual relationship. The ALC’s comment was merely a recognition of the obvious: Mastercard has a financial, income-producing relationship with the Cardholders and Merchants. Without their transactions, Mastercard earns no fees. And the banks often pass on their fees to the Merchants, who in turn increase the cost of their goods and services. Thus, “the cardholder ends up paying for part of Mastercard’s fees indirectly.” (R. p. 857); see also Levitin, at 12 (discussing how interchange and network fees are “functionally pass-thru fees to the merchant”).

A. Substantial evidence supports the ALC's findings that Mastercard derives income from the fees it charges for providing its Network in South Carolina, based on the number and dollar volume of transactions that occur here.

It is undisputed that the Network is Mastercard's revenue generator and Mastercard's five income streams are the result of Mastercard branded cards being used to purchase goods or services. As Mastercard describes in its annual 10-K, it generates both volume-based revenues and transaction-based revenues, derived from fees it charges for providing the Network. (R. pp. 4718, 4801; 4233–5440). Mastercard ascribes the fees to various Network functions. Authorization, clearing, and settlement related fees are charged per transaction; assessment fees are charged based on a bank's proportionate use of the Network.

Regardless of how they are classified, all of Mastercard's fees are driven by some combination of the number of Merchants, number of transactions, or dollar volume of transactions between Cardholders and Merchants. The more Merchants in South Carolina that accept Mastercard branded cards, the more fees Mastercard generates. As Mastercard's VP of Federal Tax acknowledged, the more transactions and the higher dollar volume, the more money Mastercard makes. (R. pp. 394–96). This may be elementary math, but it is critically important information for Mastercard, which is why it boasts to its investors the positive correlation between the number of credit and debit card transactions in its Network and its increasing revenues. (R. p. 5050) (reporting double-digit percentage increases in revenue “primarily driven by increased growth in dollar volume of activity on cards carrying our brands and the number of transactions processed by the Company.”); (R. pp. 5166, 5275, 5377).

There is no question that a portion of Mastercard's revenue increases throughout the Audit Period were the result of Cardholder/Merchant transactions occurring in South Carolina. (R. p. 4248). During that period, Mastercard processed 1.2 billion total credit card transactions and 190 million

debit card transactions that were initiated by Merchants located in South Carolina, with a total gross dollar volume of \$73.5 billion and \$9.7 billion, respectively. (R. pp. 6183–202). The fees from those transactions may have been charged to the Issuers and Acquirers, but the generation of those fees and the income derived therefrom was wholly contingent upon Merchants and Cardholders engaging in a cashless transaction because Mastercard provided its Network to them at a point of sale in this state.

B. The Department's apportionment method (based on number and dollar volume of transactions) represents a reasonable approximation of Mastercard's business activity in South Carolina, consistent with section 12-6-2295(A)(5) and the principles in *DIRECTV*.

The ALC upheld the Department's method for apportioning Mastercard's income to South Carolina based on a ratio of number and gross domestic volume of transactions in South Carolina to all U.S. transactions. The Department's foreign audit corporate supervisor, who has been employed by the Department for over 44 years, testified at length about how Department auditors determined the appropriate apportionment ratio, and a detailed summary and chart of those calculations are included in the record. (R. pp. 569–70, 578, 6602).

Because Mastercard did not provide any information concerning the actual income it generated from card transactions in South Carolina, the Department was forced to develop a proxy for the gross receipts. For each of Mastercard's five major revenue streams, the Department calculated an apportionment ratio using either the dollar amount of the Mastercard transactions or the number of Mastercard transactions, thereby mirroring the method Mastercard used for computing its fees in each of those revenue streams. Notably, the information the Department used was provided by Mastercard's tax department in response to the Department's description of how it intended to calculate Mastercard's income-producing activity. (R. pp. 585–86, 615, 6183–202).

For example, Mastercard charges domestic assessment fees based primarily on the volume of activity (i.e. dollar amount) of transactions for each card. (R. p. 4731). Using information provided by

Mastercard, the Department determined the ratio for domestic assessment fees by dividing the South Carolina dollar amount of Mastercard branded transactions by the U.S. dollar amount of Mastercard branded transactions. (R. pp. 587–92, 6201). The Department multiplied that ratio by the total income Mastercard attributes to its revenue stream for U.S. domestic assessment fees, which calculated an amount representing the South Carolina gross receipts attributable to Mastercard’s revenue derived from domestic assessment fees. (R. pp. 6603–04). The Department repeated this calculation for cross border dollar volume fees, other revenues, and contra receipts (rebates and incentives). (R. pp. 595–98, 6605–13). For transaction processing fees, the Department employed a similar calculation using number of transactions (rather than dollar volume) because Mastercard calculates this fee based on number of transactions. (R. pp. 592–98, 5533–47, 6606–07).

The sum of South Carolina gross receipts for each of the five revenue streams was divided by the total U.S. receipts for those same five revenue streams to determine the amount of Mastercard’s income that was subject to South Carolina income tax. (R. pp. 599–601). That amount was multiplied by the corporate tax rate (5%) to compute Mastercard’s corporate income tax liability of \$6,041,666 for the Audit Period.¹⁰ (R. pp. 5535, 6613). Mastercard never offered alternative calculations, but it did compliment the auditors on their numbers and worksheet and for their “great job” computing Mastercard’s gross receipts in South Carolina. (R. pp. 600–02).

Mastercard argues the ALC erred by applying a single income-producing activity to the five revenue streams but should have separately analyzed the service for each revenue stream and sourced it accordingly. Ironically, Mastercard’s proposed approach suffers the same “flaw”: despite describing authorization, clearing, and settlement as different processes generating different revenue streams, it identifies only a single income-producing activity—the “final act” of delivering data to the banks.

¹⁰ The Department also assessed a license fee for the Audit Period in the amount of \$84,476. (R. p. 5536). The ALC upheld the assessment; Mastercard has not appealed it. (R. p. 49).

Regardless, the ALC did analyze each revenue stream, and the record supports the ALC's conclusion that Mastercard's provision of the Network is the activity that produces income for each revenue stream. Mastercard attempts to obfuscate the issue by isolating each step of a transaction from the cohesive, unified whole, but providing the Network encompasses all stages of a transaction, including the ultimate transfer of funds from the Cardholder to the Merchant via their respective banks. (R. p. 2888). Authorization, clearing, and settlement are necessary components of a single transaction processing service, but no one task is sufficient. (R. p. 431). If the authorization message never moves beyond a MIP machine, or a transaction is authorized but the funds are never exchanged (through clearing and settlement), the Network has failed in its essential, single purpose: for a Cardholder to obtain a good or service and the Merchant to get paid for it. *See, e.g., Comm'r v. Clark*, 489 U.S. 726, 738 (1989) (“[I]nterrelated yet formally distinct steps in an integrated transaction may not be considered independently of the overall transaction. By thus ‘linking together all interdependent steps with legal or business significance, rather than taking them in isolation,’ federal tax liability may be based ‘on a realistic view of the entire transaction.’”).

Thus, the ALC was correct to find that although Mastercard has chosen a layered fee structure that assigns a host of fees to various discrete tasks that Mastercard performs, it primarily derives its revenues from a single income-producing activity: providing a Network that facilitates cashless payments for goods and services. Moreover, because each stream of income is ultimately based on Merchant/Cardholder transactions, it is reasonable to approximate Mastercard's income in South Carolina using those transactions as the proxy for calculating the gross receipts Mastercard earns for providing its Network within the state.

1. *DIRECTV* does not establish a “last step” rule.

DIRECTV did not establish a bright-line rule that a service provider's income-producing activity is always the “last step” or “final act of delivery” to its “paying customer,” so the ALC did not

err by failing to follow this purported “binding precedent.” (Appellant Br. at 1, 18, 21–22, 24).¹¹ In *DIRECTV*, the bulk of the Court’s analysis focused on the record evidence related to “DIRECTV’s IPA”—not the income-producing activity of all service providers. Far from announcing a universal, one-size-fits-all rule, *DIRECTV* stands for the proposition that identifying what constitutes a service-provider’s income-producing activity is a fact intensive inquiry, made on a case-by-case basis. The final act of delivering a satellite signal may be the relevant income-producing activity for a direct-to-home digital television provider, but not for the owner and operator of a four-party payment processing network.

To the extent the *DIRECTV* decided any questions of law that constitute binding legal precedent, it was to reaffirm that section 12-6-2295(A)(5) is a flexible standard designed to source income to South Carolina in a way that is “reasonably attributable to [the taxpayer’s] business activity in this State.” *DIRECTV*, 421 S.C. at 72, 804 S.E.2d at 640. Thus, if a multistate corporation generates revenues from activities that occur here and elsewhere, “the revenue generated from its services performed within South Carolina are its gross receipts from South Carolina” and should be included in the numerator of the gross receipts ratio. *Id.*

Even if *DIRECTV* requires this Court to apply a “final act of delivery” standard, the facts of this case show that the relevant final act of delivery by Mastercard’s Network (through its

¹¹ Mastercard selectively quotes portions of the Department’s brief in *DIRECTV*, as well as Professor Swain’s testimony in this case, to suggest the Department “expressly advocated for a ‘final act’ standard” in the *DIRECTV* case. As the Department’s entire *DIRECTV* brief makes clear, the Department’s contention that DIRECTV’s income-producing activity was the “final act” of delivering its satellite signal was solely within the context of the specific facts and circumstances of DIRECTV’s business—not a bright line rule for all service providers. In its brief in the companion case to *DIRECTV*, the Department made it clear that section 12-6-2295(A)(5) provides a “flexible standard” based on the specifics of a given industry. *See* Final Br. of Resp., *Dish DBS Corp. v. S.C. Dep’t of Revenue*, 2017 WL 5012433, at *24 (Feb. 8, 2017). To the extent Professor Swain was attempting to extrapolate a universal test from *DIRECTV*, it was “what is the true purpose of the service.” (R. pp. 1002–03). As discussed above, the true purpose of the Mastercard network is not for Mastercard to deliver a signal to the banks—it is to enable Cardholders and Merchants to complete a cashless transaction.

Authorization Platform) occurs at the place where the Merchant and Cardholder initiate and consummate a cashless transaction. The activity that “actually generates income” for Mastercard is the facilitation of that transaction by transmitting authorization data through the Network from and to the location of the transaction so that all four parties in the network know how to proceed with the transaction. (R. pp. 1400, 2918, 2934). If the Merchant and Cardholder fall out of the transaction, Mastercard generates no revenue. (R. p. 859).

2. The ALC did not find that Mastercard’s income-producing activity is the card “swipe” by its “customers’ customers.”

Mastercard interprets *DIRECTV* to establish a rule that a taxpayer’s income-producing activity can only occur at the location of its paying customers. Thus, by defining its “customers” as only Issuers and Acquirers located outside South Carolina, Mastercard argues the ALC’s decision wrongly sources Mastercard’s income-producing activities contrary to *DIRECTV*. (Appellant Br. at 30). Not only does this argument misunderstand *DIRECTV* as discussed above, it misrepresents the ALC’s decision and relies on cases that are distinguishable from the facts of this dispute.

First, the ALC did not find that Mastercard’s income producing activity was the card “swipe” at a Merchant’s location. The ALC repeatedly found Mastercard’s income-producing activity to be the provision and operation of its Network that facilitates cashless transactions involving the Cardholder/Issuer and the Merchant/Acquirer. The Network is worldwide, and in South Carolina.

Second, Mastercard contends that other courts have rejected a “customers’ customer approach,” but the ALC rightly concluded that these cases were not applicable to the facts and law at issue in this case. For example, in the Wisconsin case cited by Mastercard, the issue involved the meaning of the term “licensee,” because Wisconsin taxed the income of a licensor of computer software if its licensee used that software in Wisconsin. See *Wisconsin Dep’t of Revenue v. Microsoft Corp*, 936 N.W.2d 160, 166 (Wis. Ct. App. 2019). The Wisconsin appellate court concluded the Wisconsin

consumers who purchased computers containing Microsoft software were not “licensees” of Microsoft. *Id.* at 167–68 (citing the specific statutory language and substantial evidence standard of review). But whether an end-user of a computer software program should be deemed a “licensee” under the specific law and facts of the Wisconsin case is unhelpful to this Court’s review of whether substantial evidence supports the ALC’s finding regarding Mastercard’s income-producing activity under section 12-6-2295(A)(5).¹²

In both Washington cases cited by Mastercard, the apportionment statute at issue expressly sourced income based on “where the customer received the benefit of the taxpayer’s service” and provided that, for service-related businesses, the “benefit is received where the customer’s related business activities occur.” *Walter Dorwin Teague Assocs., Inc. v. Dep’t of Revenue*, 500 P.3d 190, 194 (Wash. Ct. App. 2021); *LendingTree, LLC v. Dep’t of Revenue*, 460 P.3d 640, 642 (Wash. Ct. App. 2020). Thus, both cases involved factual determinations about what services the taxpayer performed, who its customers were, and where its customers received the benefit of those services. These cases are also unhelpful, because South Carolina’s statute does not source income based on the location of the taxpayer’s “customer” or where that customer “receives the benefit” of the taxpayer’s services. Instead, the plain language of section 12-6-2295(A)(5) merely requires a determination of whether any “income-producing activity” (a term that is absent in both Washington cases) occurs in South Carolina. (R. p. 42). The factual findings of an out-of-state court analyzing a different statutory framework are irrelevant to this Court’s review of the ALC’s findings under this state’s statute.¹³

¹² Notably, for purposes of sourcing the sales of telecommunication services, South Carolina treats the “end user” as a customer—even if the end user is not the contracting party. *See* S.C. Code Ann. § 12-36-1910.

¹³ Mastercard also cites *Def. Sec. Co. v. McClain*, 165 N.E.3d 1236, 1241 (Ohio 2020) for the proposition that the physical location of the purchaser is the “paramount” consideration. (Appellant Br. at 31). Like Washington, Ohio’s sourcing statute differs significantly from South Carolina. In Ohio, gross receipts were “situated” (i.e. apportioned) based on where the purchaser benefited from what was purchased. The court described the “paramount consideration” of the physical location of the purchaser because the statute expressly required it. *Id.* (quoting sourcing statute stating the “physical

C. Mastercard’s proposed gross receipt ratios result in the type of “unreasonable approximation” of a taxpayer’s business activity in South Carolina that *DIRECTV* rejected.

In contrast with the Department’s proposed apportionment method, Mastercard contends its income should be sourced to South Carolina under one of two methods, both of which it argues are required by the holding in *DIRECTV*.¹⁴ Neither method is reasonable. Both are inconsistent with the principles underlying *DIRECTV*.

In method one, Mastercard proposes measuring its gross receipts based on the location of the MIP machines, arguing that is where Mastercard performs the final act of delivering data to its bank customers. Since 2014, any transaction that includes a “value added service” is routed by Mastercard through its data centers in Missouri, so in a variation of this first method Mastercard also proposes sourcing its income to the location of the two data centers. Because the data centers are located in Missouri and there are no MIPs in South Carolina, its proposed gross receipts ratio is zero.

In method two, Mastercard proposed measuring its gross receipts based on the billing address of its South Carolina banks.¹⁵ During the Audit Period, Mastercard contracted with at least twelve member banks in South Carolina. (R. pp. 6600). Using the total fees paid by those dozen banks divided by the same “everywhere” gross receipts that the Department relied on in its calculations, Mastercard

location where the purchaser ultimately uses or receives the benefit of what was purchased shall be paramount” in determining the gross receipts ratio) (emphasis added). The case is also distinguishable on its facts, because the court found that taxpayer’s gross receipts were payments for the purchase of an “intangible contract right,” and the situs of where the purchaser benefited from the contracts were—based on the record on appeal—its physical locations outside Ohio. *Id.* at 1242.

¹⁴ Mastercard faults the Department and ALC for using a proxy, (Appellant Br. at 27), but *DIRECTV* did not reject the use of proxies *per se*, it only rejected the use of proxies that are unreasonable or unnecessary in light of the evidence.

¹⁵ The banks, not Mastercard, ultimately decide whether they are a “South Carolina bank,” so this method does not account for banks that do not identify as South Carolina banks but issue cards to Cardholders who use their cards or are domiciled in this state. (R. pp. 376–79).

calculated a gross receipts ratio that varied between 0.00000% and 0.08453%. (R. p. 6601). This method computed a total income tax due, for the entire Audit Period, of \$308,107.

Both of these methods produce a gross receipts ratio that is even more distorted than the ratios this Court rejected in *DIRECTV*. Like *DIRECTV*, Mastercard derives its revenue from fees paid in exchange for delivering its services across the country and in South Carolina. *DIRECTV*, 421 S.C. at 65–67, 77, 804 S.E.2d at 636, 642. *DIRECTV* had approximately 20 million subscribers. By contrast, in the last year of the Audit Period, Mastercard had approximately 782 million holders of Mastercard branded credit cards and 888 million holders of Mastercard branded debit cards. Ex. 25 (P0003920). This Court rejected *DIRECTV*'s proposed apportionment method (payroll/assets for four value drivers), which resulted in gross receipts ratios between 0.0246% and 0.2962%, finding it was an “unreasonable approximation” of its income-producing activity in South Carolina and did not “reasonably represent” *DIRECTV*'s business activity in the state. *Id.* at 93, 804 S.E.2d at 646.

Further, what Mastercard is really proposing is a disguised version of “cost of performance” sourcing—attributing its income to where a taxpayer's costs are incurred. (Appellant Br. at 19) (advocating for a payroll metric); (R. p. 396) (Mastercard representative testifying that “with respect to this case, we look to where the cost is incurred and that's primarily New York and Missouri.”); (R. pp. 309–15, 317–18, 330) (same); (R. p. 2892) (stressing that Mastercard's “direct and indirect costs of providing the services above are incurred – overwhelmingly – outside of South Carolina”). The General Assembly has not adopted a cost of performance approach to sourcing in section 12-6-2295 (with one clear exception),¹⁶ and the courts have never adopted such a method. *See* *DIRECTV*, 421

¹⁶ In response to the *DIRECTV* and *Dish DBS* cases, the General Assembly adopted an express cost-of-performance approach to sourcing the receipts of direct broadcast satellite service providers. *See* Act No. 265 (2018), *codified at* S.C. Code Ann. § 12-6-2295(7). The following year, the General Assembly expanded this cost-of-performance approach to include cable system operators and video service providers. *See* Act No. 49 (2019), *codified at* S.C. Code Ann. § 12-6-2295(7). The carve-out confirms the default rule is not cost-of-performance.

S.C. at 67, 804 S.E.2d at 637 (rejecting DIRECTV’s “cost of performance sourcing” method); *see also* *DIRECTV, Inc. v. S.C. Dep’t of Revenue*, Amended Final Order, Docket No. 14-ALJ-17-0158-CC (June 12, 2015) (noting that no South Carolina court has ever imposed a cost of performance approach to sourcing receipts of service providers to South Carolina); *Dish Dbs Corp. v. S.C. Dep’t of Revenue*, Final Order, Docket No. 14-ALJ-17-0285-CC, 2016 WL 3035989, at *9–10 (May 20, 2016) (finding South Carolina is not a cost of performance or pro rata cost of performance state).

D. The undisputed expert testimony establishes that the Department’s sourcing method is consistent with good tax policy.

The statutory policy and legislative purpose of section 12-6-2295(A)(5) is to tax the fraction of the taxpayer’s total income that is reasonably attributable to its business activity in South Carolina. *DIRECTV*, 421 S.C. at 72, 804 S.E.2d at 640. The unrebutted expert testimony of Professor Swain¹⁷ established that the Department’s assessment of Mastercard reflected good tax policy and is consistent with the government’s responsibility to get the tax “theoretically right.” (R. pp. 991–92).

First, the Department’s sourcing method comports with the legislative intent of Article 17. In 2006, the General Assembly significantly changed the apportionment framework for multistate taxpayers by replacing the three-factor apportionment method (based on sales, property, and payroll) with a single sales factor approach. This shift in apportionment methods represents a legislative preference to tax markets, rather than payroll and property, because attributing receipts based on the latter discourages the economic development that comes as the result of taxpayers locating their property and payroll in South Carolina. (R. p. 1008). The single sales factor reflects the demand for a business’s products or services, and the purpose of the gross receipts factor is to reflect the state’s

¹⁷ Professor John Swain was previously recognized as an expert in the field of state and local tax policy in *Dish DBS Corp. v. Dep’t of Revenue* (14-ALJ-17-0285-CC) and *DIRECTV, Inc. v. Dep’t of Revenue* (14-ALJ-17-0158-CC), both of which were also sourcing cases. (R. pp. 989–90). The ALC qualified Professor Swain without objection, and the ALC’s recitation of Professor Swain’s qualifications is on page 23 of the Final Order. (R. pp. 27, 994).

contribution to a taxpayer's income. Mastercard has created a demand for its services (a Network that enables Cardholders and Merchants to engage in cashless transactions) in South Carolina, so the Department's application of section 12-6-2295 properly attributes Mastercard's receipts it derives from the fees associated with those transactions to the state(s) that provide the demand for Mastercard's services. (R. p. 1007).

Second, the Department's sourcing of Mastercard's income is consistent with how South Carolina sources the receipts from sales of tangible personal property and intangibles, which is where the product is used. *See, e.g.*, S.C. Code Ann. § 12-6-2285 (describing jointly the items to include in "sales" and "gross receipts"); § 12-6-2280 (defining "sales in this State" to mean the place where goods are received by the purchaser after all transportation is completed); § 12-6-2295(A)(3) (including "receipts from the use of intangible property in this State") (emphasis added). As Professor Swain opined, "there is no principled reason" to source income from services differently from income derived from the sale of tangible or intangible property. (R. p. 1007). South Carolina provides the market for the transactions that occur here, so the income derived from providing the Network that makes those transactions possible should likewise be sourced here. (R. pp. 1019–20).

Finally, Professor Swain noted the Department's method discourages tax planning and tax avoidance strategies. Sourcing a portion of Mastercard's income-producing activity to the location where the transaction occurs (i.e. the market in which it has provided its services) disincentivizes Mastercard from structuring its business to locate its property (MIPs and data centers) or payroll (personnel) in low or no tax jurisdictions. (R. pp. 1008, 1026–27). For example, if all of Mastercard's income was sourced to Missouri—as Mastercard contends—the bulk of its income would be untaxed because of Missouri's sourcing rules. (R. pp. 1030–31). Good tax policy should lead to a result that avoids this type of distorting economic behavior. (R. p. 1028).

E. The ALC correctly found that Mastercard failed to satisfy its burden of proving the Department's determination was incorrect.

The ALC correctly premised its decision on the fact that Mastercard bore the burden of proving that the Department's sourcing method was incorrect. (R. p. 29); *see also DIRECTV*, 421 S.C. at 78–79, 804 S.E.2d at 643 (finding *DIRECTV* bore the burden of proof). The ALC was in the best position to weigh the evidence, determine witness credibility, and make factual findings regarding Mastercard's income-producing activity in light of the evidence presented. *Id.* at 80, 804 S.E.2d at 644. The ALC repeatedly anchored its findings in the “overwhelming” and “persuasive” evidence. (R. pp. 33, 37, 49). Conversely, the ALC found the preponderance of the evidence did not support Mastercard's claim that its income producing activity did not occur in South Carolina, and that Mastercard had not met its burden of proof. (R. pp. 30, 36).

In *DIRECTV*, this court affirmed the ALC because of the standard of review and record evidence; here, the Court should likewise affirm the ALC's well-reasoned decision because its findings are supported the substantial record evidence. *DIRECTV*, 421 S.C. at 81, 804 S.E.2d at 645 (“Our substantial standard of review dictates that we defer to the findings of the fact-finder.”).

III. The ALC properly exercised its broad discretion to qualify Professor Hawkins as an expert in “consumer credit markets” and admit his testimony, which was consistent with and supported by substantial record evidence.

The purpose of expert testimony is to assist the trier of fact in understanding the evidence or deciding a disputed factual issue. *See* Rule 702, SCRE. The ALC properly discharged its gatekeeping duties and specifically made the requisite Rule 702 threshold determinations that (1) Professor Hawkins was qualified, (2) the subject matter of his non-scientific expert testimony was reliable, and (3) his proposed testimony would assist the ALC as the trier of fact. *White*, 382 S.C. at 273, 676 S.E.2d at 688. The ALC did not ignore or give short shrift to Mastercard's objections and arguments against Professor Hawkins's testimony, but carefully considered Mastercard's Motion in Limine, lengthy *voir*

dire of Hawkins, and arguments at trial, as evidenced by the six pages of the Final Order devoted to Professor Hawkins's testimony. (R. pp. 16–22, 24, 239, 751–88). The ALC's decision to qualify Professor Hawkins over Mastercard's objections is not evidence of an abuse of discretion but the proper exercise of it. (R. p. 19). Having satisfied the Rule 702 threshold, the ALC acted within its discretion to discount Hawkins's testimony based on any perceived defects in his education, experience, and credibility, finding those potential shortcomings went to the weight of Hawkins's testimony—not its admissibility. *White*, 382 S.C. at 273–74, 676 S.E.2d at 688.

There is no “formulaic approach” for a trial court to evaluate nonscientific expert testimony under Rule 702, but the ALC's approach in this case comports with both *White* and *Wallace*. (R. pp. 19–20). Under the Court's highly deferential standard of review, the Court should affirm the ALC's reasoned decision—no matter how strongly Mastercard may disagree with it—because the record reflects the ALC properly and deliberately worked through the appropriate “thought process” in exercising its discretion according to law. *Wallace*, 440 S.C. at 543, 892 S.E.2d at 313.

A. The ALC properly evaluated Professor Hawkins's qualifications under Rule 702 and the record supports the ALC's decision to admit him as an expert in consumer credit markets.

Rule 702 contemplates a broad conception of expert qualifications: if a person's scientific, technical, or otherwise specialized knowledge will assist the trier of fact, that person may be qualified as an expert in a particular area based upon knowledge, skill, experience, training or education. *See* Rule 702, SCRE. The law does not require a specific, mandatory threshold for expert witness qualifications; instead, the expert must simply have acquired—by study or experience or both—knowledge that makes him better qualified than the fact finder (in this case, the ALC) to form an opinion on the matters of his testimony. *See Fields v. J. Haynes Waters Builders, Inc.*, 376 S.C. 545, 556, 658 S.E.2d 80, 86 (2008). Likewise, the trial court's analysis is not limited to a single consideration, but rather a cumulative evaluation of the totality of the expert's exposure to and familiarity with the subject

matter in question. *Watson v. Ford Motor Co.*, 389 S.C. 434, 447, 699 S.E.2d 169, 175–76 (2010) (“In determining a witness’s qualifications as an expert, the trial court should not have a solitary focus, but rather, should make an inquiry broad in scope.” (emphasis added)).

1. Substantial evidence supports the ALC’s findings that Professor Hawkins was qualified to testify as an expert.

The ALC diligently vetted Professor Hawkins’ qualifications in light of Rule 702, and there is ample evidence to support the ALC’s finding that Hawkins was qualified as an expert in the field of consumer credit markets—based on his knowledge, experience, education and study of the consumer credit industry in general and credit cards and credit card networks specifically. (R. pp. 16–22). The Final Order provides a thorough recitation of Professor Hawkins’s qualifications, (R. pp. 16–20), but a brief synopsis is appropriate here:

Professor Hawkins is a tenured professor at the University of Houston Law Center who (during his fourteen years as a professor) has studied, written about, and taught on consumer credit markets, which he defined as a “broad term” that includes credit cards and the operation of a payment network that facilitates lending. (R. pp. 16–18, 724–49, 789). This includes studying, teaching, and writing specifically about secured financing, bankruptcy, contracts, Texas consumer law, credit cards and credit card networks, credit card interchange fees, credit card surcharge rules, platforms that bring cardholders and merchants together, and even Mastercard’s initial public offering. (R. pp. 728–29, 731–34, 736, 740, 6550–58).¹⁸ Importantly, Professor Hawkins was offered as an expert in consumer credit markets, and Mastercard conceded he was an expert in that field. (R. pp. 781–84) (“We don’t

¹⁸ Professor Hawkins’s writings include five articles or book chapters focusing on credit cards. (R. pp. 733–34). He also peer reviews articles for the *American Law and Economic Review*, has presented at multiple symposiums related to credit cards, and published an article that discusses platforms (like Mastercard) that bring cardholders and merchants together. (R. pp. 735–36, 742–43); *see also* Jim Hawkins, PROTECTING CONSUMERS AS SELLERS, 94 Ind. L.J. 1407 (2019).

object to [Hawkins] testifying as to that issue [his expertise in consumer credit markets],” “We absolutely concede he is an expert with respect to what he identified himself as.”).

In Mastercard’s view, Professor Hawkins expertise only qualifies him to testify, at most, about the “broader or adjacent field” of consumer credit markets, but not about the specific subject matter of “revenue from credit card processing activities.” (Appellant Br. at 30). This argument wrongly defines the relevant subject matter in an overly narrow, case-specific manner. According to Mastercard, Professor Hawkins’s undisputed expertise in consumer credit markets is akin to the witness’s general automotive knowledge in *Watson*. But the record supports the ALC’s finding that Professor Hawkins’s specialized knowledge in the field of consumer credit markets included specialized knowledge on topics such as credit card companies, credit card transactions, lending businesses (and where the lending is facilitated) plus related activities like the operation of networks. (R. pp. 18, 740–41, 789–92, 864). Unlike the expert in *Watson*, Hawkins has professional experience teaching and writing on these subjects. To put it properly in *Watson*’s categories, Hawkins’s expertise was not limited solely to general automotive knowledge but included knowledge of cruise control systems as well.

At bottom, Mastercard is arguing for a rule in which no witness can testify about its “income-producing activities” unless they have previously written, studied, or taught about Mastercard’s income-producing activities. (Appellant Br. at 40, 42).¹⁹ In essence, the expert must be a specialist in the field of sourcing credit card income. Mastercard may prefer this “more rigorous standard,” but it is not a standard required by the Rules or *Watson*. (Appellant Br. at 38–41); see *Watson*, 389 S.C. at 446, 699 S.E.2d at 175 (observing that an expert need not be a “specialist” but is competent to testify if his

¹⁹ Importantly, neither of the experts who testified about DIRECTV’s income-producing activity appear were admitted as experts in state income tax apportionment or income-producing activity, let alone experts in DIRECTV’s income-producing activity, yet this Court made no suggestion in that case that they were unqualified to testify about where a satellite company generates revenues.

knowledge and skill makes him better qualified than the jury to form an opinion on the particular subject).

Mastercard's argument also ignores Rule 703, SCRE (its brief makes no reference at all to this operative rule). An expert may base his opinions on facts or data "perceived by or made known to the expert at or before the hearing." Rule 703, SCRE (emphasis added). This makes sense, because many experts are often asked to opine on technical aspects of a litigant's business operations or other proprietary information that may only be ascertained through the discovery process. Consequently, Rule 703 contemplates an expert offering opinions based on information he learns after a case commences, and even during trial itself. Thus, whether Professor Hawkins had specific, pre-existing knowledge of the ins-and-outs of Mastercard's business operations prior to this litigation is not determinative of his qualifications as an expert.²⁰

The ALC did not err in finding that Hawkins had demonstrated a specialized knowledge of consumer credit markets and the credit card industry, and therefore he could apply that specialized knowledge to the specific facts of Mastercard's operations that he learned based on his review of information about Mastercard during the pendency of the case. *Watson* does not stand for the proposition that an expert must have developed an expertise on the precise question or factual circumstances presented to the fact-finder in each specific case before the case existed. If this were the standard, no doctor could ever serve as a medical expert in a personal injury action unless the doctor already had full knowledge of the patient's medical history and injuries before the disputed injury occurred. Likewise, no engineer could testify about a product's failure unless he was an expert

²⁰ Ironically, Mastercard's own witnesses who were offered to provide specialized knowledge about the authorization process were uninformed about important aspects of the process. Mastercard's Senior Operations Engineer learned certain things within the scope of his "expertise" for the first time during the trial, and he was completely ignorant about critical terminology in the Authorization Manual like "points of interaction" despite declaring he was "very familiar" with that document. (R. pp. 481, 501).

in the failure before it happened. The error in *Watson* was that the witness did not have expertise in any cruise control systems—not that the witness lacked prior specialized knowledge of Ford's particular cruise control system. Mastercard's argument expands *Watson* far beyond its actual holding.

2. Substantial evidence supports the ALC's findings that Professor Hawkins's opinions were reliable.

Mastercard claims the ALC erred because it did not evaluate the reliability of Professor Hawkins's opinions. (Appellant Br. at 42). This is a puzzling assertion, because the Final Order specifically addresses the "reliability" concerns that Mastercard raised, and the ALC clearly indicated it had considered those issues and, as a result, was going out of its way to "pay particular attention" to the evidence to evaluate and weigh the reliability of Professor Hawkins's testimony in light of those concerns. (R. p. 20).

At bottom, Mastercard's arguments about the reliability of Professor Hawkins's testimony are largely recycled versions of its objections to his qualifications. (Appellant Br. at 42) ("His testimony is not reliable for many of the same reasons he is not qualified."). As discussed above, Professor Hawkins was not offered as an expert on the specific topic of "Mastercard," or to opine about the specifics of Mastercard's advertising.²¹ The fact that he had not previously studied the precise question of "the sourcing of income credit card processors" does not render unreliable his testimony and opinions about Mastercard's operations in light of his admitted expertise in consumer credit markets. The crux of his testimony was that Mastercard brought together four participants for the purpose of completing

²¹ Mastercard derides Professor Hawkins's supposed "inability to answer basic questions" about certain advertising campaigns of Mastercard's competitors, but the entire context of his testimony shows he properly identified "What's in Your Wallet" as an ad campaign by CapitalOne. (R. pp. 957–58). He also noted he had just published an article on credit card advertising but that law professors "generally don't do case studies where we study one particular business in depth," so although he knows how advertising works in these markets, he is less familiar with "random trivia questions." *Id.*; see also Jim Hawkins & Tiffany C. Penner, ADVERTISING INJUSTICES: MARKETING RACE AND CREDIT IN AMERICA, 70 Emory L.J. 1619 (2021).

cashless credit transactions, and that Mastercard generated income when Cardholders and Merchants accessed Mastercard's payment processing network. That is clearly within his expertise in consumer credit markets.

The Final Order demonstrates the ALC was engaged in the type of meaningful evaluation of the reliability of Professor Hawkins's opinions that is required of the trial court—not that it failed to do so. This is not “confirmation bias.” (Appellant Br. at 47). Deciding how much weight to give the expert's testimony or whether to accept an expert's opinions at all, depending on its view of the evidence as a whole, is quintessentially what the fact finder is required to do. *Small v. Pioneer Mach., Inc.*, 316 S.C. 479, 489, 450 S.E.2d 609, 615 (Ct. App. 1994) (“The jury could have either accepted or rejected the expert witness's opinions, depending on its view of the evidence.”); *see also Florence County Dept. of Social Services v. Ward*, 310 S.C. 69, 425 S.E.2d 61 (Ct. App. 1992) (“A trier of fact is not compelled to accept an expert's opinion, but may give it the weight he determines it deserves.”).

There is not a “one-size-fits-all” framework for evaluating the reliability of nonscientific expert testimony like that offered by Professor Hawkins, so the testimony must be evaluated on a case-by-case basis. *White*, 382 S.C. at 274, 676 S.E.2d at 688; *State v. Warner*, 430 S.C. 76, 85–86, 842 S.E.2d 361, 365 (Ct. App. 2020). The ALC did just that. The Final Order repeatedly identified specific examples of documentary evidence that independently supported and were consistent with Hawkins's description of how the Network operates, including the Rules and various manuals that make up the Standards, Mastercard's contracts and licensing agreements with Issuers and Acquirers, Mastercard's Annual Reports for 2007–2016, and Mastercard's fee schedule and cost letter. (R. pp. 22, 24–25, 30, 33, 35–37, 40). The ALC's evaluation of the reliability of Professor Hawkins's opinions was not

erroneous, particularly where ALC explained that it weighed Professor Hawkins's testimony in light of any perceived shortcomings in his education, experience, or credibility.²²

B. Even if the ALC erred in admitting Professor Hawkins's testimony, that error was harmless and does not warrant reversal.

Even if the ALC erred in admitting Hawkins's testimony, that error was harmless and did not prejudice Mastercard. Determining whether an error is harmless depends on the circumstances of the particular case. "No definite rule of law governs this finding; rather, the materiality and prejudicial character of the error must be determined from its relationship to the entire case." *State v. Chavis*, 412 S.C. 101, 109–10, 771 S.E.2d 336, 340 (2015). The ALC could have reached the same conclusions independent of Hawkins's testimony, based on the substantial evidence, so any error by the ALC in admitting Hawkins does not warrant reversal.

Notably, the overwhelming majority of the ALC's discussion of Professor Hawkins's testimony is found in the Final Order's findings of fact. The Final Order references Professor Hawkins's testimony only twice in its Conclusions of Law, once for the undisputed observation that "people obtain Mastercard branded cards because they are persuaded by Mastercard advertisements," and the other to note Hawkins's reliance on "several Mastercard documents to refute Mastercard's

²² The ALC rightly found that Mastercard's concerns about Professor Hawkins's "failure to disclose" his part-time employment in a private litigation firm had no bearing on whether he was qualified to testify. (R. p. 20 n.21). It is also difficult to conceive how this would be relevant to the reliability of his opinions. As the record indicates, Mastercard went to great lengths to discredit Professor Hawkins throughout the litigation and at trial, likely because Mastercard did not have an expert of its own. Mastercard even attempted (without legal justification) to "reopen" the record two weeks after trial had concluded to "supplement the record" with two inadmissible hearsay documents and renew their argument to disqualify Hawkins. But the reality is that Hawkins never hid the fact of his employment (it is easily discoverable public information, which Mastercard found in a post-trial Google search), Mastercard's counsel simply failed to ask him about it at all during his deposition or at trial. And choosing not to include his part-time employment on his CV is entirely consistent with academic guidance that differentiates between a professional resume and an academic CV, the latter of which is narrowly tailored to include only the skills and experiences relevant to a person's qualifications as an academic. See <https://research.unc.edu/wp-content/uploads/2018/02/Handout-Difference-Between-a-Resume-and-an-Academic-CV-Feb-2018.pdf> (last accessed Jan. 10, 2025).

contention that it has no relationship with Merchants.” In every instance where the ALC reached a conclusion that was consistent with Hawkins’s opinions, the ALC specifically did so because it was supported by other evidence in the record—not because it blindly accepted Hawkins’s testimony. (R. pp. 22, 24–25, 33, 36–38, 40).

Mastercard claims the ALC relied exclusively on Hawkins’s testimony to discredit competing testimony from Mastercard’s witnesses regarding whether Mastercard’s customers include Cardholders and Merchants. (Appellant Br. at 44–45). The Final Order plainly says otherwise—the ALC found that the testimony of Mastercard’s witnesses was discredited by the documentary evidence that was admitted at trial, not by Professor Hawkins’s opinions. (R. pp. 47–48).

Mastercard’s also offers a side-by-side comparison of the ALC’s decision and Hawkins’s testimony as supposed evidence of the ALC’s alleged improper reliance on Hawkins’s opinions, but a review of the record shows that each of Hawkins’s testimonial statements that Mastercard cites are essentially noncontroversial summations of Mastercard’s own documents or testimony. (Appellant Br. at 46). For example, the first element of the ALC’s analysis that Mastercard identifies as problematic is the unremarkable observation that Mastercard uses advertising to target Cardholders and Merchants in order to increase the use of its cards. (Appellant Br. at 46). This is not the ALC parroting Hawkins—it is a straightforward example of the ALC parroting Mastercard: “Our advertising plays an important role in building brand visibility, usage and loyalty among cardholders globally. . . . In order to promote usage of our cards, we conduct frequent promotions on a regional and national basis, often in conjunction with merchants” (R. p. 4257).

In addition, Professor Hawkins never offered an opinion on the “ultimate issue” in this case; namely, what is Mastercard’s income-producing activity under section 12-6-2295(A)(5). Instead, his opinions were more general: Mastercard solved the problem of the so-called two-sided market by creating a payment systems network; Mastercard generates revenue by providing its network;

Mastercard generates revenue because a Cardholder uses a card at a Merchant location; the Mastercard network is in South Carolina; and Mastercard has a relationship with all four participants in the Mastercard Network. (R. pp. 22–23, 792–94, 858).²³

Lastly, Mastercard’s reliance on *Odom*, *Crumpton*, *Graydon*, and *Ellis* is unhelpful. All four cases dealt with potential prejudice from expert testimony that was admitted in a jury trial. But this Court must assess prejudice in this case “from the posture of a bench trial as opposed to a jury trial.” *State v. Inman*, 395 S.C. 539, 565–66, 720 S.E.2d 31, 45 (2011) (emphasis added). The trial judge in a bench trial is presumed to disregard prejudicial or inadmissible evidence, so “it is well-established that it is a near insurmountable burden for a defendant to prove prejudice in the context of a bench trial.” *Id.* For that reason, “a trial judge’s role in a bench trial is to admit all evidence and then evaluate it in a non-jury setting.” *Brown v. Allstate Ins. Co.*, 344 S.C. 21, 27, 542 S.E.2d 723, 726 (2001).

Mastercard claims the ALC erred by admitting Professor Hawkins’s testimony in contravention of the principles in *Watson*, but conveniently ignores *Watson*’s ultimate holding on that issue: any error in admitting the unqualified witness—the very error that Mastercard alleges in this case—was harmless and did not alone warrant reversal. *Watson*, 389 S.C. at 449, 699 S.E.2d at 176. The same is true here. The ALC’s conclusions of law were rooted in the record as a whole—presumably Mastercard concedes its own documents are competent evidence—independent of Hawkins’s testimony, so admitting his testimony was not reversible error. *Id.* (reversing Court of Appeals because the trial court’s judgment was supported by competent evidence in the record); *see*

²³ Mastercard selectively quotes Hawkins’s testimony in criticizing him for not having an opinion on where the issuer and acquirer banks generate their credit card processing revenue. (Appellant Br. at 42). But as the context of his answer reveals, he does have opinions, he was merely hesitant to offer them “off the cuff” because he was not asked to form an opinion about where banks generate revenue for purposes of this litigation, he believes “forming an opinion is a more serious endeavor,” and before he offered an “official opinion in this case, I would want to think about it a lot.” (R. pp. 962–67). He also noted he did not feel it was appropriate to charge “the people of South Carolina” (i.e. the Department) his fees to think about and develop opinions beyond those which he has been retained to render in this litigation. (R. pp. 966–67).

also *Bodiford v. Spanish Oak Farms, Inc.*, 317 S.C. 539, 455 S.E.2d 194 (Ct. App. 1995) (finding the weight to be given the expert's testimony was a matter for fact finder, not the court of appeals).²⁴

IV. The ALC did not err by declining to waive the statutorily mandated penalties for Mastercard's failure to file, where Mastercard conceded income tax nexus with the state and did not prove its failure to file was reasonable.

Mastercard failed to file any returns or pay any tax during the Audit Period, so the Department imposed a "failure to file" penalty. The imposition of this penalty is mandated by law:

In the case of failure to file a return on or before the date prescribed by law, there must be added to the amount required to be shown as tax on the return, a penalty of five percent if the failure is not for more than one month, with an additional five percent for each additional month or fraction of the month not exceeding twenty-five percent in the aggregate.

S.C. Code Ann. § 12-54-43(C). It was not error for the ALC to uphold these penalties when the statute requires them under the undisputed facts of this case.

Mastercard urges this Court to grant a complete waiver of the failure to file penalties, despite the ALC declining to do so. But the ALC found that Mastercard had failed to satisfy its burden of proving that its failure to file was due to "reasonable cause," and this Court should not set aside that finding because it is supported by the record evidence. *See* S.C. Code Ann. §§ 12-54-160 (granting Department discretion to waive, dismiss, or reduce penalties); SC Rev. Procedure #08-6 (explaining penalty waivers are case-dependent and the taxpayer must prove a reasonable cause for its failure).

²⁴ *Crumpton* and *Ellis* are further distinguishable because they dealt with criminal matters in which a police officer was permitted to offer opinion testimony far beyond the scope of his expertise. In both cases, the court found the testimony went to the "heart of the case" because it opined on the ultimate issue: was the seized substance marijuana (*Crumpton*), and was the defendant acting in self-defense (*Ellis*). The error in *Crumpton* was exacerbated by the fact the officer's testing method had been deemed unreliable by SLED months before the trial, and the trial court conducted the reliability arguments in the jury's presence. *State v. Crumpton*, 444 S.C. 16, 27, 905 S.E.2d 448, 454 (Ct. App. 2024). And in *Ellis*, the error was compounded by the solicitor being permitted to describe this testimony as "scientific" throughout his closing argument. *State v. Ellis*, 345 S.C. 175, 178, 547 S.E.2d 490, 491 (2001).

Contrary to Mastercard's contention, (Appellant Br. at 49), the ALC did not find that Mastercard's failure to file was reasonable or in good-faith—it found the opposite. (R. p. 53). Prior to the Department's audit, Mastercard had never filed a single corporate income tax or license fee return, apparently because it did not “feel” like it had nexus with South Carolina. (R. pp. 355–356, 575); *see* S.C. Code Ann. §12-6-4970. Recognizing its feelings were unreasonable, Mastercard quickly conceded the nexus argument and began filing before the contested case hearing. *Id.* Mastercard offered no evidence that its business activities relative to South Carolina changed in any material way between the completion of the audit and when it filed its first income tax return in South Carolina (tax year 2017). (R. p. 51). Mastercard's abandonment of its nexus argument—in practice and in the litigation—is a clear admission it should have filed returns all along.

The ALC's decision is consistent with this Court's rejection of the argument that DIRECTV should not have been liable for substantial understatement penalties because of its “good-faith” basis for its sourcing position. *DIRECTV*, 421 S.C. at 83, 804 S.E.2d at 645–46. There, the Court specifically found that DIRECTV's reliance on prior case law (*Lockwood Greene* and *Mercury Motor*) was “unfounded” because its position failed to reasonably represent its business activity in South Carolina. *Id.* Similarly, Mastercard's “good-faith belief that its sourcing position was consistent with *DirecTV*” is also unfounded and does not excuse its failure to file. (Appellant Br. at 48). If it is appropriate to impose penalties for understatement of taxes in light of the underlying legislative policy of the sourcing statutes, the standard of review surely requires affirmance where Mastercard failed to file any corporate returns at all. *DIRECTV*, 421 S.C. at 84, 804 S.E.2d at 646.

CONCLUSION

During the Audit Period, Mastercard annually reported to its shareholders that a typical transaction on its Network involved all four participants, and that Mastercard produces income by charging transaction and assessment fees for its provision of the Network. It reported those fees are

based primarily on the number of transactions and dollar volume of the activity of each card. Mastercard's income is driven by billions of people and businesses worldwide who buy and sell goods and services using its Network—not by serving as the messenger between banks. Many of those Cardholders and Merchants are in South Carolina. All of those transactions are facilitated by the Network. Every transaction produces income for Mastercard. The more transactions, and the higher the dollar volume, the more income Mastercard earns. The Department's Determination, and ALC's final decision, merely accept Mastercard at its word.

The substantial record evidence supports the ALC's finding that because the "end result" of Mastercard's work is a completed payment for goods or services, its income producing activity is the provision of the Network that enables that payment to occur. The ALC correctly upheld the Department's apportionment method because it reflects a reasonable approximation of Mastercard's income attributable to its business activity in South Carolina. For the reasons explained above, the Department respectfully requests this Court affirm the ALC's Final Order.

Respectfully submitted,

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