

THE STATE OF SOUTH CAROLINA
In The Court of Appeals

APPEAL FROM THE ADMINISTRATIVE LAW COURT

Ralph K. Anderson III, Administrative Law Judge

Case No. 10-ALJ-17-0270-CC

Duke Energy Corporation.....Appellant,

v.

South Carolina Department of Revenue.....Respondent.

RECORD ON APPEAL

VOLUME IV

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SALES AND USE TAXES

Senate Bill 36, Section 1 (Act No. 32)

Durable Medical Equipment - Phase Out of Sales and Use Tax

History of Exemption. Code Section 12-36-2120(74) was added by Act No. 99 of 2007 to exempt from sales and use tax durable medical equipment and related supplies as defined under federal and state Medicaid and Medicare laws that met the following conditions:

1. The purchase must be paid directly by funds of South Carolina or the United States under the Medicaid or Medicare programs
2. State or federal law or regulation authorizing the payment must prohibit the payment of the sales or use tax and
3. The durable medical equipment and related supplies must be sold by a provider who holds a South Carolina retail sales license and whose principal place of business is located in South Carolina.

In addition, the 2007 legislation contained an uncodified provision providing for a phase-in of the exemption. For sales on or after July 1, 2007, the rate of tax was 5.5%. Reductions of the tax rate would be made if the Board of Economic Advisors forecast showed an annual general fund growth rate of at least 5% for the next fiscal year. Since the annual growth condition was not met, the sales tax rate on durable medical equipment and related supplies remained at 5.5%.

New Law. Act No. 32 of 2011 provides for a new phased-out sales and use tax rate on the sale of durable medical equipment and related supplies meeting the above requirements. The rate imposed on the gross proceeds of sales for durable medical equipment and related supplies are as follows:

- For sales occurring from July 1, 2011 to June 30, 2012. The sales and use tax rate is 3.5 % (plus any applicable local sales and use tax).
- For sales occurring from July 1, 2012 to December 31, 2012. The sales and use tax rate is 1.75% (plus any applicable local sales and use tax).
- For sales occurring on or after January 1, 2013. There is no state or local sales and use tax. The exemption under Code Section 12-36-2120(74) is fully implemented.

In addition, this amendment repealed the requirement of the 5% annual general fund growth rate contained in Act No. 99 of 2007.

Effective Date: June 8, 2011

Senate Bill 36, Section 2 (Act No. 32)

Warranty, Service and Maintenance Contracts - Amended

Act No. 32 amends the application of the sales and use tax to warranty or maintenance contracts effective September 1, 2011. The changes that are effective September 1, 2011, amend the sales and use tax law so that the application of the tax to warranty or maintenance contracts, and to the withdrawals of parts to fix a defective product under these contracts, will be the same as it was prior to October 1, 2005. See SC Revenue Ruling #93-6 and SC Revenue Ruling #03-5, Questions #19 through #22, for an explanation of the application of the tax to a warranty or maintenance contract prior to October 1, 2005 as well as on and after September 1, 2011.

The statute continues to tax the sale of a warranty or maintenance contract purchased at the same time the tangible personal property is purchased, unless the sale of the tangible personal property is exempt from the tax. However, with limited exceptions, the sales and use tax will no longer apply to a warranty or maintenance contract purchased after the tangible personal property is purchased.

Effective Date: September 1, 2011

Senate Bill 36, Sections 3 and 4 (Act No. 32)

Nexus – Distribution Facility

Distribution Facility Requirements. Code Section 12-36-2691 has been added to provide that, subject to the requirements discussed below, owning, leasing, or utilizing a distribution facility in South Carolina, including a distribution facility of a third party or an affiliate, is not considered in determining whether the person has a physical presence in South Carolina sufficient to establish nexus with South Carolina for sales and use tax purposes.

A "distribution facility" is "an establishment where shipments of tangible personal property are stored and processed for delivery to customers and no retail sales of the property are made." The provisions of Code Section 12-6-3360(M)(8), the job tax credit statute definition of "distribution facility" that allows for limited retail sales, is inapplicable to this definition. An "affiliate" is "a person that directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with another person." For this purpose, a person controls another person if that person holds a 50% ownership interest in the other person.

Code Section 12-36-2691(C) provides that this section applies only if the person or its affiliate:

1. places a distribution facility in service after December 31, 2010, and before January 1, 2013,
2. makes, or causes to be made through a third party, a capital investment of at least \$125 million after December 31, 2010, and before December 31, 2013 and,
3. creates at least 2,000 full-time jobs with a comprehensive health plan for those employees after December 31, 2010, and before December 31, 2013. "Full-time" and "new job" have the same meaning as provided in Code Section 12-6-3360 for purposes of this item.

After meeting the above requirement for creating 2,000 full-time jobs with a comprehensive health plan for those employees, the person, or its affiliate, must maintain at least 1,500 full-time jobs with a comprehensive health plan for those employees until January 1, 2016 for Code Section 12-36-2691 to remain applicable.

Code Section 12-6-2691(D) provides that this section no longer applies on the earlier of:

1. January 1, 2016,
2. when the person fails to meet the requirements of Code Section 12-36-2961(C) listed above, or
3. the effective date of any law enacted by the United States Congress that allows a state to require that its sales tax be collected and remitted even if the taxpayer does not have substantial nexus with that state.

Email Notification to Purchasers - Use Tax. Code Section 12-36-2691(E) provides that a person to whom this section applies who makes a sale through the person's Internet website shall notify a purchaser in a confirmation email that the purchaser may owe South Carolina use tax on the total sales price of the transaction and include in the email an Internet link to the Department's website that allows the purchaser to pay the use tax. The notice must include language that is substantially similar to the following:

YOU MAY OWE SOUTH CAROLINA USE TAX ON THIS
PURCHASE BASED ON THE TOTAL SALES PRICE OF THE
PURCHASE. YOU MAY VISIT WWW.SCTAX.ORG TO PAY THE
USE TAX OR YOU MAY REPORT AND PAY THE TAX ON YOUR
SOUTH CAROLINA INCOME TAX FORM.

Department's Use Tax Webpage. The Department is required to provide the means that allows a person to whom this section applies to link to the Department's website and that allows the purchaser to pay any required tax through the Department webpage. The Department must include on the webpage a table of the various sales tax rates of the State by location that permits the person to calculate the tax based on the total sales price and delivery location.

Retailer's Annual Statement to Purchasers. By February 1st of each year, the person to whom Code Section 12-36-2691 applies shall provide to each purchaser to whom tangible personal property was delivered in South Carolina, a statement of the total sales made to the purchaser during the previous calendar year. The statement must contain language substantially similar to the following:

YOU MAY OWE SOUTH CAROLINA USE TAX ON PURCHASES
YOU MADE FROM US DURING THE PREVIOUS TAX YEAR. THE
AMOUNT OF TAX YOU MAY OWE IS BASED ON THE TOTAL
SALES PRICE OF [INSERT TOTAL SALES PRICE] THAT MUST BE
REPORTED AND PAID WHEN YOU FILE YOUR SOUTH
CAROLINA INCOME TAX RETURN UNLESS YOU HAVE
ALREADY PAID THE TAX.

The statement must not contain any other information that would indicate, imply, or identify the class, type, description, or name of the products purchased. Any information that would indicate, imply, or identify the class, type, description, or name of the products purchased is considered strictly confidential. The statement may be provided by first class mail or email.

Retailer's Invoice or Other Documentation Requirements. Code Section 12-36-2692 has been added requiring that each person to whom Code Section 12-36-2691 applies provide to its customers readily visible notification on invoices, or other similar documentation that the customer must pay the South Carolina use tax on the purchase unless the sale of the tangible personal property to the customer is otherwise exempt. The person complies with this notice requirement if it provides a prominent linking notice on invoices or other similar documentation that directs its customers to information regarding the customer's use tax responsibilities. A linking notice complies with the provisions if the notice reads as follows:

See important sales tax information regarding the tax that you may owe directly to your state of residence.

A person required to provide a linking notice must also provide this notification on its Internet website and catalog.

Effective Date: June 8, 2011

MISCELLANEOUS

(Summarized by Subject Matter)

ADMINISTRATIVE and PROCEDURAL MATTERS

House Bill 3700, Part IB, Section 90, Proviso 90.21 (Act No. 73)

Revenue Laws – Interpretations and Report to General Assembly Committee Chairmen

During the current fiscal year, the Department's interpretation of South Carolina's revenue statutes must be based solely on the plain meaning of the statute's text and the legislative intent giving rise to the enactment of the statute. Terms in tax statutes may not be given broader meaning beyond the meaning of the statute. At least twice during the fiscal year, the Department shall submit a report to the Chairman of the Senate Finance Committee and the Chairman of the House Ways and Means Committee regarding any discovered ambiguity in the meaning of a revenue statute. The reports must be submitted no later than November 1 and May 1.

Effective Date: This temporary proviso is effective for State fiscal year July 1, 2011 through June 30, 2012. It will expire June 30, 2012, unless reenacted by the General Assembly in the next legislative session.

Senate Bill 20, Sections 8 through 14 (Act No. 69)

Unauthorized Aliens and Private Employer Licenses

Chapter 8 of Title 41, concerning unauthorized aliens and private employment and Chapter 14 of Title 8, concerning unauthorized aliens and public employment, have been amended. This legislation contains various law enforcement provisions related to unauthorized aliens and requirements for employers to verify the work authorization of all new hires through E-Verify. These provisions are not applicable to the Department and are not discussed in this summary. However, provisions affecting licenses administered by the Department are discussed below.

Under Code Section 41-8-20, all private employers in South Carolina are imputed a South Carolina employment license which permits a private employer to employ a person in the state. A private employer may not employ a person unless the private employer's South Carolina employment license and any other applicable licenses as defined in Code Section 41-8-10 are in effect and are not suspended or revoked.

A "license," as defined in Code Section 41-8-10(C), means an agency permit, certificate, approval, registration, charter, or similar form of authorization that is required by law and that is issued by any agency or political subdivision of the state for the purpose of

operating a business in the state. Professional licenses are excluded, but "license" includes employment licenses, articles of organization, articles of incorporation, a certificate of partnership, a partnership registration, a certificate to transact business, or similar forms of authorization issued by the South Carolina Secretary of State, and any transaction privilege tax license.

The imputed employment license and all other licenses meeting the above definition can be suspended or revoked for violation of state law concerning unauthorized aliens and private employment (Chapter 8 of Title 41). This determination is made by the Department of Labor, Licensing and Regulation.

However, under Code Section 41-8-50(J), if the director of the Department of Labor, Licensing and Regulation determines that a private employer's license must be suspended or revoked for violation of state law concerning unauthorized aliens and private employment (Chapter 8 of Title 41), the director must immediately notify the applicable licensing agency or political subdivision, such as the Department of Revenue, and that agency or political subdivision must suspend or revoke the private employer's license or licenses.

Code Section 41-8-50(K) states that a license suspension or revocation (1) does not constitute a dissolution, liquidation, or a winding down process; or a transfer, or other taxable event for tax purposes, including, but not limited to, taxes imposed or authorized by Title 12 and (2) does not affect protections against personal liability provided in Title 33.

Code Section 41-8-60 provides that a private employer may seek review of any disciplinary action of the director of the Department of Labor, Licensing and Regulation taken pursuant to Code Section 41-8-50 with the Administrative Law Court, and the action must be brought in accordance with the provisions of Chapter 23, Title 1.

Effective Date: January 1, 2012

MISCELLANEOUS TAX LEGISLATIONS

House Bill 3700, Part IB, Section 90, Proviso 90.23 (Act No. 73)

Admissions Tax Rebate – Motorsports Entertainment Complex Facility

This temporary proviso provides that up to \$114,000 in admissions tax revenue collected annually from all events held at a motorsports entertainment complex facility with at least 60,000 permanent seats must be rebated to the motorsports entertainment complex facility in the current fiscal year to keep a NASCAR race at the facility.

Effective Date: This temporary proviso is effective for State fiscal year July 1, 2011 through June 30, 2012. It will expire June 30, 2012, unless reenacted by the General Assembly in the next legislative session.

OTHER ITEMS (Including Local Taxes)

Senate Bill 584 (Act No. Unassigned)

Lexington County School District Sales and Use Tax

In the 2004 general election, the qualified electors residing in Lexington County approved a referendum imposing a 1% sales and use tax within Lexington County. The tax was originally authorized under Act 378 of 2004, the Lexington County School District Property Tax Relief Act (the Act), and became effective on March 1, 2005. Section 3(A) of the Act provides that the tax is imposed for 7 years, but it may be reimposed or extended by the General Assembly. Senate Bill 584 extends the tax for an additional 7 years beginning March 1, 2012, the day after the original 7 year period expires.

The tax is administered and collected by the Department in the same manner that other sales and use taxes are collected. It is in addition to all other local sales and use taxes and applies to the gross proceeds of sales in Lexington County that are subject to the tax imposed by Chapter 36, Title 12, and the collection and enforcement provisions of Chapter 54, Title 12. The gross proceeds of the sale of unprepared food that may lawfully be purchased with food stamps and items subject to a maximum tax are exempt from this tax.

Effective Date: May 9, 2011

REGULATORY LEGISLATION

House Bill 3178 (Act No. 66)

Liquor and Wine Tastings – Retail Liquor Stores

Code Section 61-6-1035, which allows the sampling of wines containing over 16% by volume of alcohol, cordials, and other distilled spirits sold in a retail alcoholic liquor store, has been amended to add the following new conditions:

1. The sample is limited to products from no more than one wholesaler at one time.
2. The tastings must be conducted by a manufacturer or a retailer, or its agent, and must not be conducted by a wholesaler or its agent. Previously, only manufacturers were permitted to conduct tastings.
3. All costs for the tasting must be paid for by the party conducting the tasting, whether a manufacturer or a retailer, or its agent.
4. As with products it offers for sale, the retailer must purchase all product samples used for the tastings it conducts from a licensed wholesaler.
5. A copy of a certificate of liability insurance for the party conducting the tasting must accompany notification to the South Carolina Law Enforcement Division.

Effective Date: June 17, 2011

House Bill 3295, Sections 1 and 2 (Act No. 67)

Homeowners Associations May Apply for License to Sell Alcoholic Liquor by the Drink

Code Section 61-6-1820, which provides criteria for applications for a license to sell alcoholic liquor by the drink, has been amended to allow a homeowners association chartered as a nonprofit organization by the Secretary of State to obtain a license.

Code Section 61-6-20, which provides definitions for terms used in Chapter 6 of Title 61, has been amended to add a definition for the term "homeowners association chartered as a nonprofit by the Secretary of State." Under this definition, the following requirements apply:

1. The organization must have been recognized as a nonprofit by the Secretary of State.

2. The organization's membership must be limited to individuals who own property in the residential community.
3. The organization's affairs must be governed by a board of directors elected by the membership.
4. No member, officer, agent, or employee of the association may be paid a salary or other form of compensation from any of the profit of the sale of alcoholic beverages, except as may be voted on at a meeting of the governing body.
5. Any compensation paid must be reasonable compensation for the services actually performed.
6. The organization must abide by all alcoholic liquor regulations that apply to any nonprofit organization eligible for a license, except that upon dissolution of the "homeowners association chartered as a nonprofit by the Secretary of State," the remaining assets, if any, may be distributed to its members.
7. A license must be issued only for facilities located within the boundaries of the homeowners association.

Effective Date: June 17, 2011

House Bill 3295, Section 4 (Act No. 67)

Local Option Permits – Establishments Located at International Airports

Code Section 61-6-2010, which authorizes Sunday sales of beer, wine and liquor under temporary permits, known as local option permits, in counties and municipalities that approve Sunday sales by referendum, has been amended. Subsection (G) was added to authorize a local option permit if the following requirements are met:

1. The applicant must be a business establishment located within a building on the grounds of an international airport.
2. The applicant must hold a license for possession, sale and consumption of alcoholic liquors by the drink on its licensed premises.
3. A referendum approving local option permits has passed in any county within the territory of the airport district that operates the international airport or in any municipality located within the territory of the district.

Effective Date: June 17, 2011

House Bill 3295, Section 5.B (Act No. 67)

Temporary License to Sell Alcoholic Liquor by the Drink at Special Functions – Revised

Code Section 61-6-2000 authorizes the Department to issue a license, on payment of a \$35 fee, allowing a nonprofit organization to sell alcoholic liquor by the drink for a period not exceeding 24 hours at a single function, for which tickets may be sold to nonmembers. This section has been amended as follows:

1. The term “nonprofit organization” is now defined by reference to Code Section 61-6-20, which provides that the term means an organization not open to the general public, but with a limited membership and established for social, benevolent, patriotic, recreational, or fraternal purposes.
2. A provision that allowed the Department to deny an application if it was not submitted at least 15 days before the special function has been omitted.
3. Reference to the penalty provisions for violations of Article 13, Chapter 6, Title 61 has been omitted.
4. The requirement for a criminal records check in Subsection (B) has been revised. The applicant must obtain a criminal records check conducted by the State Law Enforcement Division within 90 days prior to an application and submit it with the application. Failure to comply will result in denial of the application. An exception in the case of a subsequent application has been omitted.
5. The requirement for notification of law enforcement in Subsection (C) has been substantially revised. The applicant must complete the law enforcement notification provision contained in the application form and submit it with the application, thereby informing the Department that either the chief of police, if the event is located within the city limits, or the county sheriff has been notified of the temporary permit application and given an opportunity to object.

Effective Date: July 1, 2011

House Bill 3295, Section 6 (Act No. 67)

Sunday Beer and Wine Sales and Consumption Authorized in Certain Counties and Municipalities

Code Section 61-4-630 has been added to authorize certain establishments to sell, possess, and permit the consumption of beer and wine on the premises for a period not to exceed 24 hours on Sunday. To qualify, the establishment must (1) possess a beer and wine permit and (2) be located in a county or municipality that has conducted a favorable

referendum allowing the sale and consumption of alcoholic liquor by the drink on Sunday under Code Section 61-6-2010.

Effective Date: June 17, 2011

House Bill 3295, Section 3 (Act No. 67)

Separate Food Service Establishment -- New Permit

Code Section 61-6-2015 has been added to authorize a temporary permit to sell beer and wine for on-premises consumption for a period not to exceed 24 hours without regard to the days or hours of these sales. This permit shall be considered a biennial temporary permit, and may be issued to those holders of a permit to sell beer and wine for off-premises consumption during periods other than Sunday who have within the licensed premises a separate food service establishment serving prepared food for on-premises consumption. The permit to sell beer and wine for on-premises consumption during the 24 hour period shall apply only to this separate food-service establishment. The Department may require such proof of qualifications for the issuance of these permits as it considers necessary. The application fee and permit fee amounts are the same as for a biennial retail beer and wine permit. These permits may be issued only to qualified applicants located in a county or municipality which pursuant to Code Section 61-6-2010 has successfully held a referendum allowing the possession, sale, and consumption of alcoholic liquors by the drink for a period not to exceed 24 hours.

Effective Date: June 17, 2011

House Bill 3295, Section 5.A (Act No. 67)

House Bill 3278 (Act No. Unassigned)

Temporary Beer and Wine Permits for Special Events -- Revised

Code Section 61-4-550, which authorizes the Department to issue one-day beer and wine permits running for a period not exceeding 15 days, for a fee of \$10 per day, for locations at fairs and special functions, has been amended to permanently remove a previous requirement that permits be issued to qualified nonprofit organizations only. This previous requirement, added by Act No. 259 of 2010, was temporarily removed by joint resolution in House Bill 3278 of 2011, effective from January 27, 2011 to June 30, 2011. (For a further explanation of House Bill 3278, see SC Information Letter 11-2.)

Additional amendments to Code Section 61-4-550 are:

1. The requirement for a criminal records check in Subsection (B) has been revised. The applicant must obtain a criminal records check conducted by the State Law Enforcement Division within 90 days prior to an application and submit it with the

application. Failure to comply will result in denial of the application. An exception in the case of a subsequent application has been omitted.

2. The requirement for notification of law enforcement in Subsection (C) has been substantially revised. The applicant must complete the law enforcement notification provision contained in the application form and submit it with the application, thereby informing the Department that either the chief of police, if the event is located within the city limits, or the county sheriff has been notified of the temporary permit application and given an opportunity to object.
3. Subsection (D) has been revised to provide that the Department may issue up to 25 temporary permits on a single application if the applicant is also applying for up to 25 temporary licenses to sell alcoholic liquor by the drink under Code Section 61-6-2000. This does not prohibit the applicant from applying for additional special permits within the same 12-month period. Reference to the penalty provisions for violations of Article 1, Chapter 4, Title 61 has been omitted.

Effective Date: July 1, 2011

REMINDER

The following provisions were enacted in 2010, but are effective in 2011. They are summarized below for informational purposes.

MISCELLANEOUS TAX LEGISLATION

House Bill 4478, Section 14 (Act No. 290)

Rural Infrastructure Funds - Eligible Expenditures Expanded

Code Section 12-10-85, establishing the Rural Infrastructure Fund to provide funds to local governments for infrastructure and economic development, has been amended to expand the eligible expenditures. Funds can now be used for: (1) site preparation, (2) acquiring or improving real property, and (3) relocation expenses of an employee if the company pays wages to the employee that are at least twice the State average or the county average for the county in which the project is located, whichever is lower.

Effective Date: January 1, 2011

OTHER ITEMS (Including Local Taxes)

House Bill 4551 (Act No. 135)

911 Communications Systems - New Charge for Prepaid Wireless and Voice over Internet Protocol

Chapter 47 of Title 23 governs local emergency telephone systems (*i.e.*, 911 systems). It provides, in part, that fees ("911 charges") may be imposed to fund an emergency telephone system with respect to the public telephone system and commercial mobile radio service. While 911 charges imposed with respect to the public telephone system are paid directly to the local government imposing the 911 charge, 911 charges imposed with respect to commercial mobile radio service are paid to the Department. The Department is required to deposit these 911 charges with the State Treasurer for distribution pursuant to Code Section 23-47-65.

Chapter 47 has been amended to include new provisions that allow 911 charges to be imposed on prepaid wireless telecommunications services and "Voice over Internet Protocol" ("VoIP").

Prepaid Wireless 911 Charge: Code Section 23-47-68 has been added with respect to the new prepaid wireless 911 charge to provide the following:

1. A prepaid wireless 911 charge is levied on each prepaid wireless retail transaction occurring in South Carolina. This prepaid wireless 911 charge will be an amount equal to the average commercial mobile radio service 911 charge.
2. A prepaid wireless seller must collect the prepaid wireless 911 charge from a prepaid wireless consumer. The amount of the prepaid wireless 911 charge shall be either separately stated on an invoice, receipt, or other similar document that is provided to the prepaid wireless consumer by the prepaid wireless seller or otherwise disclosed to the prepaid wireless consumer.
3. The prepaid wireless retail transaction must be sourced the same as provided in Code Section 12-36-910(B)(5)(b).
4. The prepaid wireless 911 charge is the liability of the prepaid wireless consumer and not the prepaid wireless seller or any prepaid wireless provider. However, the prepaid wireless seller is liable to remit to the Department all prepaid wireless 911 charges that the prepaid wireless seller collects from prepaid wireless consumers.
5. The amount of the prepaid wireless 911 charge collected by a prepaid wireless seller is not includable in the base for measuring any tax, fee, prepaid wireless 911 charge, or other charge that is imposed by this State, any of its political subdivisions, or any intergovernmental agency. The prepaid wireless 911 charge is not considered revenue of the prepaid wireless seller.

6. The Department must establish procedures by which a prepaid wireless seller may document that a sale is not a prepaid wireless retail transaction, which procedures shall substantially coincide with the procedures for documenting sale for resale transactions under Code Section 12-36-950.
7. The prepaid wireless seller must remit the prepaid wireless 911 charge to the Department on a monthly, quarterly or annual basis; however, the prepaid wireless seller is entitled to retain 3% of the gross prepaid wireless 911 charges remitted to the Department as an administrative fee.

"Voice over Internet Protocol" 911 Charge: Code Section 23-47-67 has been added to impose a "Voice over Internet Protocol" ("VoIP") 911 charge in an amount identical to the amount of the 911 charge imposed on each local exchange access facility pursuant to Code Sections 23-47-40(A) and 23-47-50(A). VoIP 911 charges are remitted to the local government to which they are sourced.

Prohibition on Other 911 Charges: Code Section 23-47-69 was added to prohibit the State, any of its political subdivisions, or an intergovernmental agency from requiring any service provider to impose, collect, or remit a tax, fee, surcharge, or other charge for 911 funding purposes other than the 911 charges set forth in Chapter 47 of Title 23.

Advisory Committee: Code Section 23-47-65 was amended to change the name of the "CMRS Emergency Telephone Service Advisory Committee" to the "South Carolina 911 Advisory Committee."

Definitions: Code Section 23-47-10 was amended to add various definitions for terms related to prepaid wireless and VoIP 911 charges.

Effective Date: July 1, 2011, except that the addition of, or amendments to, Code Sections 23-47-55 (not summarized), 23-47-69, and 23-47-70 (not summarized) are effective March 30, 2010.

House Bill 4478, Section 34 (Act No. 290)

Redevelopment Authority Fees Extended for 2 Years

Code Section 12-10-88 provides that federal employers located on a closed or realigned military installation are to remit a portion of their employees' South Carolina withholding to the redevelopment authority overseeing that facility if the redevelopment authority complies with reporting requirements. These redevelopment fees may be remitted to the redevelopment authority beginning with the date the redevelopment authority first submitted the required information to the Department and for 15 years thereafter or until January 1, 2015, whichever occurs last. This provision has been amended to provide for the collection and remittance of the redevelopment fees for the 15 year period or through January 1, 2017, whichever occurs last.

Effective Date: January 1, 2011

LIST OF TEMPORARY PROVISOS

Temporary provisos are enacted as part of the annual budget bill, 2011 House Bill 3700, Part IB (Act No. 73). They are effective only for the current State fiscal year (July 1, 2011 – June 30, 2012). They expire on June 30th, unless reenacted by the General Assembly.

The following is a list of new provisos enacted during this legislative session and a list of provisos that were enacted in prior fiscal years and reenacted during this legislative session. A brief summary of the new provisos can be found in this publication under the applicable subject matter categories. A summary of the reenacted provisos can be found in SC Information Letters #09-14 and #10-9.

NEW PROVISOS

Miscellaneous (Administrative, Miscellaneous Taxes, Other, and Regulatory)

Proviso 90.21 - Revenue Laws Interpretations and Report to General Assembly
Committee Chairmen

Proviso 90.23 - Admissions Tax Rebate – Motorsports Entertainment Complex Facility

Property Taxes

Proviso 1.99 - Index of Taxpaying Ability – Imputed Value for Owner-Occupied
Residential Property

REENACTED PROVISOS

Income Taxes

Proviso 1A.16 - Teacher Supplies - Reimbursement Amount Not Taxable

Proviso 81.8 - Penalty and Interest Waiver for Qualified Individuals for 2009 Estimated
Tax Payments

Property Taxes

Proviso 89.45 - Personal Property Tax Relief Fund Not Funded

Sales and Use Taxes

Proviso 89.72 - Viscosupplementation Therapies - Sales and Use Tax Suspended

Proviso 89.67 - Respiratory Syncytial Virus Medicines Exemption – Effective Date

Proviso 89.44 - Private Schools - Use Tax Exemption

REENACTED PROVISOS (continued)

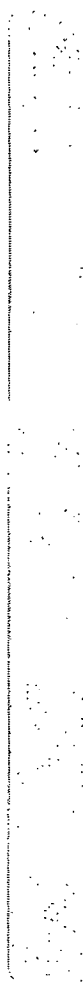
Miscellaneous (Administrative, Miscellaneous Taxes, Other, and Regulatory)

Administrative:

- Proviso 72.17 - 2% Reduction on Interest Rate on Tax Refunds
- Proviso 89.116 - Additional 1% Reduction on Interest Rate on Tax Refunds
- Proviso 81.6 - Website Posting of Tax Return Information for Candidates and
Gubernatorial Appointees – Voluntary Program

Miscellaneous:

- Proviso 81.7 - Admissions Tax Exemption for Payment to Nonprofit Athletic Booster
Organizations for Right to Purchase Athletic Event Season Tickets
- Proviso 1.17 - Local Government School Buses - Motor Fuel Tax Exemption
- Proviso 21.16 - Nursing Home Bed Franchise Fees - Suspension



P



EXHIBIT P

Q



State of South Carolina
Department of Revenue
301 Gervais Street, P. O. Box 12265, Columbia, South Carolina 29211
Website Address: <http://www.sctax.org>

SC INFORMATION LETTER #10-9

SUBJECT: Tax Legislative Update for 2010

DATE: September 14, 2010

AUTHORITY: S.C. Code Ann. Section 12-4-320 (2000)
S.C. Code Ann. Section 1-23-10(4) (Supp. 2009)
SC Revenue Procedure #09-3

SCOPE: An Information Letter is a written statement issued to the public to announce general information useful in complying with the laws administered by the Department. An Information Letter has no precedential value.

Attached is a brief summary of most of the significant changes in tax and regulatory laws and regulations enacted during the past legislative session. The summary is divided into categories, by subject matter, as indicated below.

<u>CATEGORY OF LEGISLATION & REGULATIONS</u>	<u>PAGE #</u>
1. Income Taxes, Withholding, and Corporate License Fees	
Legislation.....	6
Reminder – Prior Legislation Effective July 1, 2010 or Thereafter	20
2. Property Taxes and Fees in Lieu of Property Taxes	
Legislation.....	21
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Legislation.....	36
4. Miscellaneous	
Administrative and Procedural Matters	37
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Other Items (including local taxes).....	39
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5. Temporary Provisos - List	49

DISCLAIMER:

This is intended to be a summary of the main points of the legislation; it is not an interpretation by the Department. Please refer to the full text of the legislation for specific details and requirements.

There are several instances where some tax or incentive related legislation briefly summarized is under the jurisdiction of another state agency or political subdivision, and not the Department. In such cases, questions concerning these provisions should be made directly to the agency or political subdivision having primary responsibility for the administration of these acts. Legislation regarding distribution of funds is not summarized.

TEXT OF LEGISLATION:

A complete copy of the legislation discussed in this publication can be obtained from the South Carolina Legislative Council's website at <http://www.scstatehouse.net/html-pages/legpage.html>.

LIST OF BILLS BY SUBJECT CATEGORY

A list of significant changes in tax and regulatory laws (both permanent and temporary) and regulations enacted during the 2010 legislative session is provided below. Temporary provisos are enacted in the State budget and are only effective for the State fiscal year (July 1 – June 30); unless re-enacted they expire on June 30, 2011.

This list is divided by subject matter with the bills listed in numeric order. The list of bills with a link to the full text of each act is on the Department's website at:
<http://www.sctax.org/Tax+Policy/Legislation+for+2010.htm>.

INCOME TAXES, WITHHOLDING & CORPORATE LICENSE FEES

BILL #	ACT #	SUBJECT
728 - Sec. 1 - 4	182	Textile mill revitalization credit - Amended
850 - Sec. 1	274	New contribution check-offs for SC Forestry Commission and SC Department of Natural Resources
915	248	Community Development Act - Termination of Act postponed
1174 - Sec. 1	142	Internal Revenue Code - Conformity
- Sec. 2	142	Haiti relief (charitable deduction) in federal Public Law 111-126 adopted
- Sec. 3	142	Internal Revenue Code - Sections not adopted
- Sec. 4	142	Waiver of estimated tax penalties for large corporations
- Sec. 5	142	2007 Act 110, Section 49 penalty provision for large corporations deleted (See Section 4 above)
- Sec. 6	142	2009 Act 16, Section 3 penalty provision for large corporations deleted (See Section 4 above)
4478 - Sec. 16	290	Job tax credit amendments - New county designations & dollar amounts, qualifying business changes, etc.
- Sec. 17	290	Port volume cargo increase credit - Amended
- Sec. 18	290	Credit against license fee for infrastructure - Amended
- Sec. 19	290	Job development credit - Amended
- Sec. 20 - 21	290	Economic impact zone investment credit replaced; Capital investment tax credit added
- Sec. 22	290	Biodiesel research and development credit - Expanded to include waste grease derived biodiesel
- Sec. 23	290	Manufacturers of renewable energy systems and components - New Credit
- Sec. 24 - 27	290	Renewable energy manufacturing projects - Special benefits
- Sec. 37	290	Repeal of Act 150 of 2010 (See #4514 below)
- Sec. 38	290	Repeal of §12-6-3450 (military base closure) and part of Title 12, Chapter 14 (Economic Impact Zone Credit)
4514 - Sec. 2	150	Tax from new, large S corporation used for grants (Repealed by #4478)
4657 - Proviso 1A.17	291	Teacher supplies reimbursement not taxable - Reenacted temporary proviso
4657 - Proviso 81.8	291	No estimated tax penalty when following IRC §6654(d)(1)(D) New temporary proviso
4663	232	Fire sprinkler credits – Study Committee

LIST OF BILLS BY SUBJECT CATEGORY (continued)

PROPERTY TAXES and FEES IN LIEU OF PROPERTY TAXES

BILL #	ACT #	SUBJECT
405	279	Boats (exemption, situs, residence, and penalties)
728 - Sec. 1 - 4	182	Textile mill revitalization credit - Amended
728 - Sec. 5	182	Rehabilitated historic/low income property - Special assessment
1024	175	Paraplegic or hemiplegic exemption - Expanded
1131	161	Fee in Lieu - Qualified nuclear plant (Superseded by #4478)
4174 - Sec. 1	275	Assessable transfers of interest in real property
- Sec. 2	275	Fair market value attributable to reassessment - 15% cap clarified
4478 - Sec. 2 - 12	290	Fees in Lieu amendments - Additional time, appraisal of real property, previously taxed property, etc
- Sec. 13	290	Manufacturing property used for warehousing/wholesale distribution - Changes
- Sec. 15B.	290	Industrial Development Project - Definition of project
- Sec. 28	290	Renewable energy manufacturing facility - Depreciation rate
- Sec. 37	290	Repeal of Act 150 of 2010 (See #4514 below)
4514 - Sec. 1	150	Fee in Lieu - Simplified Fee time period expanded (Repealed by #4478)
4657 - Proviso 89.48	291	Personal property tax relief fund - Reenacted temporary proviso
4663	232	Fire sprinkler credits - Study Committee
4839	264	Medal of honor recipients - Exemption revised

SALES AND USE TAXES

BILL #	ACT #	SUBJECT
717	280	Research and testing facility - New exemption
4657 - Proviso 89.47	291	Private school use tax - Reenacted temporary proviso
4657 - Proviso 89.72	291	Respiratory syncytial virus medicine - Reenacted temporary proviso
4657 - Proviso 89.77	291	Viscosupplementation therapy - Reenacted temporary proviso
4657 - Proviso 89.107	291	Gun sales tax holiday - Reenacted temporary proviso

MISCELLANEOUS

See next page.

LIST OF BILLS BY SUBJECT CATEGORY (continued)

MISCELLANEOUS

BILL #	ACT #	SUBCATEGORY	SUBJECT
		Administrative and Procedural	
850 - Sec. 2	274		Payment by immediately available funds - penalties
4657 - Proviso 72.17	291		Interest rate paid on refunds - 2% reduction for Guardian Ad Litem - Reenacted temporary proviso
4657 - Proviso 81.6	291		Political candidate tax return inquiry - Reenacted temporary proviso
4657 - Proviso 89.142	291		Interest rate paid on refunds - Additional 1% reduction for the Joint Citizens and Legislative Committee on Children and the Department of Juvenile Justice New temporary proviso
		Miscellaneous Taxes	
3584	170		Cigarette tax increase; Definition of cigarette expanded
4233	228		Beer defined for license tax purposes
4478 - Sec. 14	290		State Rural Infrastructure Fund - Use expanded
4657 - Proviso 1.17	291		Motor fuel exemption for school buses - Reenacted temporary proviso
4657 - Proviso 21.16	291		Nursing home fee suspended - Reenacted temporary proviso
4657 - Proviso 81.7	291		Season tickets admission tax exemption - Reenacted temporary proviso
		Other	
4478 - Sec. 34	290		Redevelopment Authority fees extended for 2 years
4551	135		911 communications system - Monthly charge
		Regulatory	
4516	259		Special permits for nonprofits; technical correction; and repeal of §61-6-510
4572	231		Beer equipment and displays; Beer tastings and sales
4657 - Proviso 81.9	291		Bingo License provision - §12-21-3940(D) suspended (See #4837) New temporary proviso
4837	263		Bingo license provision - §12-21-3940(D) repealed; nonprofit definition
Regulation Doc. 4077	7-202		Premises defined; Reg. 7-401.1 and Reg. 7-700 repealed

INCOME TAXES, WITHHOLDING, and CORPORATE LICENSE FEES

House Bill 1174, Section 1 (Act No. 142)

Internal Revenue Code Conformity

Code Section 12-6-40(A)(1)(a) has been amended, except as otherwise provided, to update South Carolina's income tax laws to conform to the Internal Revenue Code of 1986, as amended through December 31, 2009, and includes the effective date provisions contained therein.

Effective Date: March 31, 2010

House Bill 1174, Section 3 (Act No. 142)

Internal Revenue Code Sections Not Adopted

Four new provisions have been added to Code Section 12-6-50 which lists specific Internal Revenue Code sections not adopted by South Carolina. Code Sections 12-6-50(4) and (16) have been amended to specifically not adopt Internal Revenue Code Sections 85(c) and 6654(d)(1)(D). Code Sections 12-6-50(5A) and (5B) have been added to specifically not adopt Internal Revenue Code Sections 108(i) and 163(e)(5)(F).

Internal Revenue Code sections enacted as part of the American Recovery and Reinvestment Act of 2009, Public Law 111-5, but not adopted by South Carolina, provide the following for federal income tax purposes:

1. Internal Revenue Code Section 85(c) excludes \$2,400 of unemployment compensation from gross income for 2009.
2. Internal Revenue Code Section 6654(d)(1)(D) decreases required estimated tax payments for 2009 by allowing quarterly estimated tax payments based on 90%, rather than 100%, of the tax due on the 2008 individual income tax return for qualified individuals. Note: See Proviso 81.8 (Act No. 291) summarized below for penalty waiver information for qualifying individuals who complied with Internal Revenue Code Section 6654(d)(1)(D).
3. Internal Revenue Code Section 108(i) relates to the deferral and ratable inclusion of income arising from business indebtedness discharged by the reacquisition of a debt instrument.

4. Internal Revenue Code Section 163(e)(5)(F) relates to original issue discount on certain high yield obligations.

Effective Date: March 31, 2010

House Bill 4657, Part IB, Section 81, Proviso 81.8 (Act No. 291)

Penalty and Interest Waiver for Qualified Individuals for 2009 Estimated Tax Payments

Under this temporary proviso, the Department will waive interest and penalties for state estimated quarterly individual income tax payments for qualifying individuals who comply with Section 1212 of federal Public Law 111-5, codified as Internal Revenue Code Section 6654(d)(1)(D). An individual is considered a qualified individual for purposes of South Carolina penalty waiver if the individual meets the adjusted gross income requirement and the 50% of gross income from a small business requirement contained in Section 1212, Public Law 111-5 for South Carolina or federal purposes.

Effective Date: This temporary proviso is effective for State fiscal year July 1, 2010 through June 30, 2011. It will expire June 30, 2011, unless reenacted by the General Assembly in the next legislative session.

House Bill 1174, Sections 4, 5, and 6 (Act No. 142)

Penalty Waiver for Federal Changes to Corporate Estimated Tax Payments

1. Code Section 12-6-3910(E) has been added to allow the Department to waive estimated tax penalties for corporations that calculate South Carolina estimated tax payments based on a federal law that: (a) increases estimated payments in one period and decreases estimated payments in another period or (b) changes the dates of estimated tax payments are due for not more than one month.
2. In related amendments, Section 49 of Act 110 of 2007 and Section 3 of Act 16 of 2009 are repealed. These sections provided for South Carolina estimated tax penalty waivers associated with changes in federal estimated tax penalties for large corporations. The federal laws were repealed before the changes were to take effect.

Effective Date: March 31, 2010

House Bill 850, Section 1 (Act No. 274)

Forestry Commission and Department of Natural Resources – New Check-offs

Code Section 12-6-5060, providing for various income tax check offs on South Carolina's individual income tax form, has been amended to provide for a designation for a taxpayer to make a contribution to the South Carolina Forestry Commission for use in the state forest system and the South Carolina Department of Natural Resources for use in its programs and operations.

Effective Date: June 17, 2010

House Bill 1174, Section 2 (Act No. 142)

Charitable Deduction for Haiti Relief Adopted

South Carolina has adopted federal Public Law 111-126 which allows taxpayers the option to deduct qualifying charitable contributions in 2009 rather than 2010 for aid to victims of the January 12, 2010, Haiti earthquake. To qualify for the 2009 deduction, the contributions must be in cash, must otherwise qualify for the deduction, and must be made between January 11, 2010 and March 1, 2010.

Effective Date: March 31, 2010

House Bill 4478, Section 23 (Act No. 290)

Manufacturers of Renewable Energy Systems and Components - New Credit

Code Section 12-6-3588 has been added to provide an income tax credit to companies in the solar, wind, geothermal, and other renewable energy industries who are expanding or locating in South Carolina. To qualify, a company must: (1) manufacture renewable energy systems and components in South Carolina for solar, wind, geothermal, or other renewable energy uses; (2) invest at least \$500 million in new qualifying plant and equipment in the year the tax credit is claimed; and (3) create one and one-half full time jobs for every \$500,000 of qualifying capital investment that each pays at least 125% of the State's average annual median wage as defined by the Department of Commerce. A taxpayer may separately qualify for new facilities in separate locations or for separate expansions at existing facilities in South Carolina.

Expenditures qualifying for this credit must be certified by the State Energy Office. To obtain the amount of credit available to a taxpayer, each taxpayer must submit a request for the credit to the State Energy Office by January 31st for qualifying expenditures incurred in the previous calendar year. By March 1st, the State Energy Office must notify

the taxpayer of the qualifying expenditures and the allocated credit amount. The credit is claimed for the tax year which contains December 31st of the previous calendar year.

The credit is equal to 10% of the cost of the company's total qualifying investment in plant and equipment in South Carolina for renewable energy operations. A taxpayer's total credit for all expenditures allowed must not exceed \$500,000 for any year and \$5 million total for all years. Unused credits can be carried forward 15 years after the tax year in which a qualified expenditure was made. This credit is in lieu of any other applicable income tax credits or abatements allowed by state law. In the event of an overlap or conflict in available credits or abatements, the taxpayer may select the credit or abatement desired in the manner prescribed by the Department.

Note Expiration: "The income tax credit program is for a five-year period beginning January 1, 2010, and ending December 31, 2015."

Effective Date: January 1, 2011

House Bill 4478, Sections 20, 21, and 38 (Act No. 290)

Capital Investment Tax Credit - Replacing Economic Impact Zone Investment Tax Credit. Repeal of Certain Code Sections in Economic Impact Zone Act in Chapter 14 of Title 12 and Repeal of Credit for Hiring Displaced Workers in Code Section 12-6-3450

Chapter 14 of Title 12 contains the Economic Impact Zone Community Development Act of 1995. Chapter 14 has been substantially amended. Among the changes are the following:

1. Code Section 12-14-20, containing the purpose of the Economic Impact Zone Community Development Act of 1995, is amended to provide that the purpose of Chapter 14 is to establish a program of providing tax incentives for the creation of capital investment in order to revitalize capital investment in South Carolina, primarily by encouraging the formation of new businesses and the retention and expansion of existing businesses; and to promote meaningful employment. Previously, the Act's purpose was to provide for the establishment of economic impact zones on or in the vicinity of closed or realigned military installations in which various tax incentives may apply to businesses and individuals located in the economic impact zone in order to economically revitalize the area.
2. Code Section 12-14-60, providing for the economic impact zone investment tax credit, has been amended to delete all references to "economic impact zone" and to provide for a capital investment tax credit as follows:

0.5% of total aggregate bases of all qualifying 3 year manufacturing and productive equipment property;

1.0% of total aggregate bases of all qualifying 5 year manufacturing and productive equipment property;

1.5% of total aggregate bases of all qualifying 7 year manufacturing and productive equipment property;

2.0% of total aggregate bases of all qualifying 10 year manufacturing and productive equipment property; and

2.5% of total aggregate bases of all qualifying 15 year or greater manufacturing and productive equipment property.

The definition of qualified manufacturing and productive equipment property in Code Section 12-14-60(B) was amended to replace references to "economic impact zone" with "this State."

3. To repeal the following code sections in Chapter 14 of Title 12:

- a. Code Section 12-14-30. This section contained definitions of the terms "economic impact zone," "applicable federal military installation," "applicable federal facility," and "internal revenue code."
- b. Code Section 12-14-40. This section provided for the designation and revocation of an area as an economic impact zone.
- c. Code Section 12-14-50. This section provided for an individual income tax deduction for 20% of the purchase price of economic impact zone stock.
- d. Code Section 12-14-70. This section contained definitions of the terms "economic impact zone business," "qualified business," and "nonqualified financial property" relating to the individual income tax deduction.

In a related amendment, Code Section 12-6-3450, providing a tax credit to employers who hire persons who were employed in an economic impact region and who job was terminated as a result of the closing or realignment of an applicable federal military installation or applicable federal facility, has been repealed.

Effective Date: January 1, 2011, except the repeal of Code Sections 12-14-30, 12-14-40, 12-14-50, 12-14-70, and 12-6-3450 are effective June 23, 2010.

House Bill 4478, Sections 16 and 38 (Act No. 290)

Job Tax Credit – Amended

Code Section 12-6-3360, dealing with the job tax credit, has been amended by this Act. Among the changes are the following:

1. The county rankings have been changed from five designations to four designations. Counties will now be ranked as “Tier I,” “Tier II,” “Tier III,” and “Tier IV” counties. “Tier I” counties are the 12 counties with a combination of the lowest unemployment rate and highest per capita income. “Tier IV” counties are the 11 counties with a combination of the highest unemployment rate and lowest per capita income. Previously, counties were ranked as “developed,” “moderately developed,” “underdeveloped,” “least developed,” and “distressed” counties. Code Section 12-6-3360(B).
2. The dollar amount of the basic job tax credit for each new job created based on the new county designations of Tier I, II, III, and IV are:

\$1,500 per year for each new full time job created in a Tier I county,

\$2,750 per year for each new full time job created in a Tier II county,

\$4,250 per year for each new full time job created in a Tier III county, and

\$8,000 per year for each new full time job created in a Tier IV county.

Note: The credit is one-half of the dollar amount listed above for a taxpayer with 99 or fewer employees claiming the small business job tax credit under Section 12-6-3360(C)(2) for jobs with gross wages less than 120% of the county’s or state’s average per capita income.

Previously, the annual basic credit amount for each new, full time job was \$1,500 in a developed county, \$2,500 in a moderately developed county, \$3,500 in an underdeveloped county, \$4,500 in a least developed county, and \$8,000 in a distressed county. Code Section 12-6-3360(C).

3. Several types of businesses qualifying for the credit have been added or changed as follows:
 - a. A taxpayer that operates an “agribusiness operation” can now qualify for the job tax credit. Code Section 12-6-3360(A).
 - b. A taxpayer that operates a retail facility or service-related industry can qualify for the job tax credit only in a Tier IV county. Previously, a retail facility or service related industry in an underdeveloped county not traversed by an interstate

highway, least developed county, or distressed county could qualify for the job tax credit. Code Section 12-6-3360(A).

- c. The definition of "processing facility" has been expanded to include "meat, poultry, and any other variety of food processing operations." Processing facility continues to mean an establishment that prepares, treats, or converts tangible personal property into finished goods or another form of tangible personal property. The term includes a business engaged in processing agricultural, aquacultural, or maricultural products and specifically includes meat, poultry, and any other variety of food processing operations. It does not include an establishment in which retail sales of tangible personal property are made to retail customers. Code Section 12-6-3360(M)(6).
4. Special provisions have been deleted that qualify certain areas and counties for an increased credit designation. The restriction that a county's designation cannot be lowered in credit amount more than one tier in the following calendar year has also been deleted. Previously, rankings were done with equal weight given to unemployment rate and per capita income and then adjusted in accordance with special rules in Section 12-6-3360(B) and (L), as applicable. Code Section 12-6-3360(B) and former Code Section 12-6-3360(L).
5. Section 38 of the Act repealed Code Section 12-6-3450 concerning a tax credit for persons terminated as a result of closing or realignment of federal military installations. Code Section 12-6-3450(A)(1)(b) was referenced in Code Section 12-6-3360(F)(2)(d) and Code Section 12-6-3360(M)(3). The general definition of "new job" in Code Section 12-6-3360(M)(3) continues to provide that "this exclusion of a new job created by an employee shifting does not extend to a job created at a new or expanded facility located in a county in which is located an 'applicable federal facility' as defined in Section 12-6-3450(A)(1)(b)."

Effective Date: January 1, 2011, except the repeal of Code Section 12-6-3450 is effective June 23, 2010.

House Bill 4478, Section 17 (Act No. 290)

Port Cargo Volume Increase Credit - Amended

Code Section 12-6-3375 provides a tax credit to a taxpayer engaged in manufacturing, warehousing, or distribution that uses a South Carolina port facility and that increases its port cargo volume at these facilities by at least 5% in a calendar year over its base year port cargo volume. The amount of the credit is determined by the Coordinating Council for Economic Development ("Council") upon application by the taxpayer. The changes to the credit include:

1. The credit has been expanded to allow it to be used against employee withholding taxes. The total amount of credit available for all taxpayers continues to be \$8 million a calendar year. Only \$4 million of the \$8 million may be used against withholding. Previously, the credit could only be used against income taxes.
2. The time for the taxpayer to submit an application to the Council for certification of the credit amount has changed. The taxpayer may now submit the application after the calendar year in which the increase occurs. Prior to amendment, a taxpayer had to submit the application by March 1st of the calendar year following the year of the increase.
3. The Council continues to have the sole discretion in allocating the credit and may now make allocations on a monthly, quarterly, or yearly basis. Previously, credits were allocated on a yearly basis.
4. The provisions in subitems (A)(2) and (B)(2) that provided that a taxpayer could not receive more than \$1 million in credit a year unless the total \$8 million credit had not been allocated have been deleted.
5. The Council may annually award up to \$1 million in credit to a new warehouse or distribution facility which commits to spending at least \$40 million at a single site and creating 100 new full-time jobs, without regard to base year cargo requirements. The Council can award the credit in the year the facility is announced, but cannot tender the credit certificate until the taxpayer has provided proof that the capital investment and job requirements have been, or will be, satisfied. Any credit certificate expires 3 years after issuance if satisfactory proof has not been received.

Effective Date: January 1, 2011

Senate Bill 728, Sections 1 - 4 (Act No. 182)

Textile Mill Revitalization Credit - Amended

The South Carolina Textile Communities Revitalization Act, contained in Title 12, Chapter 65, provides a credit for the rehabilitation of abandoned textile mill sites in South Carolina. Code Section 12-65-30 allows a taxpayer who rehabilitates an abandoned textile mill site to choose one of the following credits: (1) a credit against income tax, corporate license fees, or both or a credit against bank taxes or (2) a credit against real property taxes.

General amendments applicable to the Textile Communities Revitalization Act include:

1. Code Section 12-65-20(3) has been amended to provide that a "textile mill" is a facility or facilities that were "initially" used for textile manufacturing, dying, or finishing operations and for ancillary uses to those operations. The amendment replaced the word "last" with "initially."
2. Code Section 12-65-30(D) has been amended to add that a taxpayer is not eligible for the credit if the facility has previously received textile mill credits. The statute continues to provide that a taxpayer who owned the textile mill site when it was operational and immediately prior to its abandonment is not eligible for the credit.
3. Code Section 12-65-60 has been added to provide a procedure which allows the taxpayer to apply to the county or municipality in which the textile mill site is located for certification of the site. The certification can be done by either ordinance or binding resolution of the applicable governing body. The certification must include findings that the site was a textile mill as defined in Code Section 12-65-20(3); that the site is abandoned as provided in Code Section 12-65-20(1); and that the geographic site is consistent with Code Section 12-65-20(4), which provides a definition of textile mill site. The taxpayer may conclusively rely upon the certification in determining the credit allowed. If the taxpayer relies on the certification, a copy must be included with the first return on which the credit is claimed.
4. Code Section 12-65-50 has been added to provide rules to determine the statutory provisions applicable to a taxpayer.
 - a. The provisions of Title 12, Chapter 65 apply to all textile mill sites, or portions thereof, placed in service on or after January 1, 2008.
 - b. Entire textile mill sites placed in service on or before December 31, 2007, are governed by the former provisions of Chapter 32, Title 6 (*i.e.*, the former statutory provisions containing the textile revitalization credit) in effect as of December 31, 2007.

- c. If a portion of the textile mill site was placed in service on or before December 31, 2007, but not all, then the taxpayer may elect to either: (i) have the portion that was placed in service on or before December 31, 2007, governed by the former provisions of Chapter 32, Title 6, in effect as of December 31, 2007, as if the portion were an entire textile mill site; or (ii) have the portion be governed by the provisions of Title 12, Chapter 65 such that the portion must be deemed to be a phase of the site placed in service on a date subsequent to December 31, 2007, identified by the taxpayer.

Additional amendments that pertain only to the "income tax/corporate license fee/bank tax" portion of this credit include:

1. Code Section 12-65-30(C)(2) has been amended to revise the rules regarding the "Notice of Intent to Rehabilitate" indicating a taxpayer's intent to rehabilitate a textile mill site and an estimate of expenses it will incur in the site rehabilitation. As amended, only a taxpayer that has acquired the textile mill site after December 31, 2007, is required to give a Notice. Transfers between affiliated taxpayers of phases of any textile mill site are not deemed an acquisition for this purpose.

A taxpayer files the Notice with the Department before receiving the building permits for the applicable rehabilitation at the site or phase. If the Notice is not filed prior to receiving the applicable building permits, then only rehabilitation expenses incurred after the Notice is provided qualify. If the actual expenses of the rehabilitation exceed 125% of the estimated expenses set forth in the Notice, the taxpayer qualifies for the credit based on 125% of the estimated expenses as opposed to the actual expenses incurred in rehabilitating the site.

2. Code Section 12-65-30(A)(2) has been expanded to allow the credit to be used against insurance premium taxes imposed by Chapter 7, Title 38. Previously, this part of the credit was allowed against taxes under Chapters 6 (income taxes) and 11 (bank taxes), Title 12; license taxes under Chapter 20, Title 12, or both.
3. Code Section 12-65-30(C)(5) has been amended to provide that a taxpayer's credit is limited to 50% of each of the following: (a) tax liability under either Chapter 6 or Chapter 11 of Title 12; (b) corporate license fee liability under Chapter 20, Title 12; or (c) insurance premium taxes under Chapter 7, Title 38.
4. Code Section 12-65-30(C)(7), providing for the allocation of the credit by a taxpayer that is partnership or a limited liability company taxed as a partnership among any of its partners or members, has been amended to further provide that such taxpayer may allocate the credit on an annual basis, including allocating the entire credit to any partner or member who was a partner or member at any time during the year in which the credit is allocated.

Effective Date: May 28, 2010

House Bill 4478, Section 22 (Act No. 290)

Alternative Fuels Research and Development Credit - Extended to Waste Grease Derived Biodiesel

Code Section 12-6-3631, providing an income tax credit for qualified expenditures a taxpayer incurs for research and development of certain alternative energy sources, has been amended to include certain expenditures to develop feedstocks and processes for waste grease derived biodiesel in the definition of "qualified expenditures for research and development." The amendment also provides that the credit for research and development for waste grease derived biodiesel is 10% of the qualified expenditures.

Effective Date: January 1, 2011

Senate Bill 915 (Act No. 248)

Community Economic Development Act – Termination of Act Postponed

The Community Economic Development Act enacted in 2000, authorizes grants to community development corporations and community development financial institutions as provided in Title 34, Chapter 43. It also provides tax credits to investors in such entities pursuant to Code Section 12-6-3530. The amendment postpones the termination of the Act from June 30, 2010 to June 30, 2015.

Effective Date: June 14, 2010

House Bill 4663, Section 1 (Act No. 232)

Fire Sprinkler System Tax Credit - Committee Appointed to Study Credit Use

Code Section 12-6-3622, dealing with the fire sprinkler system tax credit, has been amended to add subsection (e) which requires the General Assembly to appoint a study committee composed of three members appointed by the President Pro Tempore of the Senate and three members appointed by the Speaker of the House of Representatives, including one representative from each of the following organizations: the South Carolina Fire Sprinkler Association, the South Carolina Home Builders Association, the South Carolina Association of Counties, and the Municipal Association of South Carolina. The study committee will develop strategies to increase participation in the tax credit program by local taxing entities and to review and make recommendations for increasing the installation of interconnected hard-wired smoke alarms. The committee will report its findings to the General Assembly by January 20, 2011. At that time the committee will dissolve.

Effective Date: June 7, 2010

House Bill 4478, Section 19 (Act No. 290)

Job Development Credit Amended

Code Section 12-10-80 provides a credit against employee withholding taxes to new or expanding businesses making qualifying investments and creating a minimum number of new jobs in South Carolina and entering into a revitalization agreement with the Coordinating Council for Economic Development ("Council"). Code Section 12-10-80 has been amended as follows:

1. A provision has been added to provide that a company's job development credits are suspended during any quarter the company fails to maintain 100% of the minimum job requirement set forth in the revitalization agreement. A company can only claim credits on jobs, including a range of jobs approved by the Council, as set forth in the company's final revitalization agreement. This codifies an existing guideline of the Council. Code Section 12-10-80(A)(6).
2. A provision has been added to clarify that credits may be claimed beginning with the withholding quarter after the Council's approval of the company's documentation that the minimum job and capital investment requirements have been met. This codifies an existing guideline of the Council. Code Section 12-10-80(A)(7).
3. Subsection (C)(3), which provides for the eligible expenditures that can be reimbursed from job development credits has been amended: (a) to clarify that real property acquired by capital or operating lease with at least a 5 year term, may qualify as an eligible expenditures if approved by the Council and (b) to provide only employee relocation expenses for those employees to whom the company is paying gross wages of at least twice the lower of the per capita income of the state or the county in which the project is located, qualify as eligible expenditures.

Effective Date: January 1, 2011

House Bill 4478, Section 18 (Act No. 351)

Credit against License Fee on Utilities and Electric Cooperatives for Eligible Infrastructure Projects - Amended

Code Section 12-20-105, which provides a credit for amounts paid in cash for qualifying infrastructure for an eligible project against the license fee imposed on utilities and electric cooperatives in Code Section 12-20-100, has been amended as follows:

1. Subsection (B)(2), which formerly allowed an office, business, commercial, or industrial park or combination of these parks to be considered an eligible project for purposes of the credit, has been amended to allow a project located in an office, business, commercial, or industrial park or combination of these parks to be

considered an eligible project. The amendment also expands who can own or construct a project to include agencies of the State.

2. Subsection (C)(4) has been amended to allow incubator buildings owned by the county, political subdivision, or agency of the State to qualify as eligible infrastructure.
3. Section (H) was added to provide that by March 1 of each year the Department will issue a report to the Chairman of the Senate Finance Committee, the Chairman of the House Ways and Means Committee, and the Secretary of the Department of Commerce outlining the history of the credit including the amount of credit allowed and the types of infrastructure provided to eligible projects.

Effective Date: January 1, 2011

House Bill 4478. Sections 24 - 27 (Act No. 290)

Renewable Energy Manufacturing Facility - New Tax Incentives

The South Carolina Life Sciences Act in Chapter 15, Title 12, providing certain tax benefits to life science facilities located in South Carolina, has been renamed The South Carolina Life Sciences and Renewable Energy Manufacturing Act, and expanded to apply to a "renewable energy manufacturing facility."

Code Section 12-15-20(B) has been added to define "renewable energy manufacturing facility." It is a business which manufactures qualifying machinery and equipment for use by solar and wind turbine energy producers. It also includes a facility manufacturing qualifying advanced lithium ion, or other batteries for alternative energy motor vehicles as described in Code Section 12-6-3377 or for other vehicles certified by the South Carolina Energy Office. The South Carolina Energy Office must qualify a facility as a renewable energy manufacturing facility and the decision is determinative as to whether the facility qualifies for the special tax benefits.

Code Section 12-15-30 provides special tax benefits to a renewable energy manufacturing facility that invests at least \$100 million in the project, as defined in Code Section 12-10-30(8) and creates at least 200 new full time jobs at the project with an average cash compensation level of at least 150% of the annual per capita income (of the state or of the county in which the facility is located, whichever is lower) based on the most recent per capita income data available as of the end of the tax year the jobs are filled. These benefits are:

- a. Job Development Credit Expense Benefit - Employee relocation expenses that qualify for reimbursement under Code Section 12-10-80(C)(3) include such expenses associated with a new or expanded facility.

Note Expiration: This incentive is only available for capital investments and new jobs created after June 30, 2010 and before July 1, 2014.

- b. Job Development Credit Retention Benefit - The Coordinating Council for Economic Development may approve a waiver for the facility to retain 95% of their job development credit under Code Section 12-10-80(D)(2). The "regular" job development credit provisions allow a taxpayer to retain 55% - 100% of job development credit benefits depending on the county in which its facility is located.

Note Expiration: This incentive is only available for capital investments and new jobs created after June 30, 2010 and before July 1, 2014.

Code Section 12-15-40 provides special allocation and apportionment tax benefits to a facility meeting the requirements of subitem (1)(a) of Section 12-15-20. It provides that the Department can enter into an agreement to allow the facility to use a special method of allocation and apportionment of income under Code Section 12-6-2320 for a period of up to 15 years.

Note: See the "Property Tax" Section below for a summary of the amendment in House Bill 4478, Section 28 (Act No. 290) providing for the depreciation rate for a renewable energy manufacturing facility.

Effective Date: June 23, 2010

Senate Bill 4514, Section 2 (Act No. 150) and House Bill 4478, Section 37 (Act No. 290)

Income Tax Paid by Shareholders of Large S Corporations Used for Project Funding

Code Section 12-6-590(C) was added to provide that half of all income taxes paid (up to \$5 million) by shareholders of an S corporation engaged in manufacturing with a new \$500 million capital investment at a single site and 400 new employees is to be placed in a fund and distributed by the Coordinating Council for Economic Development for public infrastructure improvements which directly support the project.

Effective Date: April 27, 2010

Note Repeal: This provision was repealed June 23, 2010 by House Bill 4478, Section 37 (Act No. 290).

REMINDER

The following provision was enacted in 2006, but is effective for tax years beginning after 2010. It is summarized below for informational purposes.

Senate Bill 91, Sections 50 through 55 (Act No. 110)

(See also House Bill 3749, Sections 55 through 60 (Act No. 116))

Single Factor Apportionment - Related Amendments Effective Upon Final Phase In of Single Sales Factor Apportionment Method

Effective for tax years beginning after 2006, Act No. 384 of 2006 amended Code Section 12-6-2250 to enact a single factor apportionment factor for businesses dealing in tangible personal property using the 3 factor (with double weighted sales) apportionment method. The single factor apportionment factor is being phased in and will replace the 3 factor (with double weighted sales) apportionment method for tax years beginning in 2011.

The following amendments, effective for tax years beginning after 2010, update cross references from Code Section 12-6-2250 (the 3 factor apportionment method with double weighted sales and phase in provisions of the single sales factor) to Code Section 12-6-2252 (the single sales factor apportionment method) for the following code sections:

1. Code Section 12-6-1130(6) dealing with computation of the depletion deduction;
2. Code Section 12-6-2240 dealing with apportionment of income; and
3. Code Section 12-6-2290 dealing with gross receipts factor.

The following code sections will be repealed once the sales factor is fully phased in effective for tax years beginning after 2010:

1. Code Section 12-6-2250 (the 3 factor apportionment method with double weighted sales and phase in provisions of the single sales factor);
2. Code Section 12-6-2260 (3 factor apportionment method property factor definition); and
3. Code Section 12-6-2270 (3 factor apportionment method payroll factor definition).

Effective Date: Tax years beginning after 2010.

PROPERTY TAXES and FEES IN LIEU OF PROPERTY TAXES

House Bill 4174, Sections 1.A, 1.B, and 1.C (Act No. 275)

Assessable Transfers of Interest in Real Property - Revisions to Included Transactions

The fair market value of real property is generally determined as a result of a periodic countywide reassessment program. Any increase in fair market value resulting from a countywide reassessment program is limited to 15% within a 5 year period. However, valuation may change as a result of an interim appraisal triggered by an assessable transfer of interest (ATI). The 15% cap does not apply to increases in value resulting from an interim appraisal triggered by an ATI.

Code Section 12-37-3150(A) contains a non-exhaustive list of transactions that constitute an ATI and thus trigger a new appraisal (ATI transactions). Some ATI transactions have specific exceptions that do not trigger a new appraisal (ATI exceptions). Certain items of Code Section 12-37-3150(A) have been amended as follows:

Item (3) provides that a conveyance to a trust is an ATI transaction, except if the settlor and/or the settlor's spouse conveys the property to the trust and the settlor and/or the settlor's spouse is the sole present beneficiary. New subitem (b) adds another ATI exception for conveyances by the settlor and/or the settlor's spouse of property subject to the special 4% assessment ratio applicable to primary residences, where there is no present beneficiary other than a child or children of the settlor and/or the settlor's spouse. However, a subsequent conveyance by the beneficiary child or children is not subject to this ATI exception.

Item (6) provides that a conveyance by distribution under a will or by intestate succession is an ATI transaction, except if the distributee is the decedent's spouse. New subitem (b) adds another ATI exception if (1) each distributee is a child of the decedent, (2) the decedent had no surviving spouse, and (3) the property is subject to the special 4% assessment ratio applicable to primary residences. However, a subsequent conveyance by the distributee child or children is not subject to this ATI exception.

Item (8) provides that a transfer of a majority ownership interest (greater than 50%) in a corporation, partnership, sole proprietorship, limited liability company, limited liability partnership or other legal entity, either in a single transaction or a part of a series of related transactions within a 25 year period, is an ATI transaction. This ATI transaction must be reported to the property tax assessor by the legal entity within 45 days of transfer. Item (8) has been amended to clarify that the provision does not apply to transfers that are not subject to federal income tax, as provided in Code Section 12-37-3150(B)(1), including but not limited to transfers of interests to spouses. In addition,

item (8) has been amended to provide that failure to provide notice or accurate information of this ATI transaction subjects the property to a civil penalty of not less than \$100 or more than \$1,000 as determined by the assessor. This penalty is enforceable and collectible as property tax and is in addition to any other applicable penalties. Failure to provide notice is a separate offense for each year after the notice was required.

Effective Date: Applies to real property transfers after 2009. However, no refund is allowed on account of value adjusted by the changes to the provisions of Code Section 12-37-3150.

House Bill 4174, Section 1.D (Act No. 275)

Assessable Transfers of Interest in Real Property - Certain Transfers Excluded

Code Section 12-37-3150(B) contains a list of transactions that do not constitute an assessable transfer of interest (ATI) and thus do not trigger a new appraisal (non-ATI transactions). Code Section 12-37-3150(B) has been amended to add the following non-ATI transactions:

Item (10) - a transfer of an undivided, fractional interest in real estate, if the ownership interest conveyed in a single transaction or series of related transactions within a 25 year period is not more than 50% of the entire fee simple title to the real estate.

Item (11) - transfers between a single member limited liability company that is not taxed separately as a corporation and its single member.

Item (12) - a conveyance, assignment, release, or modification of an easement. This includes, but is not limited to, (a) a conservation easement as defined in Chapter 8, Title 27; (b) a utility easement; or (c) an easement for ingress, egress, or regress.

Item (13) - a transfer or renunciation by deed, release or agreement of a claim of interest in real property for the purpose of quieting and confirming title in the name of one or more of the existing owners or for the purpose of confirming or establishing the location of an uncertain or disputed boundary line.

Item (14) - the execution or recording of a deed to real property for the purpose of creating or terminating a joint tenancy with right of survivorship, provided the grantors and grantees are the same.

Effective Date: Applies to real property transfers after 2009. However, no refund is allowed on account of value adjusted by the changes to the provisions of Code Section 12-37-3150.

House Bill 4174, Section 2 (Act No. 275)

Fair Market Value of Real Property - 15% Cap Clarified

Code Section 12-37-3140(B), which provides generally for a limit of 15% on any increase in the value of real property attributable to a periodic countywide appraisal and equalization program, has been amended to clarify that the 15% limit must be calculated on the land and improvements as a whole.

Effective Date: June 16, 2010

House Bill 4478, Section 13 (Act No. 290)

Manufacturers' Real Property Used for Warehousing and Wholesale Distribution - Changes to Requirements for Alternative Classification

Code Section 12-43-220(a) concerns the classification of real and personal property owned by or leased to manufacturers and utilities and generally provides for an assessment ratio of 10.5% on property used in the conduct of the business. Item (4) has been amended to provide that real property owned by or leased to a manufacturer and used primarily for warehousing and wholesale distribution is not considered used in the conduct of the manufacturing business. Previously, this exception was available only for property used exclusively for warehousing and wholesale distribution. Real property that falls outside the manufacturers and utilities classification is generally taxed based on a 6% assessment ratio.

The amendment further clarifies that real property subject to this exclusion must not be physically attached to the manufacturing plant unless the warehousing and wholesale distribution area is separated by a permanent wall.

Effective Date: January 1, 2011

House Bill 4478, Section 28 (Act No. 290)

Renewable Energy Manufacturing Facility Machinery and Equipment - Depreciation Rate

Code Section 12-37-930 provides a schedule for depreciation of manufacturers' machinery and equipment used in the conduct of the manufacturing business. Schedule item 35, which provides a 20% depreciation rate for machinery and equipment used directly in the manufacturing process by a life sciences facility, has been amended to apply the 20% depreciation rate to machinery and equipment used directly in the manufacturing process by a renewable energy manufacturing facility.

To qualify as a renewable energy manufacturing facility, a business must:
(1) manufacture either qualifying machinery and equipment for use by solar and wind turbine energy producers or qualifying batteries for alternative energy motor vehicles; (2) invest \$100 million or more in the project, as defined in Code Section 12-10-30(8); and
(3) create at least 200 new full-time jobs at the project with an average cash compensation level of at least 150% of the annual per capita income (of the state or of the county in which the facility is located, whichever is lower) based on the most recent per capita income data available as of the end of the tax year in which the jobs are filled.

Note: See the "Income Tax" Section above for a summary of certain tax benefits for a renewable energy manufacturing facility provided in House Bill 4478, Sections 24 - 28 (Act No. 290).

Effective Date: June 23, 2010

House Bill 4839 (Act No. 264)

Medal of Honor Recipients - Exemption Clarified

Code Section 12-37-220(B)(43) provides an exemption for the home and an acre or less of land owned in fee or for life or jointly with a spouse by a resident of this State who is a recipient of the Medal of Honor. This provision has been amended to clarify that it applies regardless of when the Medal of Honor was awarded or the conflict involved.

Effective Date: June 11, 2010

Senate Bill 1024 (Act No. 175)

Paraplegic/Hemiplegic Persons - Exemption Expanded

Code Section 12-37-220(B)(2) allows an exemption for the home and an acre or less of land owned in fee or for life or jointly with a spouse by a paraplegic or hemiplegic person, including certain persons with Parkinson's Disease, Multiple Sclerosis, or Amyotrophic Lateral Sclerosis (ALS, also known as Lou Gherig's Disease). This provision has been amended to clarify that the exemption is allowed to the surviving spouse of any qualifying person, provided the spouse does not remarry, resides in the dwelling, and obtains the fee or a life estate in the dwelling.

Effective Date: Applies for property tax years beginning after 2009.

Senate Bill 405, Section 2 (Act No. 279)

Boats - Local Option for In-State Situs Revised

Code Section 12-37-714(2) provides that boats and boat motors that are not currently taxed in South Carolina and that are not used exclusively in interstate commerce (*i.e.*, qualifying boats and boat motors) are subject to South Carolina property taxes if present within the State (a) for 60 consecutive days or (b) for 90 days in the aggregate in a property tax year. Alternatively, a county, by ordinance of the local governing body, may subject qualifying boats and boat motors to property tax if present within the State for an alternative period of 180 days in the aggregate.

The provision has been amended to clarify that the number of consecutive days is to be disregarded if the county opts for the 180 day alternative period. The amendment further allows a county, by ordinance of the local governing body, to subject qualifying boats and boat motors to property tax if present within the State for 90 days in the aggregate, regardless of the number of consecutive days.

Effective Date: June 16, 2010

Senate Bill 405, Sections 1 and 3 (Act No. 279)

Boats Classified as a Primary or Secondary Residence - Revised

Code Section 12-37-224, allowing certain boats or watercraft to be treated as a primary or secondary residence for property tax purposes, and assessed at a 4% or 6% assessment ratio, respectively, has been amended. The amendments pertaining to the assessment ratio and valuation of these boats and watercraft are as follows:

1. New subsection (B) was added to clarify that a boat or watercraft that qualifies for classification as a primary or secondary residence is one that contains (a) a cooking area with an onboard power source, (b) a sleeping quarter, and (c) a toilet with exterior evacuation. Previously, Code Section 12-37-224 provided for primary or secondary residence status if the boat or watercraft qualified for deduction of the interest expense on a qualified primary or secondary residence pursuant to the Internal Revenue Code.
2. New subsection (B) allows only an individual to claim one qualifying boat or watercraft that he owns as a primary residence (4% assessment ratio). In addition, an individual may claim a second qualifying boat or watercraft that he owns as a secondary residence (6% assessment ratio). Finally, a person other than an individual may claim a qualifying boat or watercraft that the person owns as a secondary residence (6% assessment ratio). A "person" is defined to include an individual, a sole proprietorship, a partnership, an S corporation, and a limited liability company taxed as a sole proprietorship, a partnership, or an S corporation.

An individual claiming a boat as a primary residence must make the same certification required to obtain the 4% assessment ratio for any other legal residence under Code Section 12-43-220(c)(2)(ii).

3. New item (B)(1) of Code Section 12-37-224 provides that the fair market value of qualifying boats and watercraft must be determined in the manner that motor vehicles are valued for property tax purposes (*i.e.*, by reference annually to nationally recognized publications except that the value may not exceed 95% of the previous year's value). The amendment restated but did not change the method of valuation.

In a related amendment, Code Section 12-37-220(B)(38)(b), providing that, by ordinance, a local governing body of a county may exempt from property tax 42.75% of the fair market value of a watercraft and its motor, has been amended to clarify that the exemption does not apply to a boat or watercraft classified for property tax purposes as a primary or secondary residence under Code Section 12-37-224. A corresponding amendment was made to Code Section 12-37-224.

Effective Date: June 16, 2010

Senate Bill 405, Section 4 (Act No. 279)

Transfer of Title to Watercraft - Delinquent Property Tax Penalties Revised

Code Section 50-23-295, which prohibits transfer of title to watercraft or an outboard motor unless the seller certifies that property taxes due for tax years beginning after 1999 have been paid and are current as of the date of sale, has been amended. The civil penalty for falsely signing the certification has been revised and a new criminal penalty has been added.

Civil penalty revised. As amended, subsection (B) provides that a seller who falsely signs the certification that property taxes are current and paid on a watercraft transferred to the buyer, is liable to the buyer for 3 times the amount of damages directly associated with the false certification, as well as applicable costs and reasonable attorney's fees. This provision for damages is in addition to all applicable criminal penalties. Previously, subsection (B) provided that, in addition to all criminal penalties, the penalty for falsely signing the certification was a \$500 fee and suspension of any title issued in the seller's name pending payment of the \$500 fee and all taxes due.

New criminal penalty added. As amended, subsection (B) provides that a person who knowingly sells a watercraft for which he owes unpaid and outstanding property taxes, or on which he knows there is a property tax lien, is guilty of a misdemeanor. A person convicted of this misdemeanor must be fined not more than \$1,000 or imprisoned not more than 30 days.

Effective Date: June 16, 2010

Senate Bill 728, Section 5 (Act No. 182)

**Rehabilitated Historic Property and Low and Moderate Income Rental Property -
Special Property Valuation**

Code Section 4-9-195 provides a special method for valuing rehabilitated historic property and low or moderate income rental property for property taxes that result in a special assessment. Under Code Section 4-9-195(E), once a property has received a final certification and is assessed as either rehabilitated historic property or low or moderate income property rental property, it remains certified and is granted the special assessment until a disqualifying event occurs, including a sale or transfer of ownership during the special assessment period other than in the ordinary course of probate proceedings. Notifications of any change affecting ability must be given immediately to the appropriate county and taxing authorities.

Subsection (E) has been amended to provide that the sale or transfer of the property during the special assessment period will no longer disqualify the property from receiving the special assessment. In addition to being applicable to future transactions, this change applies retroactively to any special property assessment granted prior to the effective date of the change notwithstanding any ordinance in effect to the contrary.

Effective Date: May 28, 2010

Senate Bill 728, Sections 1 - 4 (Act No. 182)

Textile Mill Revitalization Credit - Amended

The South Carolina Textile Communities Revitalization Act, contained in Title 12, Chapter 65, provides a credit for the rehabilitation of abandoned textile mill sites in South Carolina. Code Section 12-65-30 allows a taxpayer who rehabilitates an abandoned textile mill site to choose one of the following credits: (1) a credit against real property taxes or (2) a credit against income tax, corporate license fees, or both or a credit against bank taxes.

General amendments applicable to the Textile Communities Revitalization Act include:

1. Code Section 12-65-20(3) has been amended to provide that a "textile mill" is a facility or facilities that were "initially" used for textile manufacturing, dying, or finishing operations and for ancillary uses to those operations. The amendment replaced the word "last" with "initially."
2. Code Section 12-65-30(D) has been amended to add that a taxpayer is not eligible for the credit if the facility has previously received textile mill credits. The statute continues to provide that a taxpayer who owned the textile mill site when it was operational and immediately prior to its abandonment is not eligible for the credit.

3. Code Section 12-65-60 has been added to provide a procedure which allows the taxpayer to apply to the county or municipality in which the textile mill site is located for certification of the site. The certification can be done by either ordinance or binding resolution of the applicable governing body. The certification must include findings that the site was a textile mill as defined in Code Section 12-65-20(3); that the site is abandoned as provided in Code Section 12-65-20(1); and that the geographic site is consistent with Code Section 12-65-20(4), which provides a definition of textile mill site. The taxpayer may conclusively rely upon the certification in determining the credit allowed. If the taxpayer relies on the certification, a copy must be included with the first return on which the credit is claimed.
4. Code Section 12-65-50 has been added to provide rules to determine the statutory provisions applicable to a taxpayer.
 - a. The provisions of Title 12, Chapter 65 apply to all textile mill sites, or portions thereof, placed in service on or after January 1, 2008.
 - b. Entire textile mill sites placed in service on or before December 31, 2007, are governed by the former provisions of Chapter 32, Title 6 (*i.e.*, the former statutory provisions containing the textile revitalization credit) in effect as of December 31, 2007.
 - c. If a portion of the textile mill site was placed in service on or before December 31, 2007, but not all, then the taxpayer may elect to either: (i) have the portion that was placed in service on or before December 31, 2007, governed by the former provisions of Chapter 32, Title 6, in effect as of December 31, 2007, as if the portion were an entire textile mill site; or (ii) have the portion be governed by the provisions of Title 12, Chapter 65 such that the portion must be deemed to be a phase of the site placed in service on a date subsequent to December 31, 2007, identified by the taxpayer.

Note: See the "Income Taxes, Withholding, and Corporate License Fees" Section above for a summary of additional amendments in this Act that pertain only to the "income tax/corporate license fee/bank tax/insurance premium tax" part of this credit.

Effective Date: May 28, 2010

House Bill 4663, Section 1 (Act No. 232)

Fire Sprinkler System Tax Credit - Committee Appointed to Study Credit Use

Code Section 12-6-3622, dealing with the fire sprinkler system tax credit, has been amended to add subsection (e) which requires the General Assembly to appoint a study committee composed of three members appointed by the President Pro Tempore of the

Senate and three members appointed by the Speaker of the House of Representatives, including one representative from each of the following organizations: the South Carolina Fire Sprinkler Association, the South Carolina Home Builders Association, the South Carolina Association of Counties, and the Municipal Association of South Carolina. The study committee will develop strategies to increase participation in the tax credit program by local taxing entities and to review and make recommendations for increasing the installation of interconnected hard-wired smoke alarms. The committee will report its findings to the General Assembly by January 20, 2011. At that time the committee will dissolve.

Effective Date: June 7, 2010

House Bill 4478, Sections 2 - 5 (Act No. 290)

Little Fee - Revised for Time Limits, Valuation, and Qualifications

1. Code Section 4-12-30(B)(4)(b) has been amended to provide that if a project consists of a manufacturing, research and development, corporate office, or distribution facility, each sponsor or sponsor affiliate is not required to invest \$2.5 million, if the total investment in the project exceeds \$5 million. Previously, the total investment had to exceed \$10 million.

Effective Date: Agreements executed after January 1, 2011. However, a taxpayer and a county may amend an existing agreement at any time prior to the expiration of the fee to incorporate this change into the agreement.

2. Code Section 4-12-30(C)(4) has been amended to provide that a single piece of property may be subject to the fee for no more than 30 years. Previously, the statute provided that a single piece of property could be subject to the fee for up to 20 years. By resolution on a finding of substantial public benefit, the county may agree to extend this period for another 10 years. Corresponding amendments provide that if a county allows the additional 10 year extension, a single piece of property can be subject to the fee for up to 40 years, and the project itself can be subject to the fee for up to 50 years. For the super fee, a single piece of property can be subject to the fee for up to 40 years (with the extension) and the project itself can be subject to the fee for up to 53 or 55 years depending on the specifics of the project. Previously, the super fee time limits were 30 years and 43 or 45 years, respectively.

Effective Date: Effective for agreements executed after January 1, 2011. However, a taxpayer and a county may amend an existing agreement at any time prior to the expiration of the fee to incorporate this change into the existing agreement.

3. Code Section 4-12-30(D)(2)(a)(i), which provides that real property is generally valued at original cost for the life of the fee, has been amended to provide that a county and a sponsor or sponsor affiliate may agree (initially or by amendment) that the value of real property subject to the fee will be determined by an appraisal completed by the Department. If the county and the sponsor or sponsor affiliate agree to appraisal by the Department, the property will be subject to reappraisal no more than once every 5 years.

Effective Date: Effective in each county in the first property tax year in which a county reassessment program is implemented after December 31, 2010.

4. Code Section 4-12-30(J)(1)(b) has been amended to provide that property that has been subject to South Carolina property taxes is eligible for the fee if it was placed in service in the State pursuant to an inducement agreement or other preliminary county approval before the execution of a lease agreement. Before this amendment, previously taxed property would qualify only if it had not been placed in service.

Effective Date: January 1, 2011

House Bill 4478, Section 6 (Act No. 290)
(See also Senate Bill 1131 (Act No. 161))

Big Fee - Revised for Nuclear Power Plants, Extended Time Periods, Valuation, and Qualification

1. Code Section 4-29-67(A)(1)(d) has been added to provide a definition of a "qualified nuclear plant facility." A "qualified nuclear plant facility" is a nuclear electric power generating plant regulated by the Nuclear Regulatory Commission and includes all real and personal property incorporated into or associated with the facility located or to be located within this State with a total minimum level of investment of \$1 billion. Senate Bill 1131 made a substantially similar change to Code Section 4-29-67.

Effective Date: May 12, 2010 (Act No. 161) and June 23, 2010 (Act No. 290)

2. Code Section 4-29-67(B)(4) has been amended to provide that if a project consists of a qualified nuclear plant facility, a sponsor or sponsor affiliate is not required to invest \$45 million each, if the total investment in the project exceeds \$45 million. Senate Bill 1131 made a substantially similar change to Code Section 4-29-67.

Effective Date: May 12, 2010 (Act No. 161) and June 23, 2010 (Act No. 290)

3. Code Section 4-29-67(C)(3) has been amended to provide that a single piece of property may be subject to the fee for no more than 30 years. Previously, the statute provided that a single piece of property could be subject to the fee for up to 20 years. By resolution on a finding of substantial public benefit, the county can agree to

extend this period for another 10 years. Corresponding amendments provide that if a county allows the additional 10 year extension provided for in the statute, a single piece of property can be subject to the fee for up to 40 years, and the project itself can be subject to the fee for up to 50 years. For the super fee, a single piece of property can be subject to the fee for up to 40 years (with the extension) and the project itself can be subject to the fee for up to 53 or 55 years depending on the specifics of the project. Previously, the super fee time limits were 30 years and 43 or 45 years, respectively.

Effective Date: January 1, 2011. However, a county may amend an existing agreement at any time prior to the expiration of the fee to incorporate this change into the agreement.

4. Code Section 4-29-67(D)(2)(a)(iii)(A) which provides that real property is generally valued at original cost for the life of the fee, has been amended to provide that a county and a sponsor or sponsor affiliate may agree (initially or by amendment) that the value of real property subject to the fee will be determined by an appraisal completed by the Department. If the county and the sponsor or sponsor affiliate agree to appraisal by the Department, the property will be subject to reappraisal no more than once every 5 years.

Effective Date: Effective in each county in the first property tax year in which a county reassessment program is implemented after December 31, 2010.

5. Code Section 4-29-67(K)(1)(b) has been amended to provide that property that has been subject to South Carolina property taxes, is eligible for the fee if it was placed in service in the State pursuant to an inducement agreement or other preliminary county approval before the execution of a lease agreement. Before this amendment, previously taxed property would qualify only if it had not been placed in service.

Effective Date: June 23, 2010

6. Code Section 4-29-67(W) now provides a qualified nuclear plant facility additional time to enter into an initial lease agreement with the county and if the project qualifies as a super fee, a taxpayer operating a qualified nuclear plant facility is given additional time to make the minimum investment and complete the project. Senate Bill 1131 made a substantially similar change to Code Section 4-29-67.

Effective Date: May 12, 2010 (Act No. 161) and June 23, 2010 (Act No. 290).

House Bill 4478, Sections 8 - 12 (Act No. 290)
(See also Senate Bill 1131, Sections 1 - 2 (Act No. 161))

**Simplified Fee - Revised for Nuclear Power Plants, Extended Time Period,
Valuation, and Qualification**

1. Code Section 12-44-30(17) has been added to define a "qualified nuclear plant facility." A "qualified nuclear plant facility" is a nuclear electric power generating plant regulated by the Nuclear Regulatory Commission and includes all real and personal property incorporated into or associated with the facility located or to be located within this State with a total minimum level of investment of \$1 billion. Code Section 12-44-30(2) has been amended to provide that the "commencement date" of a qualified nuclear plant facility is the last day of the first property tax year in which economic development property is placed in service. Code Section 12-44-30(13) has been amended to provide that the "investment period" for a qualified nuclear plant facility is the period beginning with the first day that economic development property is purchased or acquired for the qualified nuclear plant facility and ending 10 years after the commencement date. Code Section 12-44-40(F) has been added extending the statutory time period for a qualified nuclear plant facility to enter into a fee agreement. Senate Bill 1131 made substantially similar amendments to Code Sections 12-44-30 and 12-44-40.

Effective Date: May 12, 2010 (Act No. 161) and June 23, 2010 (Act No. 290).

2. Code Section 12-44-30(19) has been amended to provide that if a project consists of a manufacturing, research and development, corporate office, or distribution facility, each sponsor or sponsor affiliate is not required to invest the \$2.5 minimum investment if the total investment at the project exceeds \$5 million. Previously, the project had to exceed \$10 million to qualify. This item was also amended to include qualified nuclear plant facility as an eligible project for the reduced combined investment. Senate Bill 1131 made a substantially similar change to Code Section 12-44-30 regarding qualified nuclear plant facilities.

Effective Date: May 12, 2010 (Act No. 161) and June 23, 2010 (Act No. 290).

3. Code Section 12-44-30(21) has been amended to provide that the "termination date" is the last day of the property tax year that is the 29th year following the first property tax year in which an applicable piece of economic development property is placed in service. By resolution or a finding of substantial public benefit, the county may agree to extend this period for another 10 years. Previously, the termination date was the 19th year after the economic development property is placed in service or the 29th year

for property subject to an enhanced investment fee, and a single piece of property could be subject to the fee for a total of 30 years.

Effective Date: January 1, 2011. However, a county and a sponsor may amend an existing fee agreement any time before the expiration of the fee to incorporate this change.

4. Section 12-44-50(A)(1)(c)(i) which provides that real property is generally valued at original cost for the life of the fee, has been amended to provide that a county and a sponsor or sponsor affiliate may agree (either initially or by amendment) that real property subject to the fee will be determined by an appraisal completed by the Department. If the county and the sponsor or sponsor affiliate agree to appraisal by the Department, the property will be subject to reappraisal no more than once every 5 years.

Effective Date: Effective in each county in the first property tax year in which a countywide reassessment program is implemented after December 31, 2010.

5. Code Section 12-44-110(2) has been amended to provide that property that has been subject to South Carolina property taxes, is eligible for the fee if it was placed in service in the State pursuant to an inducement agreement or other preliminary county approval before the execution of a lease agreement. Before this amendment, previously taxed property would qualify only if it had not been placed in service.

Effective Date: January 1, 2011

Senate Bill 4514, Section 1 (Act No. 150) and House Bill 4478, Section 37 (Act No. 290)

Simplified Fee - "Termination Date" Definition

Code Section 12-44-30(21), defining "termination date", has been amended to provide that the termination date is the last day of a property tax year that is the 29th year following the first property tax year in which an applicable piece of economic development property is placed in service. Prior to amendment, it was the 19th year.

Effective Date: April 27, 2010

Note Repeal: This provision was repealed June 23, 2010 by House Bill 4478, Section 37 (Act No. 290).

House Bill 4478, Section 7 (Act No. 290)

Special Source Revenue Bonds or Credits - Eligible Uses Expanded

Code Section 4-29-68 allows a county to issue special source revenue bonds to pay for, among other things, improved or unimproved real property associated with a manufacturing or commercial project. Code Section 4-29-68(A)(2) has been amended to provide that bonds may be issued, or a credit against the fee may be given, to pay for the cost of personal property including machinery and equipment used in the operation of such a project.

If the bonds, or monies from a credit allowed against the fee due on the property, are used to pay for personal property, and the personal property is removed from the project during the time the fee is in effect and the removed property is not replaced with qualifying replacement property, the amount of the fee due for that property must be paid for the year it is removed and for the 2 years following its removal from the project. If any bond funds or credit fund are used to pay for both real and personal property, or infrastructure and personal property, all of the funds will be presumed to have first been used to pay for personal property. The fee amounts described above will be remitted to the county in which the project is located.

Effective Date: January 1, 2011

House Bill 4478, Section 15B (Act No. 290)

Industrial Development Projects - Definition of Project Changed

Code Section 4-29-10(3), which provides a definition of project that is to be used for industrial development projects under Chapter 29, Title 4 (including industrial development bonds and special source revenue bonds) has been amended to provide that for purposes of Chapter 29, Title 4, unless a different meaning clearly appears from the context, a "project" includes any "recovery zone property" as defined in Internal Revenue Code Section 1400U-3(b) and any "Qualified Conservation Purpose" as defined in Internal Revenue Code Section 54D(f) or any other purposes set forth in Section 54D(e). None of the other restrictions contained in the definition of "project" relating to the use or the user of the project apply to "recovery zone property."

Recovery zone property is property to which Internal Revenue Code Section 168 applies (or would apply but for Section 179) and which was constructed or acquired for use in the zone after the designation of the recovery zone. To qualify, the original use of the property must commence with the taxpayer in the recovery zone and the property must be used in the active conduct of a qualified business in the zone. A qualified business is any trade or business except the rental of residential real property or certain leisure and other businesses, such as country clubs, massage parlors, and stores that are primarily engaged in the sale of alcohol.

A "recovery zone" is an area designated by a state or local political subdivision as having significant poverty, unemployment, home foreclosures or general distress or an area that has already been designated as an Empowerment Zone or Renewal Community.

A "qualified conservation purpose" includes (a) expenditures incurred for certain energy facilities and purposes; (b) research and development facilities that support alternative energies; (c) mass commuting facilities that reduce the consumption of energy from vehicles used for mass commuting; (d) demonstration projects for the promotion of commercialization of certain green technologies; and (e) public education campaigns to promote energy efficiency.

Note: The definition of "project" contained in Code Section 4-29-67(A)(1)(c), the big fee statute, was not amended.

Effective Date: June 23, 2010

SALES AND USE TAXES

Senate Bill 717 (Act No. 280)

Nonprofit Research and Testing Facility - New Exemption

Code Section 12-36-2120 has been amended to add an exemption for machinery and equipment, building and other raw materials, and electricity used in the operation of a facility owned by a nonprofit organization exempt under Internal Revenue Code Section 501(c)(3) when the facility is principally used for researching and testing the impact of natural hazards, such as wind, fire, water, earthquake, and hail, on building materials used in residential, commercial, and agricultural buildings.

To qualify for this exemption, the taxpayer must send a notice to the Department of its intent to qualify for the exemption and must invest at least \$20 million in real or personal property at a single site in this State over a 3 year period beginning on the date provided by the taxpayer to the Department in the notice. After the taxpayer notifies the Department of its intent to qualify and use the exemption, the Department must issue an exemption certificate to the taxpayer to be used for qualifying exempt purchases. The taxpayer must also send a notice to the Department within 6 months of the third anniversary of the taxpayer's first use of the exemption advising the Department that it has either met or not met the \$20 million investment requirement.

The Department may assess any tax due on the machinery and equipment purchased tax free but due the State as a result of the taxpayer's failure to meet the \$20 million investment requirement. The running of the periods of limitations for assessment of taxes is suspended for the time period beginning with notice to the Department before the taxpayer uses the exemption and ending with notice to the Department that the taxpayer has either met or not met the \$20 million investment requirement.

Effective Date: June 16, 2010

MISCELLANEOUS

(Summarized by Subject Matter)

ADMINISTRATIVE and PROCEDURAL MATTERS

House Bill 4657, Part IB, Section 89, Proviso 89.142 (Act No. 291)

Additional 1% Reduction on Interest Rate on Tax Refunds

This new temporary proviso decreases by 1% the interest rate for tax refunds paid during the current fiscal year, in addition to the 2% reduction reauthorized in temporary Proviso 72.17 (for a total 3% interest rate reduction). Of the revenue resulting from this 1% reduction, \$250,000 must be used by the Senate for operating expenses of the Joint Citizens and Legislative Committee on Children. The remaining revenue must be used by the Department of Juvenile Justice for programs for mentoring or other alternatives to incarceration. The revenue resulting from the 2% reduction continues to be used for operations of the State's Guardian ad Litem Program.

Effective Date: This temporary proviso is effective for State fiscal year July 1, 2010 through June 30, 2011.

Senate Bill 850, Section 2 (Act No. 274)

Failure to File and Failure to Pay Penalties and Interest for Payment in Immediately Available Funds - Amended

Code Section 12-54-250(E) has been repealed. Code Section 12-54-250(E) provided that when payment was made with immediately available funds, the payment of the funds and the filing of the return were considered simultaneous acts for calculating failure to file and failure to pay penalties and interest. As a result, penalties and interest were calculated based on the later of the return file date or payment date. Now the failure to file penalty will be based on the date the return is filed and the failure to pay penalty will be based on the payment date. Code Sections 12-54-43(C) and (D).

Effective Date: June 17, 2010

MISCELLANEOUS TAX LEGISLATION

House Bill 3584 (Act No. 170)

Cigarette Tax Increase and Definition of Cigarette Expanded

Code Section 12-21-625 has been added to impose a surtax on cigarettes of \$0.025 per cigarette. This surtax is in addition to the \$0.0035 per cigarette excise tax imposed on cigarettes under Code Section 12-21-620.

With the new surtax, the State cigarette tax rate will increase from \$0.07 to \$0.57 per pack of 20 cigarettes and from \$0.0875 to \$0.7125 per pack of 25 cigarettes. The new surtax became effective July 1, 2010.

In addition, the definition of a "cigarette" was expanded to include "any roll for smoking containing tobacco or any substitute for tobacco, wrapped in any substance, weighing 3 pounds per thousand or less, however labeled or named, which because of its appearance, size, type of tobacco used in the filler, or its packaging, pricing, marketing, or labeling, is likely to be offered to, or purchased by, consumers as a cigarette" This new definition became effective May 13, 2010.

Effective Date: May 13, 2010; however, the cigarette tax increase became effective July 1, 2010.

House Bill 4233 (Act No. 228)

Beer Definition Revised Retroactively for Beer License Tax Purposes

Code Section 12-21-1010(3), which contains the definition of "beer" for purposes of the beer tax in Article 7, Chapter 21, Title 12, has been amended to provide that "beer" has the same meaning as used in the Alcoholic Beverage Control Act in Title 61. The beer tax now applies to:

1. All beers, ales, porters, and other similar malt or fermented beverages containing not in excess of 5% of alcohol by weight, as provided in Code Section 61-4-10(1); and
2. All beers, ales, porters, and other similar malt or fermented beverages containing more than 5% but less than 14% of alcohol by weight that are manufactured, distributed, or sold in containers of 6 ½ ounces or more or the metric equivalent, as provided in Code Section 61-4-10(2).

Effective Date: June 7, 2010, and applies retroactively to May 2, 2007.

House Bill 4478, Section 14 (Act No. 290)

Rural Infrastructure Funds - Eligible Expenditures Expanded

Code Section 12-10-85, establishing the Rural Infrastructure Fund to provide funds to local governments for infrastructure and economic development, has been amended to expand the eligible expenditures. Eligible expenditures funds can be used for now include: (1) site preparation, (2) acquiring or improving real property, and (3) relocation expenses of an employee if the company pays wages to the employee that are at least twice the State average or the county average for the county in which the project is located, whichever is lower.

Effective Date: January 1, 2011

OTHER ITEMS (Including Local Taxes)

House Bill 4551 (Act No. 135)

911 Communications Systems - New Charge for Prepaid Wireless and Voice over Internet Protocol

Chapter 47 of Title 23 governs local emergency telephone systems (*i.e.*, 911 systems). It provides, in part, that fees ("911 charges") may be imposed to fund an emergency telephone system with respect to the public telephone system and commercial mobile radio service. While 911 charges imposed with respect to the public telephone system are paid directly to the local government imposing the 911 charge, 911 charges imposed with respect to commercial mobile radio service are paid to the Department. The Department is required to deposit these 911 charges with the State Treasurer for distribution pursuant to Code Section 23-47-65.

Chapter 47 has been amended to include new provisions that allow 911 charges to be imposed on prepaid wireless telecommunications services and "Voice over Internet Protocol" ("VoIP").

Prepaid Wireless 911 Charge: Code Section 23-47-68 has been added with respect to the new prepaid wireless 911 charge to provide the following:

1. A prepaid wireless 911 charge is levied on each prepaid wireless retail transaction occurring in South Carolina. This prepaid wireless 911 charge will be an amount equal to the average commercial mobile radio service 911 charge.
2. A prepaid wireless seller must collect the prepaid wireless 911 charge from a prepaid wireless consumer. The amount of the prepaid wireless 911 charge shall be either

separately stated on an invoice, receipt, or other similar document that is provided to the prepaid wireless consumer by the prepaid wireless seller or otherwise disclosed to the prepaid wireless consumer.

3. The prepaid wireless retail transaction must be sourced the same as provided in Code Section 12-36-910(B)(5)(b).
4. The prepaid wireless 911 charge is the liability of the prepaid wireless consumer and not the prepaid wireless seller or any prepaid wireless provider. However, the prepaid wireless seller is liable to remit to the Department all prepaid wireless 911 charges that the prepaid wireless seller collects from prepaid wireless consumers.
5. The amount of the prepaid wireless 911 charge collected by a prepaid wireless seller is not includable in the base for measuring any tax, fee, prepaid wireless 911 charge, or other charge that is imposed by this State, any of its political subdivisions, or any intergovernmental agency. The prepaid wireless 911 charge is not considered revenue of the prepaid wireless seller.
6. The Department must establish procedures by which a prepaid wireless seller may document that a sale is not a prepaid wireless retail transaction, which procedures shall substantially coincide with the procedures for documenting sale for resale transactions under Code Section 12-36-950.
7. The prepaid wireless seller must remit the prepaid wireless 911 charge to the Department on a monthly, quarterly or annual basis; however, the prepaid wireless seller is entitled to retain 3% of the gross prepaid wireless 911 charges remitted to the Department as an administrative fee.

“Voice over Internet Protocol 911 Charge: Code Section 23-47-67 has been added to impose a “Voice over Internet Protocol” (“VoIP”) 911 charge in an amount identical to the amount of the 911 charge imposed on each local exchange access facility pursuant to Code Sections 23-47-40(A) and 23-47-50(A). VoIP 911 charges are remitted to the local government to which they are sourced.

Prohibition on Other 911 Charges: Code Section 23-47-69 was added to prohibit the State, any of its political subdivisions, or an intergovernmental agency from requiring any service provider to impose, collect, or remit a tax, fee, surcharge, or other charge for 911 funding purposes other than the 911 charges set forth in Chapter 47 of Title 23.

Advisory Committee: Code Section 23-47-65 was amended to change the name of the “CMRS Emergency Telephone Service Advisory Committee” to the “South Carolina 911 Advisory Committee.”

Definitions: Code Section 23-47-10 was amended to add various definitions for terms related to prepaid wireless and VoIP 911 charges.

Effective Date: July 1, 2011, except that the addition of, or amendments to, Code Sections 23-47-55 (not summarized), 23-47-69, and 23-47-70 (not summarized) are effective March 30, 2010.

House Bill 4478, Section 34 (Act No. 290)

Redevelopment Authority Fees Extended for 2 Years

Code Section 12-10-88 provides that federal employers located on a closed or realigned military installation are to remit a portion of their employees' South Carolina withholding to the redevelopment authority overseeing that facility if the redevelopment authority complies with reporting requirements. These redevelopment fees may be remitted to the redevelopment authority beginning with the date the redevelopment authority first submitted the required information to the Department and for 15 years thereafter or until January 1, 2015, whichever occurs last. This provision has been amended to provide for the collection and remittance of the redevelopment fees for the 15 year period or through January 1, 2017, whichever occurs last.

Effective Date: January 1, 2011

REGULATORY LEGISLATION

House Bill 4837 (Act No. 263)

(See also House Bill 4657, Part IB, Section 81, Proviso 81.9 (Act No. 291))

Bingo Licenses and Definition of Nonprofit Organization - Changes

Code Section 12-21-3940(D), which concerns bingo licenses and prohibits the issuance of a bingo license at an establishment that holds an alcoholic liquor-by-the-drink license issued under Code Section 61-6-1820, has been repealed. Bingo licenses may now be issued at an establishment that holds an alcoholic liquor-by-the-drink license.

Code Section 12-21-3950(5), which defines the term "nonprofit organization" for purposes of the Bingo Tax Act of 1996 (Title 12, Chapter 21, Article 24), has been amended to include organizations exempt from federal income taxes under Internal Revenue Code Section 501(c)(7). For purposes of the Bingo Tax Act of 1996, a "nonprofit organization" now means "an entity which is organized and operated exclusively for charitable, religious, or fraternal purposes and which is exempt from federal income taxes pursuant to Internal Revenue Code Section 501(c)(3), 501(c)(4), 501(c)(7), 501(c)(8), 501(c)(10), or 501(c)(19)."

Effective Date: June 11, 2010

House Bill 4516, Section 1 (Act No. 259)

Temporary Beer and Wine Permits for Special Events – Revised

Code Section 61-4-550, which authorizes the Department to issue one-day beer and wine permits running for a period not exceeding 15 days, for a fee of \$10 per day, for locations at fairs and special functions, has been amended as follows:

Permits restricted to nonprofit organizations. Under the amendment, an applicant for this permit must be a “nonprofit organization,” defined as:

1. An entity that is organized and operated exclusively for social, benevolent, patriotic, recreational, or fraternal purposes, and that is exempt from federal income taxes pursuant to Internal Revenue Code Section 501(c)(3), (4), (6), (7), (8), (10), or (19);
or
2. Political parties and their affiliates duly certified by the Secretary of State.

Criminal records check required for all principals. The initial application must be accompanied by a criminal records check of all principals of the organization, conducted by the State Law Enforcement Division not more than 90 days preceding the date of the application. Failure to comply will result in denial of the application. For a subsequent application, a new criminal records check is required only if (a) more than 2 years have elapsed since the most recent criminal records check was conducted or (b) the nonprofit organization has added or replaced a principal. “Principal” has the same meaning as in Code Section 61-2-100(H)(2). All principals are deemed to be the applicant for this permit.

Notification of sheriff required. The applicant must give written notice to the sheriff or sheriff’s designee in the county in which the fair or special event is to be held, a minimum of 15 days before the first day of the event, unless the sheriff waives the 15-day requirement. An objection by the sheriff or sheriff’s designee within 72 hours of receipt of the notice, submitted in writing to the Department is sufficient grounds to deny the application.

Penalties. The penalties imposed for violations of Article 1, Chapter 4, Title 61 apply to nonprofit organizations that are granted temporary permits under Code Section 61-4-550.

Effective Date: Applies to applications for functions beginning on January 1, 2011.

House Bill 4516, Sections 2 - 4 (Act No. 259)

Temporary License to Sell Alcoholic Liquor by the Drink at Special Functions - Revision, Repeal, and Technical Correction

The Alcoholic Beverage Control Act, Chapter 6 of Title 61, contains 2 statutes authorizing the Department to issue licenses to sell alcoholic liquor by the drink for a period not exceeding 24 hours. One statute has been amended and one statute has been repealed.

Temporary License Provision Amended. Code Section 61-6-2000, which authorizes the Department to issue licenses allowing nonprofit organizations to sell alcoholic liquor by the drink for a \$35 fee for a single function in a period not exceeding 24 hours, has been amended as follows:

Type of function. Previously, the temporary license was allowed for a "single social occasion." Under the amendment, the temporary license is allowed for a "special function," the nature and date of which must be described in the application, and the amendment clarifies that tickets may be sold at the door.

Deadline for application; terms and conditions on license. The Department may deny an application if the completed application and filing fee are not submitted at least 15 days before the date of the special function. The Department may waive the 15-day requirement on request of the applicant. The Department has discretion to specify the terms and conditions of the license in accordance with applicable statutes and regulations.

Definition of "nonprofit organization" added. Under the amendment, an applicant for this permit must be a "nonprofit organization," defined as:

1. An entity that is organized and operated exclusively for social, benevolent, patriotic, recreational, or fraternal purposes, and that is exempt from federal income taxes pursuant to Internal Revenue Code Section 501(c)(3), (4), (6), (7), (8), (10), or (19); or
2. Political parties and their affiliates duly certified by the Secretary of State.

Criminal records check requirements clarified. The initial application must be accompanied by a criminal records check of all principals of the organization, conducted by the State Law Enforcement Division not more than 90 days preceding the date of the application. Failure to comply will result in denial of the application. For a subsequent application, a new criminal records check is required only if (a) more than 2 years have elapsed since the most recent criminal records check was conducted or (b) the nonprofit organization has added or replaced a principal. "Principal" has the same meaning as in Code Section 61-2-100(H)(2). All principals are deemed to be the applicant for this license.

Notification of sheriff required. The applicant must give written notice within 15 days to the sheriff or sheriff's designee in the county in which the special function is to be held, unless the sheriff waives the 15-day requirement. An objection by the sheriff or sheriff's designee within 72 hours of receipt of the notice, submitted in writing to the Department, is sufficient grounds to deny the application.

Number of licenses issued pursuant to a single application. The Department may issue up to 25 temporary licenses on one application for special functions in a 12-month period to the same nonprofit organization. However, the nonprofit organization is not prohibited from applying for additional temporary licenses in the same 12-month period.

Penalties. The penalties imposed for violations of Article 13, Chapter 6, Title 61 apply to nonprofit organizations that are granted temporary permits under Code Section 61-6-2000.

Repeal and Technical Correction. Code Section 61-6-510, which authorizes the Department to issue temporary licenses allowing certain nonprofit organizations, nonprofit educational foundations and qualified political parties to sell alcoholic liquor by the drink for a \$35 fee for a period not exceeding 24 hours, has been repealed. This repeal is also reflected in a technical correction to Code Section 61-4-240, which provides that a temporary permit to sell beer and wine may be issued with certain temporary licenses to sell alcoholic liquor by the drink. The technical correction removes a reference to Code Section 61-6-510.

Effective Date: Applies to applications for functions beginning on January 1, 2011.

House Bill 4572, Section 1 (Act No. 231)

Beer Equipment and Beer Displays - Certain Restrictions on Dealings Between Beer Manufacturers, Wholesalers, and Retailers Revised

Code Section 61-4-940, which restricts certain dealings between beer manufacturers, beer wholesalers and beer retailers, has been amended as follows.

1. Subsection (B) prohibits manufacturers and wholesalers from furnishing fixtures and equipment to retailers, and likewise prohibits retailers from accepting such fixtures and equipment. The amendment to subsection (B) allows a wholesaler to store equipment primarily used by the wholesaler to deliver and stock beer, for a temporary period, at the retailer's licensed location if the retailer consents. Such equipment includes, but is not limited to, pallets, carts, and hand trucks.
2. Subsection (C), which allows a wholesaler to provide certain items and services at no charge to a retailer, has been amended to allow a wholesaler to furnish a retailer with

product displays pursuant to the provisions of 27 Code of Federal Regulations (C.F.R.), Section 6.83, excluding electronic refrigeration equipment. Such product displays must be furnished at no charge to the retailer. Product displays are defined by 27 C.F.R. 6.83 as "any wine racks, bins, barrels, casks, shelving, or similar items the primary function of which is to hold and display consumer products." Further, 27 C.F.R. 6.83 provides value limitations and advertising requirements for the product displays. A link to 27 C.F.R. 6.83, one of the federal "Tied House" regulations (Part 6 of 27 C.F.R.), is provided at the federal Alcohol and Tobacco Tax and Trade Bureau website: http://www.ttb.gov/trade_practices/laws_regs_tp.shtml.

3. Subection (F) has been amended to provide that no license holder on one tier of the beer business may require a license holder on another tier to furnish the product displays described in Subsection (C), as amended.

Effective Date: June 7, 2010

House Bill 4572, Section 2 (Act No. 231)

Breweries – Beer Tastings and Sales

Code Section 61-4-1515 has been added to allow South Carolina breweries to offer samples, with or without cost, and retail sales of beer brewed in South Carolina on the licensed premises.

Tastings. The following conditions apply:

1. Tastings must not be offered except as part of a tour by consumers of the licensed premises and the entire brewing process used there.
2. Consumers must not be intoxicated or under age 21.
3. Samples must be brewed at the licensed premises and must not exceed 2 ounces per brand of beer with an alcohol content over 8% by weight or 4 ounces of beer with an alcohol content under 8% by weight.
4. Not more than 4 brands of beer brewed at the licensed premises may be sampled by a consumer in a 24 hour period.

Retail sales. The following restrictions apply:

1. The beer must be brewed on the licensed premises with an alcohol content not exceeding 14% by weight.
2. Beer sales must not exceed an amount equivalent to 288 ounces per individual per day.

3. Beer must not be sold except as part of a tour by the consumer of the licensed premises and the entire brewing process used there.
4. Beer must not be sold for other than personal use; it cannot be resold and must not be sold to a holder of a retail beer and wine license for the purpose of resale in the license holder's business.
5. The price charged by the brewery must approximate retail prices generally charged for identical beverages in the county in which the brewery is located.
6. The brewery must remit beer taxes in accordance with the provisions of Code Sections 12-21-1020 and 12-21-1030. The brewery must also remit appropriate sales and use taxes and local hospitality taxes.

Penalty for violation. A fine of \$100 must be assessed for each violation of Code Section 61-4-1515 in addition to other applicable fines and penalties. This fine must be sent to, and used by, the Department for the costs of alcohol licensure and regulation.

Effective Date: June 7, 2010

House Bill 4572, Section 3 (Act No. 231)

Beer Tastings at Certain Retailers – New Provision

Code Section 61-4-960 has been added to allow the holder of a retail permit for the sale of beer for off-premises consumption, whose primary product is beer or wine, to conduct not more than 24 beer tastings at any one retail location in a calendar quarter. The following conditions apply:

1. A notice with details of the specific date and hours of the tasting must be sent to the State Law Enforcement Division by first class mail or by electronic mail at least 10 days before the tasting.
2. Tastings must be conducted by the retailer or an agent or independent contractor of the retailer. Manufacturers, wholesalers, and their employees, agents or independent contractors are barred from conducting a tasting. However, manufacturers (but not wholesalers) may attend a tasting to provide information and offer educational material on the products sampled.
3. The products sampled must be supplied by the retailer and may not be supplied at no cost or reduced cost by the manufacturer or wholesaler.

4. Not more than one container of each product to be sampled may be open at any time. Open containers must be visible at all times and must be removed when the tasting ends.
5. Not more than 8 products may be offered for sampling at any one tasting, and no more than 2 of those products may have an alcohol content exceeding 10% by weight.
6. Samples must not exceed the following quantities:
 - a. 2 ounces of beer with an alcohol content not exceeding 5% by weight;
 - b. one ounce of beer with an alcohol content between 5% and 14% by weight.
7. A person must not be served more than one sample of each product and must not be allowed to loiter on the store premises. Persons who are intoxicated or under age 21 must not be offered, or allowed to consume, any sample.
8. A retailer must not offer more than one sampling per day or for a period exceeding 4 hours.
9. Tastings of beer may not be offered in conjunction with a wine tasting or with a tasting in an adjacent retail alcoholic liquor store licensed in the same name.
10. The tasting must be held in an area of the retail store designated for tastings.

A fine of \$100 must be assessed for each violation of Code Section 61-4-960 in addition to other applicable fines and penalties. This fine must be sent to, and used by, the Department for the costs of alcohol licensure and regulation.

Effective Date: June 7, 2010

Document No. 4077

Definition of "Premises" for Beer, Wine and Liquor Licenses - New Regulation

SC Regulation 7-202 has been added to revise the definition of "premises" for purposes of licenses for beer, wine, and liquor. Previously, "premises" was defined in SC Regulations 7-401.1 and 7-700, both of which have been repealed.

The purpose of the new regulation is the determination of the extent of the physical place where a business or entity that has been approved to hold a license undertakes the privileges and responsibilities associated with that license. The term "premises" generally means all of the buildings and grounds that are both (1) subject to the direct control of the license holder, as shown by certain documents, and (2) used by the license holder to conduct its business.

A presumption arises that the buildings and grounds described with particularity in the license application are used by the license holder to conduct its business. The regulation provides that the premises may be subject to conditions or restrictions or both imposed under Code Section 61-2-80. In addition, there are provisions governing multiple tracts or buildings, separate locations of a business, the premises of nonprofit organizations and specific facilities licensed to serve alcoholic liquor by the drink, including golf courses, fishing piers and resort complexes.

Effective Date: July 23, 2010

LIST OF TEMPORARY PROVISOS

Temporary provisos are enacted as part of the annual budget bill, 2010 House Bill 4567, Part IB (Act No. 291). They are effective only for the current State fiscal year (July 1, 2010 – June 30, 2011). They expire on June 30th, unless reenacted by the General Assembly.

The following is a list of new provisos enacted during this legislative session and a list of provisos that were enacted in prior fiscal years and reenacted during this legislative session. A brief summary of the new provisos can be found in this publication under the applicable subject matter categories. A summary of the reenacted provisos can be found in SC Information Letter #09-14.

NEW PROVISOS

Income Taxes

Proviso 81.8 - No estimated tax penalty when following IRC 6654(d)(1)(D)

Miscellaneous (Administrative, Miscellaneous Taxes, Other, and Regulatory)

Proviso 89.142 - Additional 1% Interest Rate Reduction on Refunds

Proviso 81.9 - Bingo License

REENACTED PROVISOS

Income Taxes

Proviso 1A.17 - Teacher Supplies - Reimbursement Amount Not Taxable

Property Taxes

Proviso 89.48 - Personal Property Tax Relief Fund Not Funded

Sales and Use Taxes

Proviso 89.77 - Viscosupplementation Therapies - Sales and Use Tax Suspended

Proviso 89.72 - Respiratory Syncytial Virus Medicines

Proviso 89.47 - Private Schools - Use Tax Exemption

Proviso 89.107 - 2010 Sales Tax Holiday for Guns

Miscellaneous (Administrative, Miscellaneous Taxes, Other, and Regulatory)

Proviso 72.17 - 2% Reduction on Interest Rate on Tax Refunds used for operations of the State's Guardian ad Litem Program

Proviso 81.6 - Website Posting of Tax Return Information for Candidates and Gubernatorial Appointees

Proviso 81.7 - Admissions Tax Exemption for Payment to Nonprofit Athletic Booster Organizations for Right to Purchase Athletic Event Season Tickets

Proviso 1.17 - Local Government School Buses - Motor Fuel Tax Exemption

Proviso 21.16 - Nursing Home Bed Franchise Fees Suspension

EXHIBIT Q



301 Gervais Street, P.O. Box 125, Columbia, South Carolina 29214

SC REVENUE RULING #87-5

SUBJECT: Tax Credit for New Jobs

EFFECTIVE DATE: Approval by Commission

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

REFERENCE: S.C. Code Section 12-7-1220 (formerly 12-7-616)

AUTHORITY: S.C. Code Section 12-3-170

SCOPE: A Revenue Ruling is the Commission's official interpretation of how tax law is to be applied to a specific set of facts. A Revenue Ruling is public information and remains a permanent document until superseded by a Regulation or is rescinded by a subsequent Revenue Ruling.

Questions:

1. What is the definition of the term "full-time employee" as used in Section 12-7-1220?
2. What is the definition of the term "service related industry" as used as used in Section 12-7-1220?

Facts:

Several industries have inquired as to what constitutes a "full-time employee" and what industries are considered "service related industries" as used in the determination of the tax credit for new jobs.

Discussion:

Section 12-7-1220(B) as amended provides as follows:

"Permanent business enterprises engaged in manufacturing, processing, warehousing, wholesaling, research and development, and service related industries in counties designated by the Commission as less developed areas are allowed a job tax credit for taxes imposed by Section 12-7-230 equal to one thousand dollars annually for each new full-time employee job...."

The wording above is repeated in subsections (C) and (D) of Section 12-7-1220, except that the amount of the credit differs. There are no definitions within the statute as to the particular meaning of "full-time employee" and "service related industry."

1. Full-time is defined in Webster's dictionary as "the amount of time considered normal or standard for working during a given period." There are numerous definitions and court cases dealing with the number of hours required of a "full-time employee." One of the most widely known appears to be the number of hours required by a full-time employee as used by the Bureau of Labor Statistics. The Bureau of Labor Statistics for employment and unemployment cites a full-time worker as "those employed 35 hours a week or more."
2. The S.C. Supreme Court (Fennell v. South Carolina Tax Commission, 103 S.E.2d 424) cited the following definition of "service" from Webster:

"Any result of useful labor which does not produce a tangible commodity. In economics, such business concerns as railroads, telephone companies or laundries and such persons as physicians, are regarded as performing services."

Thus "service related industries" would be businesses primarily engaged in providing services as opposed to retail businesses engaged in selling merchandise for consumption or manufacturing business engaged in transforming materials or substances into new products.

The determination as to whether a business is a service related industry can be made by comparing the gross receipts of the business derived from providing services to total gross receipts of the business. If over 50 percent of the gross receipts are from providing services, then the business would be service related. This method has been utilized by the commission in determining whether a multistate taxpayer is providing services and thus would utilize the gross receipts ratio to apportion its income. (A multistate taxpayer deriving over 50 percent of its income from dealing in tangible personal property would utilize the three factor ratio to apportion its income).

Conclusion:

For purposes of determining the tax credit for new jobs the following definitions shall apply.

"Full-time employee" - As a general rule, it shall be presumed that an employee who works at least 35 or more hours per week is a full-time employee. However, if the facts show that a lesser number of hours is standard or customary for a particular job or industry, then a lesser number may be allowed.

A "service related industry" shall mean a business that derives over 50 percent of its gross receipts from providing services (as opposed to selling or dealing in tangible personal property). (Sept. 16, 1987)

SOUTH CAROLINA TAX COMMISSION

s/S. Hunter Howard Jr.
S. Hunter Howard, Jr., Chairman

s/John M. Rucker
John M. Rucker, Commissioner

s/A. Crawford Clarkson, Jr.
A. Crawford Clarkson, Jr., Commissioner

Columbia, South Carolina
September 16, 1987

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R

EXHIBIT R

Westlaw

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Administrative Law Judge Division
State of South Carolina

*1 CONSOLIDATED HYDRO SOUTHEAST, INC., PETITIONER
vs.
SOUTH CAROLINA DEPARTMENT OF REVENUE AND TAXATION, RESPONDENT

Docket No. 95-ALJ-17-0634-CC

May 13, 1996

APPEARANCES:

Cary H. Hall, Esquire for Petitioner

Jeffrey M. Nelson, Esquire for Respondent

ORDER AND DECISION

STATEMENT OF THE CASE

This matter comes before me pursuant to S.C. Code Ann. § 12-60-460 (Supp. 1995) on a request for a contested case hearing by Consolidated Hydro Southeast, Inc. (taxpayer) on the assessment by the Department of Revenue and Taxation (Department) for additional corporate license fees for the period June 30, 1990 through June 30, 1992.

After notice to the parties, a hearing was conducted on December 8, 1995. Based upon the testimony and evidence presented, I conclude that the taxpayer is liable for the license fees on gross receipts derived from supplying hydro-electric power to utilities in South Carolina. Any issues raised in the proceedings or hearing of this case but not addressed in this Order are deemed denied. ALJD Rule 29(B).

STIPULATED FACTS

At the hearing of this matter the parties stipulated to the following facts:

1. Consolidated Hydro Southeast, Inc. is a company which owns and operates several small hydro-electric power generation facilities in South Carolina and is engaged in the business of the production of electricity. These facilities are defined under federal law (the Public Utility Regulatory Policy Act of 1978, or "PURPA" [codified at 16 U.S.C. §§ 2601 *et seq.*] and 18 C.F.R. § 292.602) as "qualifying facilities".
2. PURPA requires public utility companies to purchase electrical power produced by qualifying facilities.
3. The South Carolina Public Service Commission (PSC) addressed certain provisions of PURPA, and the con-

tractual relationships between public service utilities and qualifying facilities in South Carolina in Order No. 85-347 issued by the PSC on August 2, 1985.

4. The taxpayer derives gross receipts from the sale of electrical power produced by its qualifying facilities. These receipts are from payments made by public utility companies. The public utilities pay the taxpayer for electrical power based on the terms of contracts between the public utility companies and the taxpayer.

5. The Department performed an audit of the taxpayer's corporate income tax returns for the period June 30, 1990 through June 30, 1992. Several adjustments were made to the taxpayer's returns as a result of this audit.

6. At issue in this case is whether the taxpayer owes additional license fees under S.C. Code Ann. §§ 12-19-100 and 12-19-110 [Supp. 1995]. The parties disagree on the meaning and intent of certain language contained in Section 12-19-110 and whether this section is applicable to gross receipts the taxpayer derived from the sale of electric power to public utilities.

7. Based on the taxpayer's gross receipts for the period of the audit, if Section 12-19-110 is applicable to the taxpayer, the amount of additional license fees owed by the taxpayer for the period June 30, 1990 through June 30, 1992 is \$11,115.00 plus current interest. On June 28, 1995, the taxpayer was assessed \$14,573.10 in tax and interest computed through September 16, 1994.

FINDINGS OF FACT

*2 Based upon the evidence presented, I make the followings of fact, taking into account the burden on the parties to establish their respective cases by a preponderance of the evidence and considering the credibility of the witnesses:

1. The taxpayer does not file reports with the South Carolina Public Service Commission (PSC).
2. The taxpayer does not obtain approval from the PSC to sell any of its affiliated businesses.
3. Federal Regulations promulgated pursuant to PURPA require electric utilities to purchase power from qualifying facilities at a rate reflecting the cost to the utilities to produce the power.
4. Contracts between the taxpayer and the electric utility are negotiated without PSC involvement.
5. The PSC requires that the contracts be submitted for review for compliance with PURPA.
6. The taxpayer may petition the PSC for relief when a dispute arises about the cost of supplying electric power to the electric utilities.

DISCUSSION

The taxpayer asserts that it is not liable for the payment of the additional license fee imposed under S.C. Code Ann. § 12-19-110 for two reasons: (1) it is not a "regulated business" encompassed in the statute; and (2) it does not provide or sell a "service".

The Department argues that although the taxpayer is not directly regulated by the PSC, the business it conducts and from which it derives revenue is regulated. Further, the Department asserts that even though electricity is defined as "tangible personal property" under portions of the tax code, it is also specifically recognized as a

"service" under S.C. Code Ann. § 12-36-60 (Supp. 1995) which provides that " 'tangible personal property' ... also includes services and intangibles, including ... furnishing ... sales of electricity." (Emphasis added)

At issue in this case is the interpretation of S.C. Code Ann. § 12-19-110 (Supp. 1995) which provides in pertinent part:

In addition to the license fee provided by Section 12-19-100 and all other license taxes and fees or taxes of whatever kind, there is levied an annual license fee of three mills upon the gross receipts derived from services rendered from regulated business within this State ... from every express company, street railway company, navigation company, waterworks company, power company, distribution electric cooperative, light company, gas company, telegraph company, and telephone company....

In particular, the phrase "gross receipts derived from services rendered from regulated business within the State" is the subject of inquiry. (emphasis added).

A. "Regulated Business"

The taxpayer claims that it is not a regulated business and therefore is not subject to the additional tax. For support, it relies on the evidence that it is not regulated by the PSC and PSC Order No. 85-347 interpreting provisions of federal regulations on the relationship between electric utilities and qualifying cogeneration facilities. In accordance with regulations promulgated by the Federal Electric Regulatory Commission (FERC) for the implementation of PURPA, an electric utility is required to purchase electric energy produced by qualifying facilities at a rate reflecting the cost that the purchasing utility can avoid as a result of obtaining energy from these sources instead of generating an equivalent amount of energy itself or purchasing from other suppliers. In order for the qualifying facilities to estimate the avoided costs, the FERC regulations require the utilities to furnish certain information to the appropriate regulatory authority relating to the costs of energy and capacity on their systems. In South Carolina, the regulatory agency is the PSC. The PSC may grant a waiver to the utilities of the obligation to provide additional services to qualifying facilities under certain conditions.^[FN1]

*3 As a result, the various contracts between the qualifying facilities producing the energy and the electric utilities purchasing the energy for resale to the consumer are affected. PURPA, and the regulations promulgated to implement it, provides for the states to exercise authority regarding regulation of various aspects of qualifying facility transactions. *See* Public Service Commission Order No. 85-347, August 2, 1985 p. 9. Under the Order, negotiated contracts between an affected utility and a qualifying facility should be submitted, upon execution, to the PSC for it to conduct a general review to determine whether the contract complies with the provisions of its Order No. 85-347 and the intent of PURPA. The PSC may, on its own motion, conduct a more detailed review of the contract by hearings or other proceedings. The PSC has the power to make adjustments as necessary to accomplish the purposes of PURPA and the federal regulations implementing the Act.

Although the qualifying facility is not directly controlled by the PSC, its business of producing and providing energy to affected electric utilities is subject to control by the PSC. Under PURPA, the qualifying facilities are created by federal law and controlled by the FERC. The business of producing and supplying electric energy to utilities and ultimately the consumer is a regulated business as that term is used in Section 12-19-110.

The term "regulated business" as used in the statute also refers specifically to the particular transaction occurring not the business entity. The license fee is not imposed upon businesses simply because they are regulated. Prior to 1985, the statute imposed a license fee upon the entire gross receipts from business within the State by a power company. The South Carolina Supreme Court construed this language to impose a license fee on power companies based upon entire gross receipts and not just receipts from customer charges. *Duke Power Co. v. S.*

C. Tax Comm'n, 292 S.C. 64, 354 S.E.2d 902 (1987). In that case, Duke Power excluded proceeds from the sale of a portion of its unfinished Catawba Nuclear Plant from the additional license tax. The Tax Commission included the transaction within the gross receipts from business in South Carolina. Duke Power brought an action to recover the taxes paid. The circuit court excluded the proceeds from the gross receipts on the basis that the license fees only applied to receipts from customer charges. The Supreme Court reversed the circuit court holding that the statute as written encompassed the proceeds from all business of a power company within the state not just its business relating to providing energy to customers.

While the *Duke Power* case was pending, the legislature amended the statute to its current form. It clarified the language by specifying that "business" means "regulated business" and the tax was limited to gross receipts of services. Until the Tax Commission was abolished in 1995, it interpreted this section to include only receipts derived from those activities that are regulated in some respect. See *Tax Commission Decision 91-41*. Even if a corporation engages in other business that is not regulated, only that portion of the corporate business that is regulated in some manner is subject to the provisions of Section 12-19-110. *Id.* The Department is the successor to the Tax Commission and it continues to interpret the statute in this manner. Long-standing agency construction is entitled to weight and should not be overruled without cogent reasons. *Etiwan Fertilizer Co. v. S. C. Tax Comm'n*, 217 S.C. 354, 60 S.E.2d 682 (1950).

*4 The taxpayer is a regulated business and the business of selling hydro-electric power to utilities for resale to consumers is a regulated business.

B. "Services Rendered"

The taxpayer asserts that the assessed transactions are not subject to the license fee under Section 12-19-110 because electricity is defined as "tangible personal property" under S.C. Code Ann. §§ 12-36-60 and 12-36-910. However, the specific language of these sections is contrary to this claim. Section 12-36-60 provides that "tangible personal property" under the sales and use tax statutes, "also includes services and intangibles, including communications, laundry and related service, furnishing and accommodations and sales of electricity." Thus, while electricity is included in the statutes discussing the application of sales tax on the sale of tangible personal property, the sale of electricity is specifically recognized and defined as a service.

Section 12-36-910(A) generally imposes on every person engaged in the business of selling tangible personal property at retail a sales tax on the gross proceeds of sales. Section 12-36-910(B) imposes the sales tax to "gross proceeds accruing or proceeding from the sale of electricity". Additional subsections also provide for the taxation of dry-cleaning, laundering and voice and message transmission services. By specifying that electricity and other services are also subject to sales tax, the statute indicates that these services are not tangible personal property within the meaning of the general definition but are services that are subject to the same sales tax imposed upon tangible personal property.

PalmettoNet, Inc. v. S. C. Tax Comm'n, ___ S.C. ___, 456 S.E.2d 385 (1995) supports this view. The facts of this case are somewhat analogous to the present situation. PalmettoNet operated a telecommunication system which carried long-distance telephone calls. It challenged the imposition of sales taxes imposed on transactions between it and carrier companies who, using PalmettoNet's facilities, provided long distance services to consumers. The circuit court held that telecommunication systems were wholesale services that were not subject to sales taxes. The Supreme Court affirmed reiterating that the transaction between PalmettoNet and the carrier constituted a service. For a charge, PalmettoNet provided everything necessary for the carrier to provide long distance service to consumers and PalmettoNet could not sell telecommunication services directly to the custom-

ers. In the present case, the taxpayer provides all of the power necessary for the utilities to resell to consumers.

The sale of hydro-electric power to the electric utilities is the sale of services.

CONCLUSIONS OF LAW

Based upon the foregoing Findings of Fact and Discussion, I conclude as a matter of law:

1. S.C. Code Ann. § 12-60-460 (Supp. 1995) authorizes the Administrative Law Judge Division to conduct contested case hearings on tax assessments by the State through the Department of Revenue and Taxation.

*5 2. S.C. Code Ann. § 12-19-110 (Supp. 1995) imposes upon every power company a license fee upon the gross receipts derived from services rendered from regulated business in the state.

3. The term "regulated business", as used in Section 12-19-110, refers to transactions of entities as well as portions of business entities that are regulated by the PSC or by a federal regulatory agency.

4. The sale of hydro-electric power by a qualifying facilities to electric utilities is regulated by FERC and the PSC.

5. The sale of hydro-electric power constitutes the sale of services under Section 12-19-110.

ORDER

Based upon the Findings of Fact, Discussion, and Conclusions of Law, it is hereby

ORDERED, that for the period June 30, 1990 through June 30, 1992, Consolidated Hydro Southeast is liable for the additional license fee imposed pursuant to S.C. Code Ann. § 12-19-110 (Supp. 1995) in the amount of \$11,115.00 plus current interest totaling \$14,573.00 through September 16, 1994 due and payable to the Department of Revenue and Taxation.

AND IT IS SO ORDERED.

Alison Renee Lee
Administrative Law Judge

FN1. 18 C.F.R. § 292.305(b)2 provides for a waiver when the State authority or the FERC finds, after proper notice and an opportunity for a hearing, that compliance with the requirement would (a) impair the electric utility's ability to give adequate service to the rest of its customers, or (b) place an undue burden on the electric utility.

1996 WL 909155 (S.C.Admin.Law.Judge.Div.)

END OF DOCUMENT

S

EXHIBIT S

1 correct?

2 A. Yes.

3 Q. Okay. So they can be metered. And you also
4 testified that if something can be metered, it's a
5 material?

6 A. No.

7 Q. That's not true?

8 A. Because right in front of you, I would
9 conclude that a product, other than hours of service,
10 can be metered, it is the result of manufacturing, not
11 service. So if you want to go into hours of service,
12 then, no, it's not manufactured. But if you're paying
13 by quantity of goods transferred, then it is
14 manufactured.

15 Q. So if I could buy cell phone service in some
16 other way than hours of service, which I can.

17 A. Yes. You can do a flat rate.

18 Q. Right.

19 A. So could Duke. Duke could charge me \$30 a
20 month, and I could use as little or as much as I want.
21 That would be a service. That would be definitely a
22 service.

23 Q. Okay. So in your view, electricity -- the
24 electricity that Duke sells, the electric energy that
25 Duke sells, it would change from a material to a

1532

T

1532

EXHIBIT T

1 Energy provides is a service." and you described that
2 service as transforming energy from one form to
3 another.

4 Why do you conclude that what Duke energy
5 provides is a service?

6 A. I conclude that it is a service because Duke
7 Energy is not, you know, providing something in
8 material form as is an object. So in my opinion,
9 transforming energy from one form to the other is a
10 service.

11 Q. Okay. Is that -- is that substantially based
12 upon your conclusion, then, that electricity is not
13 tangible personal property?

14 A. That's correct.

15 Q. What is the electricity or electromagnetic
16 field that Duke Energy provides? What is that? It's
17 not -- your conclusion is it is not tangible personal
18 property?

19 A. Correct.

20 Q. What is it?

21 A. It's something intangible. It's a field.

22 Q. So you believe it is an intangible property?

23 A. No, it is intangible.

24 Q. Okay. So it's intangible, but it is not
25 property?

EXHIBIT U

1 correct?

2 A. Yes.

3 Q. Okay. So they can be metered. And you also
4 testified that if something can be metered, it's a
5 material?

6 A. No.

7 Q. That's not true?

8 A. Because right in front of you, I would
9 conclude that a product, other than hours of service,
10 can be metered, it is the result of manufacturing, not
11 service. So if you want to go into hours of service,
12 then, no, it's not manufactured. But if you're paying
13 by quantity of goods transferred, then it is
14 manufactured.

15 Q. So if I could buy cell phone service in some
16 other way than hours of service, which I can.

17 A. Yes. You can do a flat rate.

18 Q. Right.

19 A. So could Duke. Duke could charge me \$30 a
20 month, and I could use as little or as much as I want.
21 That would be a service. That would be definitely a
22 service.

23 Q. Okay. So in your view, electricity -- the
24 electricity that Duke sells, the electric energy that
25 Duke sells, it would change from a material to a

1 service if Duke went ahead and sold it on a single
2 charge, you know, \$40 per month for all the
3 electricity?

4 A. All you can eat.

5 Q. That's a service?

6 A. All you can eat. For example, a good example
7 at a restaurant because I brought it up.

8 Q. Yeah.

9 A. Okay. Normally, you would think that's a
10 material transfer. But if it's just a matter of you
11 sit there and eat all you want and I'll charge you 10
12 bucks, that's transformed into a service.

13 Q. The manner in which you bill for something
14 changes its --

15 A. Sure.

16 Q. -- characteristic?

17 A. For example, my garbage pickup. I pay them
18 once a month. They take as little or as much as I
19 produce. That's a service. No question.

20 Q. Okay.

21 A. And by the way, a lot of garbage companies
22 will charge their commercial clients on a ton basis.
23 Tons transfer. Okay. Well, that's different. Then it
24 is a transfer of a commoditized product.

25 MR. TRESH: Can we take like a five-minute

EXHIBIT V

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South Carolina Revenue Procedure

2009

South Carolina Revenue Procedure No. 09-1, 01/13/2009

South Carolina Revenue Procedure No. 09-1, 01/13/2009**Date Issued:** 01/13/2009**Tax Type(s):** Personal Income Tax, Corporate Income Tax**SUBJECT:** Applying for an Alternative Allocation/Apportionment Method (Income Tax)**EFFECTIVE DATE:** January 13, 2009**SUPERSEDES:** SC Revenue Procedure #95-4 and all previous documents and any oral directives in conflict herewith.**REFERENCES:** S.C. Code Ann. Section 12-6-2320 (2000)**AUTHORITY:** S.C. Code Ann. Section 12-4-320 (Supp. 2000)

S.C. Code Ann. Section 1-23-10(4) (2000)

SC Revenue Procedure #05-2

SCOPE: The purpose of a Revenue Procedure is to provide procedural guidance to the public and Department personnel. It is an advisory opinion issued to assist in the administration of laws and regulations by providing guidance that may be followed in order to comply with the law. It is effective until superseded or modified by a change in statute, regulation, court decision, or another Departmental advisory opinion.

INTRODUCTION

Code Section 12-6-2210 provides for the determination of taxable income of a business. A taxpayer whose entire business is transacted or conducted in South Carolina is subject to income tax based on the entire taxable income of the business for the taxable year. A taxpayer that transacts or conducts its business partly within and partly outside of South Carolina is subject to income tax based on the portion of its business

carried on in South Carolina. This portion is determined through allocation and apportionment of income. The sum of these amounts is South Carolina taxable income.

Code Sections 12-6-2220 and 12-6-2230 provide that certain classes of income, less related expenses, are allocated. Items directly allocated include nonbusiness interest, nonbusiness dividends, nonbusiness rents and royalties from the lease or rental of real estate or tangible personal property, gains (not subject to depreciation recapture) and losses from the sale of real property, and nonbusiness gains and losses from sales of intangible property.

The income remaining after allocation is apportioned in accordance with South Carolina Code Section 12-6-2240. South Carolina generally requires the use of one of the following apportionment methods:

1. (a) A "three factor" apportionment method (based on property, payroll, and double-weighted sales) or (b) a "single factor"¹ apportionment method (based on sales) for taxpayers whose principal business in South Carolina is dealing in tangible personal property. This method is typically used by businesses that manufacture, sell, distribute, or rent tangible personal property. See Code Sections 12-6-2250, 12-6-2252, and 12-6-2295.
2. A "gross receipts" apportionment method for taxpayers not dealing in tangible personal property. This method is typically used by financial businesses and service businesses, including doctors, architects, businesses that install or repair tangible personal property, and contractors. See Code Sections 12-6-2290 and 12-6-2295.
3. A "special" apportionment method for certain companies, such as railroad companies, telephone companies, pipeline companies, airline companies, and shipping lines. See Code Section 12-6-2310.
4. An individualized apportionment method tailored to a particular business because the normally required method would not fairly represent the extent of the taxpayer's business in South Carolina. See Code Section 12-6-2320(A).
5. An individualized apportionment method tailored to a particular business as an economic incentive. See Code Section 12-6-2320(B).

The purpose of this advisory opinion is to provide a procedure for a taxpayer to request use of an alternative allocation/apportionment method set forth in Code Section 12-6-2320(A) if the taxpayer believes that the statutory formula does not fairly represent the extent of the taxpayer's business activities in South Carolina. This request will be referred to as an Application for Modification of an Allocation/Apportionment Method ("Application").²

WHERE TO FILE THE APPLICATION

The Application must be filed separately and not attached to a tax return being filed. Mail the Application to the following address:

Department of Revenue
Attn: Administrator of Audit Services

301 Gervais Street
P.O. Box 125
Columbia, S.C. 29214

CONTENT OF APPLICATION

The Application must set forth a complete statement of the facts and reasons relating to the request to change the allocation/apportionment method currently used by the taxpayer (or any affiliated corporation included in filing a South Carolina consolidated return with the taxpayer that is requesting to change its allocation/apportionment method under this procedure) or would be required to be used if the taxpayer is not yet operating in South Carolina, including the following:

1. Full name and address, and as applicable, taxpayer identifying number or social security number of the taxpayer applying for the change in allocation or apportionment method.
2. The taxpayer's tax year.
3. The tax year the taxpayer proposes the change to be effective.
4. The present allocation/apportionment method used in South Carolina. If the taxpayer currently has no operations in South Carolina, the method that would be the method required to be used under South Carolina law if the taxpayer had been operating in this State.
5. If applicable, the approximate number of years that the present allocation and apportionment method has been used in South Carolina.
6. A complete and precise statement of the reasons for the modification requested, including why the present method does not fairly represent the activities of the taxpayer within this State.
7. Evidence supporting the taxpayer's Application including any court decisions on the matter, copies of all contracts, deeds, agreements, instruments or other documents which evidence the necessity for the modification. Do not send originals.
8. Projected net income of the taxpayer attributable to South Carolina in the tax year the new allocation/apportionment method would commence and for five years thereafter. Please provide these projections using the current (or currently required) method of allocation/apportionment and the alternative method proposed by the taxpayer. These projections should be as complete as possible and should include income allocated as well as the computations of each of the factors in question.
9. Any other relevant information that the taxpayer believes may have a bearing on the Department's decision about whether to grant the allocation/apportionment method requested.

The Application must also answer the following questions:

10. Is the proposed allocation/apportionment method to be used solely by the taxpayer or is the request to

change the allocation/apportionment method to be applicable to all affiliated corporations that join with the taxpayer in filing a South Carolina consolidated return?

11. Is the taxpayer currently being audited by the Department?

12. In the past five years, has the taxpayer been audited by the Department and adjustments made to its allocation and/or apportionment method or to specific items that the taxpayer allocated or apportioned to South Carolina?

13. During the past five years, has the taxpayer or any of its affiliates applied to the Department to use a different method of allocating or apportioning income or to use separate accounting to determine its net income attributable to South Carolina?

14. Has the taxpayer made requests to any other states to use an alternative method of allocating/apportioning income? What was the result?

REVIEW OF THE APPLICATION

The Department's Field Operations Division, Audit Services Department will review the information submitted and will issue a decision as to whether the taxpayer may adopt the alternative method of allocation/apportionment requested. With its decision, Audit Services will issue a letter setting forth its reasons for approving or denying the taxpayer's request to change its allocation or apportionment method. Written approval of the new method must be received prior to using the new method to determine income allocated or apportioned to South Carolina.

APPEAL OF A DECISION

If the taxpayer disagrees with the decision of Audit Services, the taxpayer may appeal the denial of the Application. Any appeal will follow the procedures established in South Carolina Revenue Procedure #06-2 for a proposed assessment.

FOR MORE INFORMATION

If you have questions regarding the Application, please call the Administrator of Audit Services at 803-898-5604.

SOUTH CAROLINA DEPARTMENT OF REVENUE

s/Ray N. Stevens

Ray N. Stevens, Director

Columbia, South Carolina

January 13, 2009

1

Effective for tax years beginning after 2006, a single factor apportionment method for businesses dealing in tangible personal property using the three factor (with double weighted sales) apportionment method is being phased in and will replace the three factor (with double weighted sales) apportionment method for tax years beginning in 2011.

2

The procedure for a taxpayer to request approval of an economic development incentive based on alternative allocation or apportionment under Code Section 12-6-2320(B) is provided in a separate advisory opinion. It is available on the Department's website at www.sctax.org.

END OF DOCUMENT -

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EXHIBIT W

Expert Report

Prepared by

Dr. Ioannis "John" Papapolymerou

Professor

School of Electrical and Computer Engineering

Georgia Institute of Technology

Atlanta, GA 30332

Atlanta - October 21, 2011

DES00000715

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DES00000716

I. Introduction

Electrical/electromagnetic devices are widely used today by people in their everyday lives to cover a variety of their needs: from washing/drying their clothes and illuminating their house, to warming up their food, talking to their friends on their cell phones and watching the news or a favorite movie on their TV set. All of this is possible due to electricity and magnetism or more precisely the electromagnetic force that exists in our physical universe (the latter is governed by four fundamental forces: nuclear; electromagnetic; weak-interaction; and gravitational).

Electricity is known since the 6th century B.C. when *Thales of Miletus* (624 B.C.-546 B.C.), an ancient Greek philosopher and mathematician, wrote that when a piece of amber was rubbed in wool it attracted light objects such as straws and feathers (we know now that this is a manifestation of an electrostatic force by friction). Magnetism was also known in ancient Greece, as rocks that attracted pieces of iron or other pieces of similar rock had been observed. It was not until 1600 A.D. that the term "electric" appeared in a treatise on the electric force generated by friction, authored by *William Gilbert* a physician to Queen Elizabeth I (he christened it electricity from the Greek word for amber, "electron", in honor of Thales' experiments). It was not until a century later (1752 A.D.) that one of our founding fathers and greatest scientists of modern times, *Benjamin Franklin*, demonstrated that lightning is a form of electricity and also introduced the terms of positive and negative charges to account for the fact that some materials would repel while others would attract after rubbing a piece of amber with various materials (silk, wool etc.). By that time it was also understood that charges create an electric field. Electrical forces were first investigated systematically by *Charles de Coulomb*, a colonel in the Engineering Corps of the French Army, in 1784 who found experimentally that the intensity of the electric force between two charges is proportional to the product of their charges and inversely proportional to the square of the distance R between them (the unit of charge was named Coulomb in his honor). The electric force is in the direction of the line that connects the two charges.

In the early 1800s scientists understood how electric currents induce magnetism and *Joseph Henry* (an American physicist and first secretary of the Smithsonian Institution) developed the first electric motor and discovered electromagnetic induction (he also assisted *Morse* in the development of the telegraph). Shortly thereafter, *Michael Faraday* (an English physicist and chemist) doing similar experiments as Henry built the first electric generator (the converse of the electric motor) and published his results in 1831 (before Henry published his). Faraday in essence demonstrated that a changing magnetic field induces an electric field. His device (the Faraday wheel) was the world's first *dynamo* or electric generator. It was Faraday's discovery, more than any other one, that allowed electricity to be transformed from a topic of scientific curiosity for the few to a powerful technology utilized by everybody. In 1873, *James Clerk Maxwell*, a Scottish physicist and the greatest name in electromagnetic theory, incorporated into his four famous equations all the experimental findings of the previous scientists that represent the foundation of classical electromagnetic theory (he also proved

experimentally that a changing electric field must be accompanied by a changing magnetic field). Maxwell's theory predicted the existence of electromagnetic waves which are the foundation for wireless and wired telecommunications, electric power transmission, laser systems, medical systems (e.g. MRI) and other applications. He also concluded that light is an electromagnetic wave.

II. Analysis

Since it was clearly understood from the various 19th century experiments that electricity is very practical and convenient, various devices and systems based on electricity were developed to accommodate humankind's needs. The first and most important application was the generation, transmission and distribution of electric energy to households for lighting and heating purposes, as well as providing prime mover energy in the form of electric motors. Another application was energy delivery to industrial customers for manufacturing and control purposes. Power companies, like *Duke Energy Corporation* ("*Duke Energy*"), are in the business of performing the above functions. These companies are essentially in the business of first transforming kinetic/mechanical energy into electric energy, and then transmitting, distributing and delivering the electric (electromagnetic) energy in an efficient and economical way. The process typically involves three steps: generation, transmission and distribution. Electric energy generation is based on *Faraday's* experiment and basically involves the transformation of kinetic/mechanical energy to electric via a time varying magnetic field. The kinetic/mechanical energy is provided by turbines that can turn/rotate from waterfalls (hydroelectric plants), wind (wind generators) or steam pressure (steam is created by burning coal or by causing a controlled nuclear reaction that heats up a water tank). An alternative method is to use solar cells that transform solar energy to electric energy. One should emphasize here that the electric generator is efficiently transforming energy from one form to the other (a fundamental law of physics is the conservation of energy and the fact that energy cannot be created or destroyed – it simply exists), and as such the entire generation process deals with energy that already exists in nature.

The electric generator typically consists of a loop of wires that can rotate inside a steady magnetic field (the magnetic field is provided either by permanent magnets or electromagnets/coils – this is called the stator). This loop of wires (the rotor) is connected to the turbine that makes them rotate once in motion. This motion causes electromagnetic induction (per Faraday) between the two ends of the wire loop. Individual slip rings are fitted to each of the two ends of the rotor's wire loop to provide a path for the electric current to leave the armature. Brushes (which are actually carbon contacts) ride against the slip rings and complete the path for the current into the circuit to which the generator is attached. Once this electric energy is generated it must be transmitted and delivered efficiently and safely to the various customers. This is extremely important as losses in the transmission and distribution systems will make the whole system impractical (meaning customers would not get the amount of energy they need)

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and expensive. For this reason, the transmission system consists of metal wires (lines) that connect the generator to the customer (load), and substations (transformers). The latter are needed to increase the generator voltage prior to transmission and decrease it prior to delivery (transformers operate only with AC voltage/current). *Why?* At home we use a voltage of 110V (60 Hz frequency) or 220V (50 Hz frequency). If the same voltage was used to transmit the electric energy from the generator to our house over a length of several hundreds or thousands of miles the energy would be lost and transformed into heat instead of arriving at our house since larger amounts of currents would be needed on the lines (large amounts of currents produce more heat) for the same amount of power. For this reason, the generator voltage is increased to 100KV/230KV/525KV, thus, decreasing the required current. The same amount of power is transmitted however (electric power is the product of voltage with current). Before delivery, another transformer reduces the high voltage to the desired one (24 KV, 12 KV or 240V/120V). It should be emphasized here that the above system is the most efficient one to safely transmit large amounts of electric (electromagnetic) energy over large distances. The same phenomenon applies when we talk on the cell phone but at different power levels and frequencies (1 GHz instead of 60 Hz). Our cell phone receives electromagnetic energy (electricity) from the antenna of the base station, and transmits energy back when we talk. The electric energy propagates without the need of any material in between. Experiments have established the fact that electric and magnetic energy can propagate in the form of waves even in vacuum (no material is needed). Actually, this is how we know that other galaxies or star systems exist in outer space. However, for more efficient and safe energy transmission in everyday life the system shown below is used:

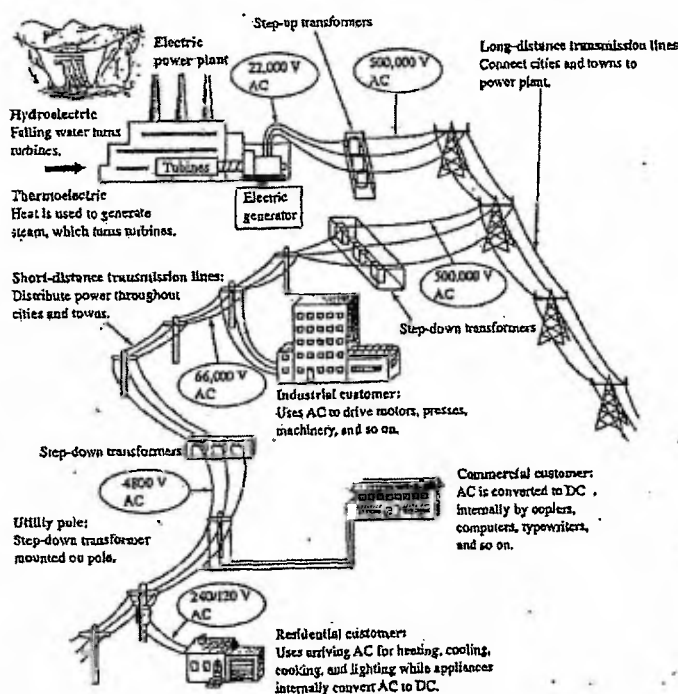
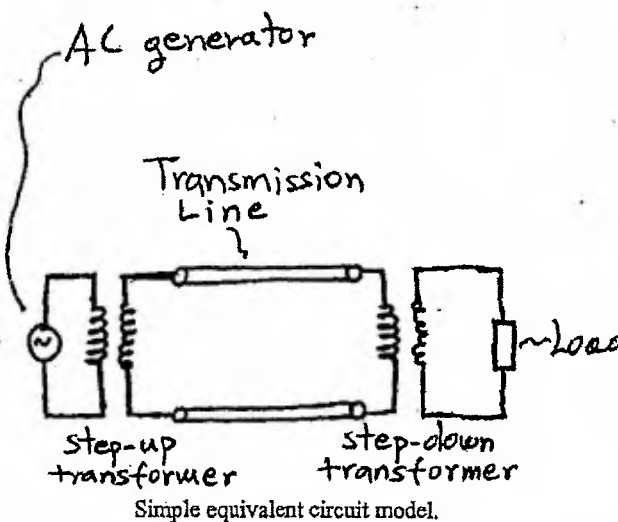


Diagram of basic electric energy supply system [1].



Simple equivalent circuit model.

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The electric generator creates an alternating (AC) voltage potential (voltage) that is applied on the transmission line. The line consists of two parallel metal wires. Transformers are inserted between the generator and input of the line to step-up the voltage, and between the end of line and the load to step-it down (simplest form). The AC voltage is required in order to operate the transformers (DC voltage cannot be used). The wires are made out of conducting material (metal such as copper or aluminum). Conductors can transmit/propagate electromagnetic energy very effectively and safely. This is due to the fact that they have electrons loosely associated with the nucleus of their atoms that jump from one atom to the other in the same direction when an electric field is present, thus, creating a net electric current and propagating the electromagnetic energy. When no electric potential exists, the electrons move in random directions and with varying speeds, thus, producing a zero average current and not propagating any energy. When an AC voltage is applied between the two wires, the electrons flow forward and backward or oscillate at a rate of 60 cycles (times) per second. **The direction of flow in the wires does not matter, as energy is propagated as long as there is a flow of electrons.** *Again, it should be emphasized that other systems/set-ups can be used for this type of energy transmission that are not as efficient as the conducting wires* (One such system/set-up is free space used in propagation of the Sun's visible and non-visible rays that carry electromagnetic energy. Another system/set-up is the usage of free space to propagate electromagnetic waves and energy in wireless communication systems, e.g. cell phones or wireless internet or radio, between a transmitter and a receiver). At the load end, this electric field is delivered with the desired strength after step-down voltage conversion. **It should be noted here that electrons are NOT delivered to the load** (generally speaking the presence of electrons is not even necessary for electromagnetic energy propagation – electromagnetic energy can propagate in vacuum as in the case of the Sun's rays and wireless communication systems). Electrons are already part of the transmission line material, as well as the material used in the customer's device (e.g. motor windings in washer or filament in light bulb). Electrons facilitate the energy propagation and make it extremely efficient. The entire system delivers energy in the form of an electromagnetic field (or electromagnetic force to be consistent with the four fundamental forces in our physical universe: nuclear, electromagnetic, weak-interaction and gravitational). *One should also emphasize here that according to a fundamental law of physics and probably the most important one, energy exists in our physical universe and cannot be created or destroyed – it can only be transformed from one form to the other.* This electromagnetic field can then be used by our device for the intended purpose. The latter is best illustrated by a household that turns on the lights, or operates a TV or operates the washer/drier motor. A substantial and fundamental operation/service that *Duke Energy* performs is the voltage transformation in the various stages of the system to efficiently and safely deliver electric energy to its customers (i.e. minimize the energy losses). Without this transformation, the delivery of large amounts of energy over large areas (e.g. entire countries or even continents) would not be possible. Furthermore, another extremely important operation/service that *Duke Energy* performs is to successfully meet its customers' energy

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requirements over time. It is well known that the energy demands (i.e. loads) of the various customers (residential, industrial etc.) can significantly change over a certain period of time. An extremely important service that *Duke Energy* performs is to accommodate these energy demands by being able to always deliver the required amounts of energy.

As part of my expert report I was also asked to answer the following question: Can the sale of electricity provided by Duke Energy be considered as manufacturing and sale of tangible personal property, where manufacturing involves the creation of a new and substantially different article having a distinctive name and substantially different character or use?

In the analysis provided in the previous section, it was made clear that companies like *Duke Energy* provide to their customers energy in the form of an electromagnetic field. One of the most fundamental laws of Physics mandates that energy is conserved and it cannot be created or destroyed (it simply exists). As such, *Duke Energy* transforms kinetic/mechanical energy (from burning coal and creating high pressure steam that rotates/moves a turbine) into electromagnetic energy that it then transmits over long distances and distributes to its customers. *Duke Energy* is not delivering electrons or metal wires to its customers. It is also not delivering batteries to its customers. The purpose of the metal wires of the power lines is to efficiently and safely propagate the electromagnetic energy from the power plant to the final delivery point. As a result, transformed energy (kinetic to electromagnetic) is being delivered to the customer and not a substantially different article that has a distinctive name and a substantially different character (to compare one could think of wood abundantly found in nature and creating chairs or tables that are a substantially different article – this is not the case here). In addition, tangible personal property is something that has physical dimensions and one can possess (e.g. a chair, a table, a book, a car).

To better understand let us make a few comparisons: tangible personal property, in my opinion, is a battery which is an electric charge storage device (one can possess it and it has specific dimensions). A capacitor, another electric energy storage device, is also tangible personal property (one can possess it and it has specific dimensions). *Duke Energy* is not delivering batteries or capacitors to its customers as part of the service it provides. Tangible personal property is a personal computer or a laptop that uses electric energy to operate. *Duke Energy* is not delivering laptops or computers to its customers under the service it provides. Tangible personal property is water (I can possess it and has dimensions). To compare, if one opens a hole in the water line/pipe water will leak. Electrons or matter will not leak when a hole is poked in the conductor of a transmission line system used by *Duke Energy*.

To further clarify that the sale of electricity provided by *Duke Energy* cannot be considered as manufacturing and sale of tangible personal property let us consider the following: electric energy can be harvested with an antenna from telecommunication or radio signals that exist around us. However, energy conversion efficiency will be low, thus, the delivered energy will be low and may not be enough to cover the specific needs of the customers. These systems

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can harvest electromagnetic energy existing in free space or in the vicinity of transmission lines to power up low energy devices (e.g. a sensor that measures temperature/humidity or a sensor that measures voltage and current in smart grid power systems).

III. Conclusions

Based on the previous analysis it is my opinion that what *Duke Energy* provides is a service, and that the electric energy it sells is not something that one can possess or has physical dimensions (e.g. a table, a chair, a book, a car). The service that *Duke Energy* provides is to transform existing energy from one form to the other, and transmit and distribute that energy in a safe and efficient manner to its customers.

References

- [1] *Power Transmission: Mechanical, Hydraulic, Pneumatic, and Electrical*, Thomas E. Scott, Prentice-Hall, 2000.
- [2] *Fundamentals of Applied Electromagnetics*, Fawwaz T. Ulaby, Eric Michielssen and Umberto Ravaioli, Prentice-Hall, 2010.

ENGINEER: ELECTRICAL

GLENN J. ROBINSON, M.S., P.E.
Engineering Design & Testing Corp.
Post Office Box 8027
Columbia, South Carolina 29202

EDUCATION:

1963 B.S. Electrical Engineering - University of Washington
1968 M.S. Electrical Engineering - University of Washington

PROFESSIONAL EXPERIENCE:

August, 1999 to present **Engineering Design & Testing Corp. - Columbia, South Carolina**
Consulting Electrical Engineer responsible for consultation with insurance companies, manufacturing industries, government and attorneys. Specific areas of expertise include: Evaluation of distribution and plant-wide electrical systems; review and evaluation of instrumentation and process control systems; troubleshooting and failure analysis of electric and control networks; evaluate cause of damage, scope of damage and cost of repair of electrical systems and equipment.

1995 to 1999 **Fibermark, Inc. - Warren & Hughesville Mills, New Jersey**
Electrical Superintendent responsible for electrical and instrument (E&I) engineering and boiler/generator administration. Implement modern controls for secondary fiber system and stock refiner. Major rebuild and startup of Hughesville dry end including complete rewiring and drive modifications in conjunction with equipment upgrade.

1992 to 1995 **Getchell Gold, Inc., Getchell Mine - Golconda, Nevada**
Project Engineer responsible for capital projects tracking and budgeting, project and E&I engineering, piping, E&I and facility design and major overhaul of demineralizer, boiler and deaerator piping and controls. Add 15 MVA electrical substation and 13KV mine feeder line (specification, procurement, design, installation and startup). Commission and start up underground mine distribution substation.

1991 to 1992 **Pitt County Memorial Hospital - Greenville, North Carolina**
Electrical Engineer responsible for project and electrical engineering. Specific projects included LAN repeater room and network extension installation, CT room layout (foundation, structure and electrical design) and miscellaneous electrical and lighting changes.

November 2006

DES00000723

1986 to 1991	Weyerhaeuser Company, Lumber Facility - Ayden, North Carolina Engineering Manager responsible for scope, design, permitting and procurement of \$60 million green-field sawmill. Responsible for plant, processing and system engineering during and after construction, electric, water and sewer utility coordination and participation in process and process control startup. Leadership and hands-on participation in numerous process improvement projects. Develop production planning software and validated and improved log sorting control software.
1979 to 1985	Weyerhaeuser Company Wood Products R&E - Tacoma, Washington Project Manager responsible for a manufacturing control system development program, related projects and transverse bucking system from concept through start-up and acceptance (first of several implementations). Stem scanner development and field test, benefit tests, system requirements, cost estimate, capital approval, team building, cost control, key software validation, startup tuning and acceptance.
1974 to 1978	The Oregon Graduate Institute - Beaverton, Oregon Staff Engineer responsible for instrument development, implementation and technical supervision. Instrumentation developed included lighting strike monitor for Bonneville Power HV transmission lines, a non-contacting lumber thickness gauge, a control product introduction for an electronics distributor and numerous monitor and data systems for researchers. Managed instrument maintenance and computer center.
1965 to 1974	The University of Washington - Seattle, Washington Staff Engineer responsible for instrument development, implementation and technical supervision.
1963 to 1965	The Boeing Company - Seattle, Washington Staff Engineer responsible for parts of missile and radar system proposals.

REGISTRATIONS:

Registered Professional Engineer in South Carolina (#20297)
Registered Professional Engineer in North Carolina (#017548)
Registered Professional Engineer in Washington (#11097)
Registered Professional Engineer in Georgia (#028024)
Registered Professional Engineer in Ohio (#72945)
Registered Professional Engineer in Indiana (#10809491)
National Council for Engineering and Surveying (#22912)

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EUA OCEAN STATE CORPORATION, et al. v. COMMISSIONER OF REVENUE, C258405-406;
C258424-425; C258882-883; C259158-159; C259653; C262566-568, 04/24/2006

EUA OCEAN STATE CORPORATION, et al. v. COMMISSIONER OF REVENUE

Case Information:

Docket/Court: C258405-406; C258424-425; C258882-883; C259158-159; C259653; C262566-568, Massachusetts Appellate Tax Board

Date Issued: 04/24/2006

Tax Type(s): Corporate Income Tax

These are appeals under the formal procedure pursuant to G.L. c. 58A, § 7 and G.L. c. 62C, § 39, from the refusal of the appellee Commissioner of Revenue ("Commissioner") to abate corporate excises assessed against appellants under G.L. c. 62C, § 26 and G.L. c. 63, §§ 32 and 39, for tax years ranging from 1994 through 1998.

Commissioner Scharaffa heard these appeals and was joined in the decision for appellants by Commissioners Gorton, Egan, and Rose. Chairman Foley took no part in the deliberation or decision of these appeals.

These findings of fact and report are promulgated at the request of both appellants and the Commissioner pursuant to G.L. c. 58A, § 13 and 831 CMR 1.32.

John S. Brown, Esq., Joseph L. Koclubes, Esq., George P. Malr, Esq., Donald-Bruce Abrams, Esq., Darcy A. Ryding, Esq., and Matthew D. Schnall, Esq. for the appellants.

Daniel A. Shapiro, Esq., and Thomas W. Hammond, Esq., for the appellee.

OPINION

FINDINGS OF FACT AND REPORT

I. INTRODUCTION

On the basis of the parties' Statement of Agreed Facts, the testimony of witnesses at the two-day hearing before the Appellate Tax Board ("Board"), and documents submitted at the hearing, the Board made the following findings of fact.

Appellants EUA Ocean State Corporation ("EUA"), National Grid USA Service Company, Inc. ("National Grid"), TCPL OSP Ltd. ("TCPL OSP"), TCPL OSL Ltd. ("TCPL OSL"), and TCPL Power Ltd. ("TCPL Power")

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appeal from the refusal of the Commissioner to abate approximately \$1.3 million in corporate excises assessed against them for various tax periods between 1994 and 1998. Appellants are partners in two Rhode Island general partnerships, Ocean State Power ("OSP") and Ocean State Power II ("OSP II" and, together with OSP, the "Partnerships"), that generated and sold electricity during the periods at issue.

The principal issue raised in these appeals is whether any of the Partnerships' sales of electricity should be treated as Massachusetts sales includible in the numerator of appellants' sales factors under G.L. c. 63, § 38(f). If, as the Commissioner maintains, electricity is tangible personal property, the sales are considered to have occurred in the state where title and possession of the electricity passed and appellants' sales factors would include their Massachusetts sales in the numerator and all electricity sales in the denominator. If, however, electricity is not tangible personal property, the sales are attributed to the state in which appellants incurred the greatest proportion of the costs of performing their income-producing activity. It is not disputed that under the non-tangible property attribution rule, all of the Partnerships' sales would be attributed to Rhode Island and not Massachusetts because they incurred all of their costs of performance in Rhode Island.

On their Massachusetts corporate excise returns, appellants did not report any of the Partnerships' sales of electricity as Massachusetts sales includible in the numerator of their sales factors. On audit, however, the Commissioner treated more than seventy-five percent of those sales as Massachusetts sales.

II. IDENTIFICATION OF APPELLANTS AND JURISDICTION

A. EUA

EUA is a Rhode Island corporation that was formed as a special purpose subsidiary of Eastern Utility Associates for the purpose of being a partner in the Partnerships. EUA was a general partner in the Partnerships and held a twenty-nine percent interest in each of the Partnerships throughout the period from 1994 through 1998. EUA's sole business activity during this time was to act as a general partner in the Partnerships.

As a result of his adjustments to the Partnerships' sales factors, the Commissioner made additional assessments against EUA with respect to both the net income and the net worth components of its corporate excise for each of the tax years 1994 through 1998. EUA is contesting approximately \$355,000 of additional assessments for these periods. On the basis of the Statement of Agreed Facts and accompanying exhibits, the Board found that EUA timely filed its returns, Applications for Abatement, and petitions for the tax years at issue. Accordingly, the Board found and ruled that it had jurisdiction over EUA's appeals (Docket Numbers C258406, C259159, and C259653).

B. TCPL OSP/NERC

TCPL OSP is a Rhode Island corporation that was formed as a special purpose subsidiary of New England Electric System for the purpose of being a partner in the Partnerships. TCPL OSP was a general partner in each of the Partnerships and held a twenty percent interest in each of the Partnerships during 1994 and throughout the period from 1996 through 1998. During those periods, TCPL OSP's sole business activity was to act as a general partner of the Partnerships. TCPL OSP was formerly known as Narragansett Energy Resources Company ("NERC").

As a result of his adjustments to the Partnerships' sales factors, the Commissioner made additional assessments against TCPL/NERC with respect to the net worth component of its corporate excise for the tax years 1994, 1996, and 1997. In addition, the Commissioner made assessments against TCPL OSP with respect to both the net worth and net income components of its corporate excise for the portion of the 1998 taxable year for which TCPL OSP filed a separate return (September 2 through December 31, 1998). TCPL OSP is contesting approximately \$36,000 in additional assessments for

these periods. On the basis of the Statement of Agreed Facts and accompanying exhibits, the Board found that TCPL OSP/NERC timely filed its returns, Applications for Abatement, and petitions for the tax years at issue. Accordingly, the Board found and ruled that it had jurisdiction over TCPL OSP/NERC's appeals (Docket Numbers C258424, C258882, and C262568).

C. NATIONAL GRID/NEPSC

During 1994 and the period from January 1, 1997 through September 1, 1998, National Grid, then known as New England Power Service Company ("NEPSC"), was the principal reporting corporation for an affiliated group that included TCPL OSP. National Grid is a party to this appeal solely as the principal reporting corporation for this affiliated group.

For tax year 1994, TCPL OSP, then known as NERC, was part of the affiliated group for which NEPSC filed a combined return. NERC's income was included in computing the tax assessed against NEPSC with respect to the group's combined net income pursuant to G.L. c. 63, § 32B. As a result of his adjustments to the Partnerships' sales factors and adjustments to the income of another member of the group, the Commissioner made an additional assessment of \$65,784 against NEPSC with respect to the combined net income for tax year 1994. The parties agree that, as a result of the Board's decision in *New England Power Service Co. v. Commissioner of Revenue*, ATB Findings of Fact and Reports 2000-56, National Grid/NEPSC is entitled to an abatement of \$65,784 for 1994, regardless of the resolution of the contested issue regarding the Partnerships' sales factors and the treatment of NERC as a business corporation rather than a utility corporation.

On the basis of the Statement of Agreed Facts and accompanying exhibits, together with the Commissioner's concession at the hearing that NEPSC had not received a Notice of Abatement Determination dated June 7, 2000 until after it had filed its petition, the Board found that NEPSC timely filed its return, Application for Abatement, and petition for tax year 1994. Accordingly, the Board found and ruled that it had jurisdiction over NEPSC's 1994 appeal (Docket Number C258405).

During the period from January 1, 1997 through September 1, 1998, NERC was also part of the affiliated group for which NEPSC filed a combined return pursuant to § 32B for tax years 1997 and 1998. As a result of his adjustments to the Partnerships' sales factors, the Commissioner reduced the amount of refund that he determined to be due to NEPSC for tax year 1997 and made an additional assessment against NEPSC with respect to NERC's income for tax year 1998.

National Grid/NEPSC is contesting approximately \$105,000 in additional assessments for tax years 1997 and 1998. On the basis of the Statement of Agreed Facts and accompanying exhibits, the Board found that National Grid/NEPSC timely filed its returns, Applications for Abatement, and petitions for the tax years 1997 and 1998. Accordingly, the Board found and ruled that it had jurisdiction over National Grid/NEPSC's 1997 and 1998 appeal (Docket Number C262566).

D. TCPL OSL

TCPL OSL is a Rhode Island corporation that was formed for the purpose of being a partner in the Partnerships. TCPL OSL was a general partner in each of the Partnerships and held a ten and one-tenth percent interest in each of the Partnerships during 1994 and throughout 1997 through 1998. During those periods, TCPL OSL's sole business activity was to act as a general partner of the Partnerships. TCPL OSL was formerly known as JMC Ocean State Corporation.

As a result of his adjustments to the Partnerships' sales factors, the Commissioner made additional assessments against TCPL OSL with respect to the net worth component of its corporate excise for tax year 1997. In addition, the Commissioner made assessments against TCPL OSL with respect to both the net worth and net income components of its corporate excise for the portion of the 1998 taxable year for which TCPL OSL filed a separate return (July 3 through December 31). TCPL OSL is contesting approximately \$14,500 in additional assessments for the tax years 1997 and 1998. On the basis of the Statement of Agreed Facts and accompanying exhibits, the Board found that TCPL OSL timely filed its

returns, Applications for Abatement, and petitions for tax years 1997 and 1998. Accordingly, the Board found and ruled that it had jurisdiction over TCPL OSL's appeals (Docket Numbers C259158 and C262567).

E. TCPL POWER

Like EUA, TCPL OSP, and TCPL OSL, TCPL Power is a Rhode Island corporation that was formed for the purpose of being a partner in the Partnerships. TCPL Power was a general partner in each of the Partnerships and held a forty percent interest in each of the Partnerships during the tax years 1994 through 1998. During those years, TCPL Power's sole business activity was to act as a general partner of the Partnerships.

As a result of his adjustments to the Partnerships' sales factors, the Commissioner made additional assessments against TCPL Power with respect to both the net worth and net income components of its corporate excise for each of the tax years 1994 through 1998. TCPL Power is contesting approximately \$670,000 in additional assessments for these periods. On the basis of the Statement of Agreed Facts and accompanying exhibits, the Board found that TCPL Power timely filed its returns, Applications for Abatement, and petitions for the years at issue. Accordingly, the Board found and ruled that it had jurisdiction over TCPL Power's appeals (Docket Numbers C258425 and C258883).

III. THE PARTNERSHIPS' BUSINESS ACTIVITIES

At all material times, each of the Partnerships owned and operated an electric generating plant in Burrillville, Rhode Island, near the Massachusetts border (the "Plants"). OSP owned and operated an approximately 249 megawatt, natural-gas fired, combined-cycle electric generating plant that included two General Electric MS-7000 EA gas turbines and one General Electric condensing steam turbine-generator ("Unit I"). OSP II owned and operated an approximately 243 megawatt, natural-gas fired, combined-cycle generating plant that, like Unit I, also included two General Electric MS-7000 EA gas turbines and one General Electric condensing steam turbine-generator ("Unit II" and, together with Unit I, the "Units"). The Partnerships derived the bulk of their revenue, roughly \$100 million per year for each Partnership, from the sale of electricity generated by the Units and the sale of "capacity," the right to purchase a portion of the electricity that the Units could generate.

The Partnerships also sold excess natural gas during periods when the Units were not operating. Revenues from these natural-gas sales ranged from \$800,000 to nearly \$10 million per year during the periods at issue. The Partnerships sold no natural gas to Massachusetts customers.

The Partnerships owned various residential properties in Massachusetts and Rhode Island that were located within a half-mile radius of the Plants. The Partnerships purchased these properties from their prior owners under a so-called "property value stabilization program." The program was instituted as part of the process by which the Partnerships gained the necessary governmental approvals for constructing the Plants in response to objections from owners who did not want to have the Plants located near their homes. During the periods at issue, the Partnerships either sold the residential properties to new owners or leased the properties. The Partnerships did not use the properties in the operation of the Plants. As the Partnerships sold the residential properties during the periods at issue, revenues decreased from \$87,286 in 1994 to \$25,033 in 1998.

The assessments at issue concern only the Partnerships' sale of electricity. The Commissioner made no adjustments concerning receipts from the Partnerships' Massachusetts real estate or the sale of "capacity" and natural gas.

IV. COMMISSIONER'S ALLOCATION OF SALES TO MASSACHUSETTS

For the majority of the tax years at issue, the utilities purchasing electricity from the Partnerships were: Boston Edison Company ("BECO"); Montaup Electric Company ("Montaup"); and New England

Power Company ("NEP") (together, "Purchasers"). TransCanada Power Marketing Ltd. ("TCPM") replaced both Montaup and NEP as a purchaser during the end of the periods at issue. During the tax years at issue, the Purchasers were engaged in the wholesale and/or retail sale of electricity.

One of the Purchasers, BECO, was primarily engaged in the retail sale of electricity in Massachusetts. However, over ten percent of BECO's sales were sales to other electricity distributors for resale. These distributors included utilities located in other New England states and power marketing and trading companies that operated throughout the United States.

Another purchaser, NEP, was engaged almost exclusively in the wholesale transmission and resale of electricity, including sales to affiliates based in Massachusetts (Massachusetts Electric Company), Rhode Island (The Narragansett Electric Company), and New Hampshire (Granite State Electric Company). NEP also sold power to unaffiliated customers during the years at issue, including power companies and municipal light departments in various states, and marketing and trading companies selling power throughout the United States. NEP also entered into system power contracts in which it sold specified quantities of power during specific periods to other wholesalers and unit power contracts in which it sold specified quantities of power.

NEP also transferred a portion of its right and obligation to purchase electricity from the Partnerships during the periods at issue. NEP transferred between two and eight percent of the total output of the Partnerships' Units during the period at issue to Unitil Power Corporation ("Unitil"), a New Hampshire utility.

A third purchaser, Montaup, was engaged primarily in the wholesale transmission of power. Montaup's customers included NEP, BECO, and Montaup's affiliates, Eastern Edison Company (based in Massachusetts), BE (based in Rhode Island), and Newport Electric Company (also based in Rhode Island). Its other customers included utilities based in Massachusetts, Rhode Island, Connecticut, a Rhode Island municipal light district, and trading companies doing business throughout New England.

The Commissioner audited appellants' Massachusetts corporate excise returns and determined that appellants' treatment of all electricity sales as non-Massachusetts sales was in error. The auditor initially treated all sales of electricity and capacity as sales of tangible personal property and relied on the "reverse dock sale rule" found in 830 CMR 63.38.1(9)(c) to treat these sales as Massachusetts sales because the electricity was "transshipped" from Rhode Island to Massachusetts customers via the "common carrier" of the New England electricity distribution system known as the "NEPOOL grid," which is described in Section V(B) below. Because for most of the tax years at issue, the Purchasers were all based in Massachusetts, the auditor assumed that the destination of all the Partnerships' sales of electricity during that period was Massachusetts.

Appellants appealed this determination to the Department of Revenue's Appeal and Review Bureau ("A&R"). A&R revised the auditor's determination and concluded that it was the location of the "residential, commercial, and industrial end-users" of the electricity, and not the location of the "intervening purchaser or supplier," that determined whether the sale was a Massachusetts sale. Accordingly, A&R determined that sales of electricity were includible in the numerator of appellants' sales factors "to the extent that the electricity [was] consumed and used by the Purchasers' ultimate retail customers in Massachusetts."

The auditor then prepared a revised set of workpapers based on his understanding of the A&R decision. To determine the identity of the Purchasers' customers, the auditor reviewed certain filings made by the Purchasers to the Federal Energy Regulatory Commission ("FERC"). He then made assumptions, based on the name of the customer or other information he was told, concerning the locations of the ultimate retail consumers of the electricity.

For example, the auditor treated all sales to Massachusetts Electric, but no sales to Narragansett Electric, as Massachusetts sales, solely based on their names. Similarly, he treated all sales to Eastern Edison, but no sales to Granite State Electric, as Massachusetts sales, because he was told that

"Eastern Edison was 100 percent Mass." and that Granite State "does business in New Hampshire."

He did not attempt to determine the identity or location of the retail customers of those entities that purchased electricity from the Purchasers. Rather, he used an "all-or-nothing" approach, classifying either all, or none, of the sales made by the Purchasers' customers as Massachusetts sales strictly based on the name of the Purchasers' customer or other information relayed to him. For example, all of BECO's sales were considered to be Massachusetts sales because the auditor "assumed [BECO] was 100 percent Mass.," even though the A&R determination acknowledged that BECO "did make some wholesale sales to other utilities such as EUA's parent, Eastern Utility Associates, which conducts a substantial portion of its operations in Rhode Island."

To determine the percentage of the Partnerships' total electricity sales attributable to Massachusetts, the auditor first determined the Partnerships' total electricity sales to each purchaser, and then computed a "Massachusetts Sales Percentage" that he applied to the Partnerships' electricity sales to each purchaser. The auditor arrived at the Massachusetts Sales Percentage by dividing what he determined to be each purchaser's sales to Massachusetts customers by the Purchasers' total sales.

Using 1994 as an example, the auditor first broke down the Partnerships' total electricity sales of \$30,245,388 among Montaup (\$11,009,196), NEP (\$19,069,501) and BECO (\$9,239,861). For Montaup, he derived a Massachusetts Sales Percentage of 61.9012 percent from an excerpted page from Montaup's 1994 FERC filings. He arrived at this percentage by first treating all \$41,466,446 of Montaup's sales to Eastern Edison Company as Massachusetts sales. He then added the Eastern Edison sales to \$20,423,209 of sales to Blackstone Valley Electric and \$5,109,429 of sales to Newport Electric to arrive at a total sales figure of \$66,988,084. The Massachusetts Sales Percentage of 61.9012 percent is equal to the Eastern Edison Sales divided by the sum of the Eastern Edison, Blackstone Valley Electric, and Newport Electric sales. The auditor disregarded all other Montaup sales, including all sales to non-affiliates.

The auditor used a similar approach to arrive at a Massachusetts Sales Percentage of 74.4157 percent for NEP for 1994. He treated all of NEP's sales to Massachusetts Electric, totaling \$357,642,672, as Massachusetts sales. He then treated \$16,044,384 in sales to Granite State Electric and \$106,914,299 in sales to Narragansett Electric as non-Massachusetts sales. Dividing the sales to Massachusetts Electric by all NEP sales, he arrived at the 74.4157 Massachusetts Sales Percentage for NEP.

For BECO, the auditor assumed that all of BECO's electricity sales were to Massachusetts customers. Accordingly, he used a Massachusetts Sales Percentage of one hundred percent.

The auditor then determined the Massachusetts sales for each of the Partnerships by multiplying the Partnerships' sales to each purchaser by the Massachusetts Sales Percentage that he had calculated for each of the Purchasers, adding the results together, and allocating the total between the two Partnerships. He then adjusted the apportionment formulas for each of the partners by adding the amounts he determined to be Massachusetts sales to the numerator of the sales factor.

The auditor acknowledged that there were difficulties in applying the methodology described in the A&R Determination letter. First, the Partnerships could not tell from their own records the location of "the ultimate retail customers" as required by the A&R Determination Letter. Moreover, because NEP's and Montaup's customers were also engaged in the transmission, distribution and wholesaling of electricity, and were therefore not the "ultimate consumers" of the electricity purchased, the FERC filings made by NEP and Montaup could not establish the location of the ultimate consumers because these records would not show whether a transmission or distribution purchaser located outside of Massachusetts resold electricity back into Massachusetts or *vice versa*.

Further, although it does not appear to be a relevant factor for applying the A&R method, the auditor also testified that the Massachusetts "headquarters" of the Purchasers also supported the assessment. The auditor testified that because the three principal Purchasers - BECO, Montaup, and NEP - were all "headquartered" in Massachusetts and headquarters is where the "retail obligation is," the actual

"possession and control" of the electricity sold to them passes in Massachusetts.

The Commissioner's allocation of electricity sales to Massachusetts and the resulting assessments against appellants are premised on his determination that sales of electricity are "sales of tangible personal property" for purposes of G.L. c. 63, § 38(f). Accordingly, the Board found the following facts concerning the Partnerships' generation, distribution, and sale of electricity to determine whether electricity constitutes "tangible personal property."

V. PARTNERSHIPS' GENERATION AND SALE OF ELECTRICITY

A. GENERATION OF ELECTRICITY

Electricity is produced at each Unit using two 80-megawatt natural gas generators and one 90 megawatt steam generator. The generation process begins with the activation of two natural gas turbines, which are similar to aircraft jet engines. The combustion of natural gas causes the rotor in each turbine to rotate at very high speed. The heat exhaust from the gas turbines is used, in conjunction with the burning of additional fuel, to heat water to produce steam. The steam is used as the power source for the steam turbine, causing the rotor in the steam turbine to rotate.

Each generator consists of a "stator" and a "rotor." The stator is a series of stationary coils around the periphery of the generator. Inside the stator is the rotor winding, a coil connected to the turbine that produces a magnetic field. The high-speed rotation of the rotor within the stator causes a changing magnetic field. The changing magnetic field induces a flow of current, or electricity, in the stator.

No new electrons or other "particles" are created by this process. The changing magnetic field caused by the rotation of the rotor causes electrons in the stator coils to move in alternating directions, resulting in "alternating current." In the United States, the standard current used is 60-cycle current, in which there are 60 alternating cycles per second, referred to as "60 hertz" or "60 HZ." In 60 hertz current, electrons change direction 120 times per second.

The rapid oscillation of electrons caused by the rotation of the rotor within the stator results in a flow of energy within the coils of the stator. The electrons themselves do not flow in any one direction; for example, individual electrons do not flow out of the generator, onto the transmission lines and into consumers' homes and businesses. Rather, the oscillation of the electrons within the stator of the generator causes a flow of electrical energy which, as described below, is distributed to electricity consumers.

B. TRANSMISSION AND DISTRIBUTION OF ELECTRICITY

The electrical energy flows out of the stator on wires to a transmission substation where the energy generated at the Units is transferred to the transmission system servicing New England, known as the New England Power Pool ("NEPOOL") transmission grid (the "grid"). The grid is a series of interconnected transmission lines throughout New England carrying power generated by the Partnerships and by other generating facilities to delivery points for distribution to New England consumers. The grid consists of that portion of the distribution system between "transmission substations," located near generating facilities, and "power substations," located near the consumer. NEPOOL is not involved in the delivery of power from generation facilities to the transmission substation or the distribution of the power from the power substation to the consumer.

The substation at which the electricity generated by the Units is transferred to the grid is called the "Sherman Farm Road Extra High Voltage/Pool Transmission Facility" ("EHV/PTF"). The EHV/PTF is also located in Rhode Island, a few hundred feet from the Plants. It is owned by Blackstone Valley Electric Company.

Efficient distribution of electrical energy over wires requires a voltage, which is the measure of the

energy's force, of 345 kilovolts ("KV"). The voltage of the power produced by the Units' generators is typically only 13 to 20 KV. Therefore, the power flowing from the generators is put through a series of "transformers" before it is transferred to the grid at the EHV/PTF. A transformer consists of two coils of wires, called "windings," that are wrapped around a magnetic core. Current flowing through one winding at a given voltage induces a magnetic field in the core, which in turn induces a current at a different voltage in the other winding. There is no physical connection or movement of electrons between the two windings; the only connection is through a magnetic field.

Once its voltage reaches the proper level, the electricity is "impressed" or "injected" onto the grid for distribution throughout New England. Electricity is distributed through an integrated system of transmission and distribution facilities using interconnected transmission lines, transformers, and other equipment to bring the power generated by the Partnerships and other power generators to consumers. Just as the voltage is stepped up at transmission substations such as the EHV/PTF to efficiently travel over wires, it must be stepped down to be usable by customers. Generally, the voltage is first reduced to an intermediate level suitable for bringing the electricity into various distribution areas, then reduced further at power substations to an appropriate distribution voltage level, and then, at or near the customer, the voltage is further reduced to a level suitable for customer use. The voltage reduction is achieved using transformers, which operate in the same general manner as the transformers used to increase its voltage.

C. CONTRACTS REGARDING THE SUPPLY OF ELECTRICITY

1. NEPOOL

NEPOOL is an organization of electric utilities created by the NEPOOL Agreement. NEPOOL was formed as a result of the unprecedented power blackout that occurred in New York and New England in 1965. The goals of NEPOOL are to maintain the reliability of the bulk power system for the delivery of electricity to consumers and to produce and deliver power at the lowest cost that is consistent with prudent utility practice.

The NEPOOL Agreement is a contractual agreement among electric utilities that is open to all electric utilities operating in New England. During the tax years at issue, the Purchasers were members of NEPOOL, but the Partnerships were not. The NEPOOL Agreement provides the central dispatching and primary pooling arrangement for electric utilities operating in New England.

(a) SCHEDULING OF POWER GENERATION

NEPOOL does not own any generating or transmission facilities. Rather, it or its agents schedule the operation of the generation facilities that contribute to the NEPOOL grid, including the Partnerships' Units, and account for the purchases and sales of electricity among its members.

Although NEPOOL is not directly involved in the physical operation of the generating plants, it does determine the output levels at which the plants operate. The output levels are based on a projection that takes into account the amount of power withdrawn from the grid by power purchasers and anticipated "line losses," the dissipation of electricity during the transmission process resulting from the inherent resistance of conductors. During most of the periods at issue, decisions concerning the plants' output levels were made by NEPOOL's dispatch agent, the New England Power Exchange, or NEPEX.

(b) SETTLING ACCOUNTS AMONG MEMBERS

During the tax years at issue, the Partnerships sold all of the electricity they produced at the Plants to the Purchasers, who were engaged in the transmission and/or distribution of electricity.

Each of the Purchasers entered into a Unit Power Agreement with each of the Partnerships governing the sale of electricity to that purchaser. Under the Unit Power Agreement, the Partnerships were

obligated to sell, and the Purchasers were obligated to purchase, the following percentages of the Partnership's output: BECO, twenty-three and one-half percent; Montaup, twenty-eight percent; NEP, forty-eight and one-half percent.

NEPOOL accounted for the activity of its members in terms of "resources" and "loads." Resources are the amount of power that a NEPOOL member contributed to the grid and "loads" are the amount of power that a member withdrew from the grid. For example, power generated and transferred to the grid by the Partnerships would be credited as resources to each of the Purchasers in proportion to the percentage of power that the purchaser was entitled and obligated to purchase. Conversely, each of the Purchasers would be charged with loads when its wholesale or retail customer withdrew power from the grid. A deficit in resources in effect represented a purchase by the NEPOOL member from other members, while an excess of resources over loads in effect represented a sale into the pool.

NEPOOL and its administrative agents determined on an hourly basis the net amount of each NEPOOL member's resources and loads. The net purchases and sales were then settled on a monthly basis as a net dollar amount due to or from each member as a result of its activities during the month.

2. PARTNERSHIPS' DELIVERY OBLIGATIONS

In addition to delineating the percentage of the Partnerships' output which each of the Purchasers was entitled, and obligated, to purchase, the Unit Power Agreements also governed the Partnerships' obligations concerning the delivery of power to the Purchasers.

The Unit Power Agreements specified that the delivery point for the electricity was in Rhode Island at the "point of interconnection with the [EHV/PTF] facilities adjacent to" the Plants. The Partnerships' responsibility for delivering the electricity ended at the transmission substation. Further transmission was the responsibility of the Purchasers, including the cost of using the transmission facilities, which are owned by other NEPOOL members, and the line losses resulting from the dissipation of electricity during transmission.

VI. BOARD'S ULTIMATE FINDINGS ON DISPUTED ISSUES

On the basis of the foregoing subsidiary findings, the Board found that electricity is not "tangible personal property" for purposes of G.L. c. 63, § 38. Electricity is not an object that is manufactured; it is a flow of power that is generated by the manipulation of magnetic fields. Electricity has no physical shape, form or geographic location. It has no height, weight, volume or other dimension by which tangible property is typically measured.

Although electricity may be perceived by the senses, such as feeling a shock, it has no form or substance which can be touched. It is of a nature similar to heat, light and sound, all of which can be sensed and even measured but, given their lack of form or substance, would not be considered "tangible."

Electricity generated and injected into the grid is indistinguishable from electricity in the transmission and distribution network. Individual electrons are not created in Rhode Island and delivered to Massachusetts; rather, the Partnerships generate power in Rhode Island that, once injected into the grid, merges with power in the grid produced by other generators and is instantaneously available to consumers throughout the network. One cannot trace the energy generated in Rhode Island and determine by any meaningful standard the ultimate destination of that energy. Concepts such as title, possession and delivery, which are relevant for determining the allocation of sales of tangible personal property under § 38, make little sense in the context of the generation and sale of electric power.

Even if such concepts were applicable to electricity, the evidence of record supports a finding that title and possession of the electricity passed from the Partnerships to the Purchasers in Rhode Island. Under the Unit Power Agreements, the Partnerships completed their performance by delivering the electricity

at the EHV/PTF substation in Rhode Island. As members of NEPOOL, it was the Purchasers, not the Partnerships, which had the right to use the transmission facilities owned by other NEPOOL members. It was the Purchasers, not the Partnerships, which were responsible for further transmission of the electricity beyond the Rhode Island substation, including the cost of using all necessary transmission facilities. Further, the Purchasers absorbed the line losses resulting from the dissipation of electricity during transmission beyond the Rhode Island substation. Accordingly, even applying tangible property rules to the sale of electricity would result in the sale taking place in Rhode Island, where title and possession of the electricity was delivered to the Purchasers.

The Commissioner's various attempts to allocate a portion of the Partnerships' electricity sales based on the "reverse dock sale rule," the location of the ultimate retail consumer, or the headquarters of the Purchasers, are flawed because they fail to recognize the nature of both electricity itself and the manner of its sale by the Partnerships to the Purchasers. Electricity is not "shipped" by a "common carrier," as required by the reverse dock sale rule. Rather, it is made available on the grid in the amounts the Purchasers were obligated to purchase and withdrawn from the grid by the Purchasers' customers. The sale of electricity is, in effect, determined by accounting adjustments based on a comparison between how much power a purchaser has made available on the grid and the level of consumption by its customers.

The Partnerships could not know the location of the "ultimate consumer" of the electricity they generated because they were not privy to the records of their Purchasers and, even if they were, the consumer location would not be revealed in the Purchasers' records of the many sales to resellers of electricity. Finally, the location of the Purchasers' headquarters is not a relevant consideration, even if electricity were tangible: it is the place where the seller's delivery obligation is completed, not the headquarters of the purchaser, which determines where a sale of tangible personal property takes place.

The Commissioner's difficulty in arriving at a reasonable apportionment approach underscores the fact that the sale of electricity does not fit the model of a sale of tangible personal property under § 38(f). Rather, because electricity lacks a physical form and a precise geographic location, making concepts such as title, possession, and delivery somewhat illusory in this context, the standard under § 38(f) that governs all sales other than sales of tangible personal property best fits the sale of electricity. That standard attributes a taxpayer's gross receipts from income-producing activity to the state in which the taxpayer incurs the greatest proportion of the costs of performing that activity.

The evidence of record in these appeals clearly establishes that the Partnerships incurred all of their costs of performance in Rhode Island; the Commissioner's own witness concedes this fact and he does not attempt to argue otherwise. Accordingly, all of their receipts from the sale of electricity are properly attributable to Rhode Island and none to Massachusetts. Because all receipts from electricity sales are attributable to Rhode Island, no receipts are includible in the numerator of appellants' Massachusetts sales factors and, therefore, appellants' sales factors are zero.

On the basis of the foregoing, the Board issued a decision for the appellants and granted an abatement in the amount of \$1,346,993.

OPINION

I. APPORTIONMENT OF NET INCOME UNDER § 38

Pursuant to G.L. c. 63, § 38, appellants are subject to a corporate excise on that part of their net income which is derived from business carried on in Massachusetts. Taxable income derived from Massachusetts business is determined by taking appellants' federal net income, applying the deductions enumerated in G.L. c. 63, § 38(a), and multiplying the result by the three-factor apportionment formula under G.L. c. 63, § 38(c). The apportionment formula is based on the ratio of the corporation's property, payroll, and sales in Massachusetts to its total property, payroll, and sales everywhere. The statutory purpose of the three-factor apportionment formula is "to obtain a fair approximation of the

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corporate income that is 'reasonably related to activities conducted within [Massachusetts].'" *Boston Professional Hockey Association, Inc. v. Commissioner of Revenue*, 443 Mass. 276, 280, n.7 ("Boston Professional Hockey Association") (quoting *Gillette Co. v. Commissioner of Revenue*, 425 Mass. 670, 681 (1997), quoting *Exxon Corp. v. Department of Revenue of Wisc.* 447 U.S. 207, 223 (1980)).

The principal issue raised in these appeals is whether any of the Partnerships' sales of electricity should be treated as Massachusetts sales includible in the numerator of appellants' sales factors under G.L. c. 63, § 38(f) ("§ 38(f)"). Under § 38(f), the sales factor is a "fraction, the numerator of which is the total sales of the corporation in this commonwealth during the taxable year, and the denominator of which is the total sales of the corporation everywhere during the taxable year."

Appellants, whether properly taxable as business corporations or utility corporations, must include in their apportionment factors appellants' pro rata share of the Partnerships' own factors. See 830 C.M.R. 63.38.1(1)(a) and 830 C.M.R. 63.38.1(13) (formerly 830 C.M.R. 63.38.1(11) in 1995 version of the Regulation). Accordingly, resolution of these appeals requires the Board to determine which, if any, of the Partnerships' sales of electricity were "in this commonwealth."

Section 38(f) provides two different rules for determining whether a sale is "in this commonwealth," depending on the nature of what is sold. In the case of tangible personal property, the general rule is that the sale takes place where the property is delivered to the purchaser. A sale of tangible personal property is "in this commonwealth" under § 38(f) if "the property is delivered or shipped to a purchaser within this commonwealth regardless of the f.o.b. point or other conditions of sale."

The determination of whether sales other than sales of tangible personal property are "in this commonwealth" is subject to a different standard. A sale of property other than tangible property is a Massachusetts sale under § 38(f) if: (1) "the income-producing activity is performed in this commonwealth;" or (2) "the income-producing activity is performed both in and outside this commonwealth and a greater proportion of this income-producing activity is performed in this commonwealth than in any other state, based on cost of performance."

Accordingly, resolution of the principal issue of whether any of the Partnerships' sales of electricity should be treated as Massachusetts sales includible in the numerator of appellants' sales factors depends on three sub-issues: 1) whether sales of electricity are sales of "tangible personal property" or sales "other than sales of tangible personal property" for purposes of § 38(f); 2) if electricity is considered tangible personal property for purposes of § 38(f), whether the electricity was delivered in Massachusetts; and 3) if electricity is not tangible personal property for purposes of § 38(f), whether the greater proportion of the Partnerships' income-producing activity is performed in Massachusetts than in any other state. Because the Board found that all of the Partnerships' income-producing activities were performed in Rhode Island, none of the Partnerships' sales would be Massachusetts sales if electricity is not tangible personal property for purposes of § 38(f). Accordingly, the first sub-issue to be determined is whether electricity is tangible personal property for purposes of § 38(f).

II. ELECTRICITY IS NOT TANGIBLE PERSONAL PROPERTY

A. THE COMMON AND ORDINARY MEANING OF "TANGIBLE PERSONAL PROPERTY" DOES NOT ENCOMPASS ELECTRICITY

Section 38(f) does not provide a definition of "tangible personal property." Further, the regulations construing § 38(f) are silent on the issue of whether electricity is tangible personal property for purposes of the sales factor and no Massachusetts case has addressed this issue.

Where a "dominant statutory term is undefined, 'the Legislature should be supposed to have adopted the common meaning of the word, as assisted by a consideration of the historical origins of the enactment.'" *Commissioner of Revenue v. Houghton Mifflin Company*, 423 Mass. 42, 45 (1996) ("Houghton Mifflin").

In cases dealing with the issue of whether a corporation was engaged in "manufacturing," the Supreme Judicial Court has recognized that electricity is not "tangible" property. In *Westinghouse Broadcasting Company, Inc. v. Commissioner of Revenue*, 382 Mass. 354 (1981) ("Westinghouse"), the taxpayer, which owned and operated a television and radio station, claimed that it should be classified as a manufacturing corporation in order to qualify for an investment tax credit under G.L. c. 63, § 31A and a property tax exemption under G.L. c. 59, § 5, d. Sixteen th (3). The court upheld the Board's denial of manufacturing classification, but noted that:

The Board in the present case did indeed allow a request for a ruling that "Westinghouse may not be denied manufacturing status merely because its end product is intangible." That proposition conformed to our view that the production of electricity may entail manufacture (see *Boston Gas Co. v. Assessors of Boston*, 334 Mass. 549, 565 (1956); *Boston & Me. R.R. v. Billerica*, 262 Mass. 439, 449 (1928)).

Westinghouse, 382 Mass. at 358.

In this same context of determining whether a corporation was engaged in manufacture, the court again used electricity as an example of an intangible product of manufacturing activity:

If it be argued that the definition [of manufacturing] contemplates corporeal or tangible input or output, the taxpayer can cite cases that may read to the contrary - those which consider the production of electricity to involve manufacture.

Houghton Mifflin, 423 Mass. at 48-9, quoting *First Data Corporation v. State Tax Commission*, 371 Mass. 444, 446 (1976) ("*First Data Corporation*").

Courts in other jurisdictions have also recognized in a number of contexts that electricity does not constitute tangible personal property within the ordinary meaning of that term. See, e.g., *Omaha Pub. Power Dist. v. Nebraska Department of Rev.*, 248 Neb. 518, 524-25 (1995) ("*Omaha Pub. Power Dist.*") ("[E]lectricity is a physical phenomenon; it is energy, not matter, and has no mass. Electricity can hardly be called 'tangible,' which means 'capable of being touched'"); *Farrand Coal Co. v. Halpin*, 10 Ill.2d 507, 512 (1957) (while recognizing electricity as personal property, Illinois Supreme Court "has at no time held electricity to be 'tangible' personal property"); *People v. Menagas*, 367 Ill. 330, 338 (1937) ("While [electricity] is intangible, it is no less personal property and is within the larceny statute"); *Elgin Airport Inn v. Commonwealth Edison Co.*, 88 Ill. App. 3d 477, 480 (noting that strict liability issue arises "[b]ecause electricity is intangible"); *Miller v. City of Los Angeles*, 185 Cal. 440, 443 (1921) ("Electricity is rather an intangible asset and the word 'property' is perhaps not the most apt word by which to describe the supply of electrical energy thus sought to be acquired for the use of the city").

The recognition by Massachusetts and other state courts that electricity is intangible is consistent with common definitions and understanding of the phrase "tangible personal property." For example, *Black's Law Dictionary* (8th Ed. 2004) ("*Black's*") defines "tangible personal property" as

Corporeal personal property of any kind; personal property that can be seen, weighed, measured, felt, or touched or is any other way perceptible to the senses, such as furniture, cooking utensils, and books.

See also *Houghton Mifflin*, 423 Mass. at 48-9 and *First Data Corporation* 371 Mass. at 446 (equating "corporeal" with "tangible"). In turn, *Black's* defines "corporeal" to be "[a] term descriptive of such things as have an objective, material existence; perceptible by the senses of sight and touch; possessing a real body." It cannot be reasonably argued that electricity has anything resembling a "body" or that electricity itself is perceptible to the senses of sight and touch, as one might see or touch a piece of furniture, a cooking utensil, or a book.

For example, wind, sunlight, sound, heat, and pain are all perceptible to the senses, but cannot be

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touched. The effects of electricity can be seen, as in a lightning strike, and felt, as in a shock, but electricity itself cannot be seen or touched because, like wind, sunlight, sound, heat, and pain, it has no physical form or body. See Black's (using "light and electricity" as examples of "movable intangible property," defined as "a physical thing that can be moved but that cannot be touched in the usual sense."); Omaha Pub. Power Dist., 248 Neb. at 531 (Caporale, J. concurring) (electricity "has no such physical substance in the sense those two words are commonly understood ... It has no readily discernible physical form in the sense that do items such as axes, books, cloth, desks, elevators, fiddles, gavels, and the like").

Accordingly, electricity is not "tangible" as that word is commonly used and understood and therefore is not "tangible personal property" for purposes of § 38(f).

B. THE ONE CASE THAT HAS ADDRESSED THIS ISSUE IN THE CONTEXT OF A STATE APPORTIONMENT FORMULA HELD THAT ELECTRICITY IS NOT TANGIBLE PROPERTY

The California State Board of Equalization ("SBE"), in construing statutory provisions substantially identical to § 38(f), held that sales of electricity constitute the performance of services, not sales of tangible personal property, and that the treatment of such sales for sales factor purposes is properly determined under the cost-of-performance rule. In *Re Appeal of PacifiCorp*, 2002-SBE-005 (Cal. S.B.E. Sept. 12, 2002) ("PacifiCorp").

The taxpayer in *PacifiCorp*, like the Partnerships in these appeals, owned and operated a power plant in a neighboring state. As here, the taxpayer sold electricity under contracts providing for delivery at a substation located in the same state as the generating plant. In rejecting an argument that the taxpayer's sales of electricity should be treated as sales of tangible personal property and that its sales should be taxed on a "destination basis," so that sales to customers located in California would be treated as California sales for apportionment purposes, the SBE held:

Like the court in *Otte* [v. Dayton Power & Co., 37 Ohio St. 3d 33 (1988)], we conclude that the sales of electricity here are sales of services that essentially consisted of appellant's setting and keeping in motion, through its generation and transmission facilities, electrically charged particles. Also as in *Otte*, we further conclude that the basic reason the generation and transmission process employed by appellant is appropriately characterized as a service is that the process does not result in either (1) the "creation" in its generation facilities of any such arguably tangible particles or (2) the "injection" of those particles into its transmission facilities.

***PacifiCorp*, supra.**

The *PacifiCorp* analysis and holding are persuasive authority on the issue raised in these appeals. Because electricity lacks physical form and a precise geographic location, concepts such as title, possession, and delivery, which are the lynchpins of apportionment for sales of tangible personal property, are ill-suited to the context of electricity sales. Even the Commissioner, in the context of a sale of electricity for sales tax purposes, recognizes that "as a matter of physics, electricity is not transported in a manner similar to other tangible personal property." See Technical Information Release 98-16. It is only through abstractions, approximations, and assumptions that the Commissioner's auditors could fit the sale of electricity into the tangible personal property model under § 38(f). Given the nature of electricity and the accounting function by which it is considered to be bought and sold, the use of the tangible personal property model does not effectuate the statutory purpose of the § 38(c) apportionment formula of approximating that part of corporate income which is related to Massachusetts activities. See *Boston Professional Hockey Association*, 443 Mass. at 280.

Rather, the standard under § 38(f) that applies to all sales other than sales of tangible personal property is best suited to attributing income from sales of electricity to the state in which appellant performed its income-producing activities. That standard attributes a taxpayer's gross receipts from

Income-producing activity to the state in which the taxpayer incurs the greatest proportion of the costs of performing that activity. In the present case, the Partnerships incurred all of their costs of performance in Rhode Island. Accordingly, all of their receipts from the sale of electricity are properly attributable to Rhode Island and none to Massachusetts.

C. THE LEGISLATIVE HISTORY OF THE SALES TAX EXEMPTION FOR ELECTRICITY AND CASES IN OTHER CONTEXTS DO NOT ESTABLISH THAT ELECTRICITY IS TANGIBLE PERSONAL PROPERTY

The Commissioner cites legislative and judicial treatment of electricity in contexts other than the corporate excise to support his argument that electricity should be considered tangible personal property for purposes of the sales factor. As described below, these authorities are neither persuasive nor determinative.

1. SALES TAX TREATMENT OF ELECTRICITY

G.L. c. 64H, § 1 provides that "for purposes of this chapter," the phrase "tangible personal property" shall also include gas, electricity and steam." The Commissioner initially asserted, in his A&R determination letter and abatement denials, that this sales tax definition supported his treatment of electricity as tangible property for purposes of the corporate excise apportionment factor. However, the sales tax definition is of little aid in analyzing the corporate excise apportionment statute at issue here.

First, § 1 explicitly provides that the definition applies "for purposes of this chapter," that is, the sales tax under Chapter 64H. Limited just to the sales tax context, the provision represents nothing more than a legislative determination that retail sales of electricity should be subject to the sales tax.

Further, § 1 also provides that the definition of tangible personal property for sales tax purposes "also" includes electricity. The clear implication of the use of the word "also" is that what follows is not simply a clarification of the general definition, but rather an addition to that definition. The need for such an addition suggests that the Legislature understood that electricity would not fall within the general definition of tangible personal property.

In his post-trial brief, the Commissioner refined his argument by suggesting that an exemption from sales tax for sales of electricity that was enacted as part of the original sales tax statute in 1966 evidenced a legislative recognition that electricity would otherwise be considered tangible personal property. The Commissioner essentially argued that the Legislature, by initially providing that electricity should not be treated as tangible personal property under the 1966 version of G.L. c. 64H, § 6(1), revealed that it considered electricity to be tangible personal property.

The fundamental flaw in the Commissioner's initial argument is also present here. The Legislature's 1966 sales tax exemption for electricity under § 6(1), like the current definition of tangible personal property under § 1, is applicable for sales tax purposes. Accordingly, the 1966 exemption, like the current sales tax definition, represents a legislative determination of how sales of electricity should be treated under the sales tax, and sheds no light on whether the Legislature considered electricity to be "tangible personal property" for any other purpose.

Moreover, the Legislature's 1990 amendments to Chapter 64H that eliminated the exemption for sales of electricity belie the notion that the Legislature understood that the meaning of tangible personal property included electricity. If, as the Commissioner argued, electricity was so clearly understood to be tangible personal property, the Legislature could simply have repealed or limited § 6(1), leaving electricity to be taxed as other tangible personal property. Initially, the Legislature did just that, in emergency legislation that was enacted on July 18, 1990. See St. 1990, c. 121, § 47.

The July 18, 1990 amendment to § 6(1) was to take effect on September 1, 1990. St. 1990, c. 121, § 110. However, prior to that effective date, on August 1, 1990, and only weeks after the amendment to

§ 6(l) was enacted, the Legislature made a further change. Despite the already broad definition of tangible personal property, which included personal property of "any nature" including any "commodities whatsoever," the Legislature amended the definition to specifically include electricity. See St. 1990, c. 150, § 359. The specific inclusion of electricity would be superfluous if, as the Commissioner maintained, the Legislature understood the general meaning of tangible personal property to include electricity. See, e.g. *State Tax Commission v. LaTouraine Coffee Co., Inc.*, 361 Mass. 773, 778 (1972) (recognizing that "[n]one of the words of ... [the] statute is to be regarded as superfluous" in determining legislative intent).

For the foregoing reasons, the Commissioner's reliance on sales tax definitions is not persuasive on the issue of whether electricity is tangible property for purposes of the corporate excise.

2. PROPERTY TAX TREATMENT OF ELECTRICITY GENERATION

The Commissioner also argued that the generation of electricity has historically been treated as a "manufacturing" operation for purposes of the local property tax exemption under G.L. c. 59, § 5, cl. Sixteen th (3) and the investment tax credit for manufacturing corporations under G.L. c. 63, § 31A. See, e.g., *Assessors of Holyoke v. State Tax Comm'n*, 355 Mass. 223, 227 (1969); *Boston Gas Co. v. Assessors of Boston*, 334 Mass. 549, 565 (1956); *Boston & Maine R.R. v. Billerica*, 262 Mass. 439, 447-49 (1928). The Commissioner therefore asserts that the fact that electricity is manufactured indicates that it is tangible personal property.

That electricity is considered to be manufactured for purposes of a local property exemption and qualification for investment tax credits does not answer the question of whether it is tangible personal property. The issue addressed in these cases is whether "manufacturing" was taking place. "Manufacturing" has been defined as "the process of transforming raw or finished materials by hand or machinery, and through human skill and knowledge, into something possessing a new nature and name and adapted to a new use." *Commissioner of Corps. & Tax'n v. Assessors of Boston*, 321 Mass. 90, 94 (1947). There is nothing in the definition which supports the notion that only tangible products result from manufacturing.

In fact, as discussed above, Massachusetts courts have recognized that the generation of electricity is an example of a manufacturing process that results in the production of an intangible product. See *Westinghouse*, 382 Mass. at 358 (holding that Board's ruling that manufacturing status cannot be denied because end product is intangible "conformed to [court's] view that the production of electricity may entail manufacturing"); *Houghton Mifflin*, 423 Mass. at 48-9, and *First Data Corporation*, 371 Mass. at 446 (recognizing that cases that consider the production of electricity to involve manufacture counter the argument that the definition of manufacturing "contemplates corporeal or tangible input or output").

Accordingly, Massachusetts manufacturing cases not only fail to advance the Commissioner's position but in fact support the Board's ruling that electricity is commonly understood to be intangible.

3. CASES HOLDING THAT ELECTRICITY IS A "COMMODITY" OR A "PRODUCT" ARE INAPPOSITE

The Commissioner cites a handful of cases in non-tax contexts to support his proposition that the general meaning of "tangible personal property" includes electricity. These cases fail to establish such a proposition and instead serve to underscore the unique nature of electricity as something quite different from tangible property.

G.E. Lothrop Theatres Co. v. Edison Elec. Illuminating Co. of Boston, 290 Mass. 189 (1935) ("*Lothrop Theatres*"), involved a dispute between an electric company and a building owner over the recovery of certain electric charges billed to both the owner and its tenants. The court noted that there "may be" cases where electricity would be considered "a commodity subject to sale and delivery rather than a

service furnished by the generating company." *Lothrop Theatres*, 290 Mass. at 193. At a minimum, this observation indicates that the determination of whether electricity is a commodity or a service depends on the context in which the question is asked; it also can be read to suggest that the court's general understanding of electricity is that it is a service.

The court also said that when electricity is sold, it "may be conceded" that there is "something corresponding to delivery in the sale of a tangible chattel." *Id.* The need for analogy contradicts the Commissioner's claim that electricity is itself tangible personal property. There is nothing in *Lothrop Theatres* that supports the notion that electricity is so commonly understood to be tangible that it must be so characterized generally or for corporate excise purposes.

In *Town of Concord, Mass. v. Boston Edison Co.*, 676 F.Supp. 396 (D.Mass. 1988) ("Town of Concord"), the court addressed whether electricity was a "commodity" for purposes of the price restrictions under the Robinson-Patman Act, 15 U.S.C.A. § 13(a). A "commodity" is not necessarily tangible personal property; in fact, it is considerably broader in scope. See *Opinion of the Justices*, 408 Mass. 1201, 1206-11 (1990) (concluding that inclusion of the term "commodities" in Article 4 of the Massachusetts Constitution authorizes taxation of services). In fact, the court in *Town of Concord* pointed out that "electricity is not an obviously tangible" item or product and acknowledged that "the average consumer of electricity" might well believe that "she is paying for a service rather than purchasing a product." *Id.* at 398.

The court's decision is based on considerations specifically relating to price restrictions under the Robinson-Patman Act, particularly whether electricity, like other items subject to those restrictions, "is a thing bought and sold in the marketplace." *Id.* The fact that the court determined that, except for not being "an obviously tangible item," "electricity is not significantly different from other items deemed commodities subject to the price discrimination prohibitions of antitrust laws" (*Id.*) does not mean that electricity should be treated as tangible personal property for purposes of the corporate excise apportionment formula.

The Commissioner's citation of a case holding that electricity is a "product" within the meaning of the strict liability rule in Restatement (Second), Torts, § 402A (1965) is also not helpful. The Wisconsin court in *Ransome v. Wisconsin Elec. Power Co.*, 87 Wis.2d 605 (1979), while never using the term "tangible personal property," relied on public policy grounds to support its decision in favor of the consumer-plaintiff. The public policy grounds supporting a ruling of strict liability have no relevance to the issue in the present appeals.

The remaining cases cited by the Commissioner, holding that electricity can be measured, add nothing to the analysis. The fact that electricity can be measured is not contested and does not answer the question of whether it is tangible personal property. If there is anything significant about the subject of measurability, it is that electricity is measured in a manner - the passage or use of current over time - that does not remotely resemble the measurements - height, weight, volume, number of items, etc. - that apply to items of tangible personal property.

II. EVEN IF ELECTRICITY IS PROPERLY CONSIDERED TANGIBLE PERSONAL PROPERTY FOR PURPOSES OF § 38(f), THE PARTNERSHIPS' SALES TOOK PLACE IN RHODE ISLAND, NOT MASSACHUSETTS

The tangible property rule under § 38(f) attributes sales to the state in which the taxpayer completes its delivery to the purchaser. Under the Unit Power Agreements with the Purchasers, the Partnerships effected delivery of the electricity they generated and sold at a specific interconnection point with the NEPOOL grid, the EHV/PTF substation in Rhode Island. At that point, the Purchasers took responsibility for further transmitting the electricity, including the cost of using all NEPOOL transmission facilities and the line losses from dissipation of power during transmission beyond the Rhode Island substation. Accordingly, the Partnerships completed their delivery obligations, and the Purchasers took possession of the electricity, in Rhode Island.

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service furnished by the generating company." *Lothrop Theatres*, 290 Mass. at 193. At a minimum, this observation indicates that the determination of whether electricity is a commodity or a service depends on the context in which the question is asked; it also can be read to suggest that the court's general understanding of electricity is that it is a service.

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By: _____

Frank J. Scharaffa, Commissioner

Donald E. Gorton, III, Commissioner

Nancy T. Egan, Commissioner

James D. Rose, Commissioner

A true copy,

Attest: _____

Assistant Clerk of the Board

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**California State Tax Reporter, In the Matter of the Appeal of PacifiCorp--
Corporation franchise (Income)-- Allocation and apportionment-- Sales
factor-- Income-producing activities, California, ¶403-326, (Sep. 12,
2002)**

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¶403-326. In the Matter of the Appeal of PacifiCorp, California State Board of Equalization, 2002-SBE-005, September 12, 2002.

Corporation franchise (Income): Allocation and apportionment: Sales factor: Income-producing activities.— Electricity is intangible and a taxpayer's sales of the generation and transmission of electricity were sales of services that, because they were performed for the most part outside of California, must be excluded from the numerator of the taxpayer's sales factor for California corporation franchise (income) tax purposes, the California State Board of Equalization (SBE) held in a matter of first impression. The SBE reversed the Franchise Tax Board, which had held that the sales were sales of tangible personal property that had to be included in the numerator.

The taxpayer, an Oregon power company, sold electricity generated at facilities outside California to California entities and treated these sales as occurring in Oregon, the contractual point of delivery. The FTB ruled that these sales were California sales because the ultimate destination of the electricity was California. Under California law, sales of tangible personal property are generally sourced to California if the property is delivered there, while sales other than sales of tangible personal property are sourced to California if a greater proportion of the income-producing activity is performed in California than in any other state. Citing *Otte v. Dayton Power & Co.*, 523 N.E.2d 835 (Ohio 1988), the SBE held that the sales of electricity were sales of services that essentially consisted of the taxpayer setting and keeping in motion, through its generation and transmission facilities, electrically charged particles. Furthermore, this process was a service because it did not result in the creation of any tangible particles or the injection of such particles into its transmission facilities. A majority of the income-producing activities related to the sales of these services were performed in states other than California and, therefore, were properly excluded from the numerator of the taxpayer's California sales factor.

The SBE rejected the FTB's argument that these transactions were not services because they did not relate to activities conducted by individuals for the benefit of others. Income-producing activity is not limited to personal services by employees but includes the use of tangible and intangible personal property in performing a service. The SBE also rejected the FTB's argument that electricity is not a service because it is purchased for its physical characteristics. The generation and transmission of electricity is separate from and not incidental to its physical characteristics, which are the electrons already in the power lines, for the use of which the taxpayer paid in separate transactions.

See ¶11-525.

Representing the Parties:

For Appellant: Eric J. Coffill, Attorney at Law Carley A. Roberts, Attorney at Law

For Respondent: Craig Swieso, Tax Counsel

Counsel for Board of Equalization: Charles D. Daly, Tax Counsel III

OPINION

This appeal is made pursuant to section 19045¹ of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of PacifiCorp against proposed assessments of additional franchise tax in the amounts of \$498,412, \$517,835, \$58,523, \$151,313, \$359,742, and \$461,972 for the years ended December 31, 1984, 1985, 1986, 1987, 1988, and 1989, respectively.

The main issue in this appeal is whether sales of electricity to California entities during the appeal years were sales of tangible personal property for purposes of section 25135. That issue is a matter of first impression in

California. An alternative issue is, if the sales of electricity were sales of tangible personal property, whether the sales occurred in Oregon rather than California.

Appellant is an Oregon power company that, through its predecessor corporation Pacific Power and Light ("PPL"), has been providing electricity to the Pacific Northwest since the beginning of the previous century. Over time, PPL expanded, through the acquisition of other corporations, both the geographic areas that it served and the kinds of businesses in which it was engaged. In 1982-1985, after acquiring a large number of companies, PPL underwent a reorganization that apparently resulted in PPL becoming a division of appellant and appellant having primary responsibility for the management of the entire group of corporations affiliated with PPL.

The sales of the electricity at issue were made through the Pacific Northwest-Pacific Southwest Intertie ("Intertie"). The Intertie, which began operation in 1968, permits the transmission of excess power available in one region served by the Intertie to another region with power needs. Appellant states that, during the appeal years, the Intertie was owned by appellant, Portland General Electric,² and the Bonneville Power Administration ("BPA").³ During most of the appeal years, the Intertie consisted of two alternating current ("AC") power lines and a direct current ("DC") power line. One AC power line ran from the Malin substation in Oregon south into California. Appellant alleges that the Western Area Power Authority⁴ owned this line. Appellant also alleges that appellant owned the other AC power line, which ran from the Malin substation south to Round Mountain, California. In addition, appellant alleges that appellant leased that AC line to Pacific Gas and Electric ("PG&E"), Southern California Edison ("SCE"), and San Diego Gas and Electric ("SDG&E").⁵ Finally, appellant alleges that the BPA owned the DC power line from Celilo near The Dalles, Oregon, to the Nevada-Oregon border and that the Los Angeles Department of Water and Power ("LADWP") owned that line from the Nevada-Oregon border through Nevada and into California until the line terminated in Los Angeles.⁶

Appellant filed a California combined report with its affiliates for the appeal years.⁷ On its Oregon corporate income tax returns for the appeal years, appellant had treated the sales of electricity to California entities as sales occurring in Oregon. Respondent's auditor in his final narrative report stated that appellant treated those sales as Oregon sales because the electricity was delivered at either the Malin substation in Oregon⁸ or the Oregon-Nevada border and ownership of electricity sold over the Intertie changed at the contractual points of delivery. Respondent's auditor also concluded that the electricity sold to its California customers was generated by appellant and that appellant had its own generation facilities in Oregon, Washington, Montana, Wyoming, and Utah. Respondent determined upon completion of its audit that sales of electricity by appellant, doing business as PPL, to a number of power companies, municipalities, and government agencies located in California were California sales that should be included in the numerator of appellant's sales factor.⁹

At protest, respondent again concluded that the sales at issue were sales of tangible personal property for purposes of section 25135 and that those sales must be included in the numerator of appellant's sales factor under the then recently decided case of *McDonnell Douglas Corp. v. Franchise Tax Board* (1994) 26 Cal.App.4th 1789 ("McDonnell Douglas"). In *McDonnell Douglas*, the taxpayer delivered aircraft to purchasers owned by the taxpayer in California, and the purchasers then arranged for the transportation of the aircraft out of California. The court in *McDonnell Douglas* rejected the "delivery" rule adopted by respondent in its Legal Ruling 348 (Feb. 21, 1973) in favor of the "destination" rule adopted by courts in a number of jurisdictions outside of California. (*McDonnell Douglas Corp. v. Franchise Tax Board*, *supra*, 26 Cal.App.4th at pp. 1793-1796.) In respondent's view, the electricity that appellant sold was analogous to the aircraft in *McDonnell Douglas* and had an ultimate destination in California.

Subsequently, appellant petitioned respondent under section 25137 to assign appellant's sales of electricity to the locations at which the title to the electricity was contractually transferred. After respondent denied appellant's petition, this timely appeal followed.

Appellant's primary contention on appeal is that the sales of electricity at issue here are sales "other than sales of tangible personal property" for purposes of section 25136. Alternatively, appellant contends that, if the sales of electricity were sales of tangible personal property, the sales should be treated as having

occurred in Oregon because a "contractual point of delivery" rule should be adopted for electricity rather than the "destination" rule announced in *McDonnell Douglas*. Appellant argues that a "contractual point of delivery" rule should be adopted for electricity because of alleged difficulties in tracing electricity from one point to another.

In support of its primary contention that electricity is an "intangible,"¹⁰ appellant relies heavily upon the California Supreme Court case of *Miller v. The City of Los Angeles* (1921) 185 Cal. 440 ("Miller") and the California Court of Appeal case of *Pierce v. Pacific Gas & Electric Co.* (1985) 166 Cal.App.3d 68 ("Pierce"). In *Miller*, the issue before the Court was whether electricity was "property" for purposes of a provision of the Los Angeles City charter that permitted the purchase of "property" by the city. (*Miller v. The City of Los Angeles*, *supra*, 185 Cal. at pp. 443-444.) After holding that electricity was "property" for purposes of the Los Angeles city charter, the Court stated that "[e]lectricity is rather an intangible asset, and the word 'property' is perhaps not the most apt word by which to describe the supply of electrical energy thus sought to be acquired for the use of the city." (*Miller v. The City of Los Angeles*, *supra*.)

In *Pierce*, the appellate court considered whether electricity that injured a consumer as the result of a transformer malfunction was a "product" rather than a service for purposes of strict liability in tort. (*Pierce v. Pacific Gas & Electric Co.*, *supra*, 166 Cal.App.3d at p. 81.) Holding that the seller of electricity was strictly liable in tort to the consumer, the appellate court in *Pierce* stated that policy justifications for imposing strict liability in tort was more significant in reaching its holding than merely whether electricity should be labeled a "product." (*Pierce v. Pacific Gas & Electric Co.*, *supra*, 166 Cal.App.3d at p. 82.) However, after observing that California and other courts "have not dwelled unduly on electricity's physical properties" in the "product" context, the appellate court quoted in a footnote the following statement suggesting that its observation might not be entirely correct: "[b]ecause electricity is intangible, it has been consistently argued by strict liability defendants in cases involving injury by electricity that the intangible force of electric current is not a 'product' within the meaning of [the Restatement of Torts]...." (*Elgin Airport Inn v. Commonwealth* (1980) 88 Ill.App.3d 477 [410 N.E.2d 620,623].") (*Pierce v. Pacific Gas & Electric Co.*, *supra*, 166 Cal.App.3d at p. 82, note 6.) Appellant also cites a number of cases from other state courts that, like *Miller* and *Pierce*, do not address the tangibility or intangibility of electricity in the context of a corporate franchise or income tax.

In further support of its position that electricity is an "intangible," appellant points out that respondent itself treated electricity as "intangible property" in its Multistate Audit Technique Manual until 1986. In addition, appellant points out that respondent has characterized electricity as an "intangible" for purposes of Public Law 86-272¹¹ in its "UDITPA Manual" (FTB Publication 1050 (Revised 10-83)) and in a letter to a commercial publisher. Appellant also notes that the Multistate Tax Commission ("MTC") considers electricity to be "intangible property" in its MTC Corporate Income Audit Procedure Guideline Manual. In addition, appellant notes that, in a 1999 report, the Federation of Tax Administrators stated that electricity should be considered a service, rather than tangible personal property, for purposes of establishing "nexus."¹²

Appellant also cites the *Appeal of Retail Marketing Services, Inc.* (91-SBE-003), decided by the Board on August 1, 1991, for the proposition that electricity can be distinguished from "tangible personal property." In *Retail Marketing Services*, we observed that there was no statutory definition of "tangible personal property" but that the taxpayer had correctly advanced the view that "the ordinary and necessary meaning of 'tangible' is that which can be felt by touch, having actual form and substance." However, we also observed that such a definition of "tangible" is much too broad to be used in determining whether the property at issue in that matter was "tangible personal property" for purposes of the property factor under section 25129. In the matter under consideration here, appellant has provided a declaration under penalty of perjury by Richard C. Dorf, Professor of Electrical Engineering at the University of California at Davis, in which he concludes that "intangible personal property," under a definition allegedly consistent with *Retail Marketing Services*, encompasses electricity.¹³ Appellant has also provided a list of cases from other states, including *Otte v. Dayton Power & Co.* (1988) 37 Ohio St. 3d 33 [523 N.E.2d 835] ("Otte"), to support the proposition that electricity is an "intangible" under *Retail Marketing Services*.

Finally, appellant characterizes respondent's change in position regarding the taxation of electricity as an invalid "underground regulation" whose purpose is merely to increase the collection of revenue. Appellant also expresses concern that treating electricity as tangible personal property might provide unanticipated nexus with California for companies engaged in electronic commerce.

Respondent continues to contend that electricity is tangible personal property whose sales occurred in California under the controlling authority of *McDonnell Douglas*. In support of that contention, respondent proposes a definition of "tangible personal property" as "the collective rights that are associated with things that exhibit physical attributes, which are not related to land." Respondent's proposed definition is distilled from a broad collection of sources that include dictionary definitions of "tangible personal property," a portion of a law review article¹⁴ that discusses the distinction between the property law concepts of "choses in possession" and "choses in action," and respondent's apparent view that the rationale underlying the holding of *Retail Marketing Services* is that the property at issue in that matter was a "chose in action" and, therefore, was "intangible personal property." Respondent also takes the position that electricity is "tangible personal property" even under the definition of "tangible" that appellant advanced in *Retail Marketing Services*. Like appellant, respondent cites a number of cases from other jurisdictions in support of its position. However, like the cases cited by appellant, respondent's cases fail to address the tangibility or intangibility of electricity in the context of a corporate franchise or income tax.

In a report submitted to us by respondent and that respondent characterizes as providing a necessary conceptual framework for discussing the scientific and technical aspects of electricity, Professor Joel Fajans, Professor of Physics at the University of California at Berkeley, states:

"Electricity is actually a catchall word encompassing many related concepts, each with a very specific definition. These concepts include *charge*, *current* (measured in amps), *voltage* (measured in volts) *power* (measured in watts) and *energy* [T]he flow of charge constitutes a *current*. Charge is usually made up of electrons, so current is typically the flow of electrons.... The ability of each charge to do something useful ... is related to voltage. Thus, the rate at which electricity performs useful services equals the product of the current (the number of charges) and the voltage (the work done by each electron.) This rate is called the *power* [¶] ... The total amount of power consumed over time is called the *energy*, which is measured in kilowatt-hours. [Fn. Omitted.] ... The power company bills users for the amount of energy that they consume....

The electric power distribution system is quite complicated. In essence, however, it can be reduced to a circuit consisting of a power source, a transmission line and a load.... The power source must be capable of supplying a current at a reasonable voltage, and can be, among other things, a battery, a hydroelectric plant, or a gas fired turbine generator. The transmission line can be as simple as a pair of wires like those in a household power cord. [Fn. Omitted.].... A load is the generic name for devices that use the electricity to perform a useful service."

(Resp. Br., exhibit B, p. 2.)

Later in his report, Professor Fajans further states:

"Electricity is physical and material because, microscopically, it consists of the flow and "pressure" of a material entity, namely electrons, and macroscopically, it can be sensed (felt, tasted, seen, and heard), measured, weighed, and stored, and is subject to the universal laws of nature. The following sections discuss each of these properties in rough order of importance.... [¶] ... Without electrons, electricity cannot be transmitted. Though electrons themselves are very small and lightweight, they are one of the basic constituents of matter; common matter like hydrogen and iron consists of electrons, protons, and neutrons in roughly equal number. Thus, there is nothing more physical and material than an electron. Since electricity itself consists of the flow of a material object, electricity is physical and material."

(Resp. Br., exhibit B, p. 5.)

Respondent acknowledges that the term "other than tangible personal property" in section 25136 encompasses not only intangible personal property but also services. However, respondent argues that sales of electricity are not sales of services because electricity (1) does not essentially relate to activities conducted by individuals for the benefit of others and (2) is purchased for its "physical characteristics." From a comment in Professor Fajans' report regarding the capital required to generate and transmit electricity, respondent also argues that services performed by individuals are only incidental in comparison to generators and power lines. Other than a definition of "services" from a legal dictionary, respondent cites no authority directly in support of its arguments.

With respect to the alternative issue here, respondent argues that appellant's position that the "destination" rule stated in *McDonnell Douglas* may not be applied to electricity because electricity cannot be traced from one point to another is wrong. In support of its argument, respondent points out that electricity is "fungible" and that it is irrelevant whether each electron sold by appellant can be traced to a destination in California as long as purchasers in California receive electricity equal to the amount of electricity sold by appellant. Respondent also argues that applying a "delivery" rule to electricity is inconsistent with the language in section 25135 that the f.o.b. point¹⁵ or other conditions of the sale must be disregarded.

Respondent concedes that if the sales of electricity at issue are sales of "other than tangible personal property" for purposes of section 25136, the sales were not in California under that section because a majority of the "income-producing activities" related to those sales were performed in other states, based on cost of performance.

Section 25128 provides that all business income shall be apportioned to California by multiplying such income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three. Section 25134 defines the sales factor as a fraction, the numerator of which is the total number of sales of the taxpayer in California during the income year, and the denominator of which is the total sales of the taxpayer everywhere during the income year.

Section 25135 provides that sales of tangible personal property are in California if: (a) the property is delivered or shipped to a purchaser, other than the United States Government, within California regardless of the f.o.b. point or other conditions of the sale; or (b) the property is shipped from an office, store, warehouse, factory, or other place of storage in California and (1) the purchaser is the United States government or (2) the taxpayer is not taxable in the state of the purchaser. Section 25136 provides that sales, other than sales of tangible personal property, are in California if: (a) the income-producing activity is performed in California; or (b) the income-producing activity is performed both in and outside California and a greater proportion of the income-producing activities is performed in California than in any other state, based on costs of performance.

California Code of Regulations, title 18, section 25136, subdivision (b), ("Regulation section 25136, subdivision (b)") provides as follows:

"The term 'income producing activity' applies to each separate item of income and means the transactions and activity directly engaged in by the taxpayer in the regular course of its trade or business for the ultimate purpose of obtaining gains or profit. Such activity does not include transactions and activities performed on behalf of a taxpayer, such as those conducted on its behalf by an independent contractor. Accordingly, income producing activity includes but is not limited to the following:

1. The rendering of personal services by employees or the utilization of tangible and intangible property by the taxpayer in performing a service.
2. The sale, rental, leasing, licensing, or other use of real property.
3. The rental, leasing, licensing or other use of tangible personal property.
4. The sale, licensing or other use of intangible personal property.

"The mere holding of intangible personal property is not, of itself, an income producing activity."

We agree with appellant's primary contention that the sales of electricity here are "other than sales of tangible personal property" for purposes of section 25136. Because their discussions of the tangibility or intangibility of electricity are not in the context of a corporate franchise or income tax and are sometimes, as in *Miller and Pierce*, mere dictum, the cases and other authority upon which appellant relies are not controlling here. However, discussions of electricity in some of those cases are nonetheless helpful in resolving the main issue in the instant matter. For example, in the *Otte* case cited by appellant, the Ohio Supreme Court distinguished electricity from a "product" in the context of strict liability in tort by stating as follows:

"A 'product' is anything made by human industry or art. electricity appears to fall outside this definition. This is so because electricity is the flow of electrically charged particles along a conductor. [The power company] does not manufacture electrically charged particles, but rather, sets in motion the necessary

elements that allow the flow of electricity. What we have here is a purported defect in the distribution system. Such a system is, in our view, a service."

(*Otte v. Dayton Power & Co.*, *supra*, 37 Ohio St. 3d at p. 37.)

Like the court in *Otte*, we conclude that the sales of electricity here are sales of services that essentially consisted of appellant's setting and keeping in motion, through its generation and transmission facilities, electrically charged particles. Also as in *Otte*, we further conclude that the basic reason the generation and transmission process employed by appellant is appropriately characterized as a service is that the process does not result in either (1) the "creation" in its generation facilities of any such arguably tangible particles or (2) the "injection" of those particles into its transmission facilities.

At this juncture in our analysis, it is necessary to point out that exactly what constitutes the "sales of electricity" at issue here is not well specified in the record. For example, appellant has not presented us with financial or other records that segregate its "sales of electricity" to California entities into such components as sales resulting from the generation of electricity and sales resulting from the transmission of electricity. However, the final narrative report of respondent's auditor notes that when a California entity purchases "power" from appellant, appellant "turns up" its generator to put more power into the Intertie. In addition, the auditor's report notes that there were "wheeling" charges for transmitting electricity over power lines. In view of the auditor's notations, we infer that the generation and transmission of electricity by appellant are the components of the "sales of electricity" that we need to consider here. The auditor's report also states that a California entity would pay a "use of facilities" charge to use power lines owned by another entity. However, as indicated in footnote 5, it appears that rental payments for the California portion of those lines are not at issue here because appellant has already included them in the numerator of its sales factor under Regulation section 25136, subdivision (b)(2).

Even though respondent seems to argue that the generation and transmission of electricity are not properly treated as services under section 25136 because they are not personal services, Regulation section 25136, subdivision (b)(1), explicitly states that "income producing activity" is not limited to personal services by employees but includes the use of tangible and intangible property in performing a service. In addition, we concluded in the *Appeal of Mark IV Metal Products, Inc.* (82-SBE-181), decided by the Board on August 17, 1982, that the fabrication in California of metal owned by a Texas customer into seat parts for that customer, through the use of the taxpayer's "own labor and machinery," was a service that was includable in the numerator of a taxpayer's sales factor under section 25136. For those reasons, we reject respondent's argument that the generation and transmission of electricity are not properly treated as services under section 25136 because they are not personal services.

Respondent appears to predicate its argument that electricity is not a service because it is purchased for its "physical characteristics" on the assumption that the generation and transmission of electricity are inseparable from, and incidental to, its "physical characteristics." However, as suggested by *Otte*, the "physical characteristics" of electricity in the instant matter are essentially the electrons already in the power lines that have been set and kept in motion by appellant's generation and transmission system.¹⁶ Because appellant has apparently already paid for the use of the electrons in the power lines by payment of the "use of facilities" charge in transactions that are separate from, and independent of, those regarding the generation and transmission of electricity, we conclude that the generation and transmission of electricity here are neither inseparable from, nor incidental to, its "physical characteristics." Because we disagree with respondent's underlying assumption, we also disagree with its argument that electricity is not a service because it is purchased for its "physical characteristics."

With regard to respondent's argument that the services performed by appellant in the generation and transmission of electricity were merely incidental in comparison to generators, *Mark IV Metal Products* clearly supports the view that the use of equipment, such as a generator, by a taxpayer as part of the process by which a service is performed does not detract from the conclusion that the taxpayer is performing a service for purposes of section 25136. As discussed above, respondent's argument that the generation and transmission of electricity were merely incidental in comparison to power lines also fails because the rentals of the power lines are transactions that are separate from, and independent of, those relating to the generation and transmission of the electricity.

Although Professor Fajan's discussion of electricity in his report seems intended to support respondent's position that electricity is "tangible personal property" by emphasizing the "physical and material" nature of electrons, his discussion is also consistent with the definition of electricity in *Otte* as a "flow of electrically charged particles along a conductor." In addition, Professor Fajan's discussion of electricity is also consistent with the conclusion of the court in *Otte* that the "distribution system" with respect to electricity there was a service. In our view, just as the "distribution system" by which the flow of electrically charged particles occurred in *Otte* was a service, appellant's generation and transmission of electricity were also services under section 25136.

Because we conclude that sales of the generation and transmission of electricity here were sales of services performed for the most part outside of California, we further conclude that those sales were sales of "other than tangible personal property" and were properly excluded from the numerator of appellant's sales factor. Therefore, based upon the foregoing discussion, we conclude that, for purposes of California tax law, electricity is intangible. In view of our conclusions, we need not address the alternative issue in this matter. Accordingly, respondent's action is hereby reversed.

ORDER

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED, AND DECREED, pursuant to section 19047 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of PacifiCorp against proposed assessments of additional franchise tax in the amounts of \$498,412, \$517,835, \$58,523, \$151,313, \$359,742, and \$461,972 for the years ended December 31, 1984, 1985, 1986, 1987, 1988, and 1989, respectively, be and the same is hereby reversed.

Dean Andal, Member

Claude Parrish, Member

* Marcy Jo Mandel, Member

Footnotes

- 1 Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the years in issue.
- 2 Portland General Electric is an Oregon subsidiary of Enron Corporation.
- 3 The BPA is an agency of the United States government. Apparently, a major purpose of Congress in authorizing the construction of the Intertie was to provide an additional market for surplus power provided by the BPA so that the BPA would have greater financial resources to repay the United States Treasury for its investment in the Pacific Northwest power system.
- 4 We assume that the "Western Area Power Authority" is the same entity as the entity designated as WAPA in footnote 9.
- 5 Apparently, appellant included rental income from the portion of the line that ran from the Oregon-California border to Round Mountain, California, in the numerator of its sales factor. Appellant's treatment of that rental income does not seem to be in dispute.
- 6 We note that appellant does not attempt to reconcile seeming inconsistencies between its statement that appellant, Portland General Electric, and the BPA were co-owners of the Intertie with its allegations regarding the ownership of the AC and DC power lines that comprised the Intertie. However, we also note that respondent does not seem to object to such inconsistencies. Therefore, we conclude that they are of little significance here.
- 7 At protest, respondent determined that appellant was unitary, and therefore should be combined, with only some of the affiliates that were included in its California combined report.

- 8 The audit report also stated that some of appellant's contracts with its California purchasers provided that the sales of electricity would occur at the Oregon-California border because of the possibility that an additional AC power line would be constructed that would not pass through the Malin substation.
- 9 Of appellant's sales of electricity to the California entities during the appeal years, approximately 47 percent (\$224,919,960) were made to SCE, 20 percent (\$92,765,217) to PG&E, 18 percent (\$85,684,193) to LADWP, Sacramento Municipal Utility District, and various California municipalities, and 14 percent (\$66,209,039) to the California Department of Water Resources. Appellant also made sales of electricity of \$4,237,171 to SDG&E during the appeal years and of \$16,036,408 to the Western Area Power Administration ("WAPA") during the 1984-1986 appeal years. Because respondent apparently has concluded that the sales to WAPA may have been, in effect, sales to purchasers that were not located in California, respondent concedes that those sales should not be included in the numerator of appellant's sales factor. The record contains no additional information regarding the functions of WAPA or its constituent parts.
- 10 Like respondent, appellant sometimes uses the term "an Intangible" or other similar designation as synonymous with the term "other than sales of tangible personal property" under section 25136.
- 11 Public Law 86-272 provides, in pertinent part, that no state shall have the power to impose a net income tax on income derived within the state if the only business activity within the state is the solicitation of orders for sale of tangible personal property, which orders are sent outside the state for approval or rejection and, if approved, are filled by shipment or delivery from a point outside the state. (15 U.S.C.A., §381(a)(1).)
- 12 "Nexus," in this context, is another way of saying that a corporate taxpayer has sufficient connections with a state to justify, for constitutional purposes, taxation of the taxpayer by that state.
- 13 Professor Dorf's testimony at the hearing in this matter was to the same effect.
- 14 Cowdrey, *Software and Sales Taxes: The Illusory Intangible* (1983) 63 B.U. L.Review 181, 197-209.
- 15 With regard to the term "f.o.b. point," California Commercial Code section 2319 (1) provides, in pertinent part, that "(a) [w]hen the [delivery] term is F.O.B. [an abbreviation for "free on board"] the place of shipment, the seller must at that place ship the goods in the manner provided in this division (Section 2504) and bear the expense and risk of putting them in the possession of the carrier; or (b) [w]hen the term is F.O.B. the place of destination, the seller must at his own expense and risk transport the goods to that place and there tender delivery of them in the manner provided in this division Section 2503."
- 16 For a more complete discussion of the generation of electricity in modern power plants, see Serway, *Physics for Scientists and Engineers with Modern Physics* (1990), pp. 886-888.
- * For Kathleen Connell per Government Code section 7.

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Selected Publications, Patents

- M. J. Hill, J. Papapolymerou, and R. W. Ziolkowski, "High-Q Micromachined Resonant Cavities in a K-band Diplexer Configuration," to be published in IEE Proceedings, H Microwaves, Antennas, and Propagation.
- M. Hill, R. Ziolkowski and J. Papapolymerou, "A high-Q Reconfigurable Planar EBG Cavity Resonator," IEEE Microwave and Wireless Components Letters, vol. 11, No. 6, pp. 255-257, June 2001
- M.J. Hill, R.W. Ziolkowski, and J. Papapolymerou, "Electronically Controlled Microwave Bandgap Filter Structures," Applied Physics Letters, Vol. 78, No. 7, pp. 1008-1011, 12 February 2001.
- C.Drouet d' Aubigny, Chris Walker, B. Jones, C. Groppi and J. Papapolymerou, "A New Laser Micromachining System for the Fabrication of THz Waveguide and Quasi-Optical Components," 2001 European Microwave Conference Workshop on "Recent Developments in Si Micromachining & MEMS for High Frequency Applications" London, England, Sept. 24-28, 2001.
- G. Ponchak, E. Tentzeris and J. Papapolymerou, "Isolation and Cross-Coupling Effects in Multilayer Polyimide Circuits," 2001 IEEE International Microwave Symposium Workshop on "High Density/Multilayer RF Interconnects", Phoenix, AZ, May 2001
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- J.M. Oldham, H.A. Leach and J. Papapolymerou, "Multilayer cost effective design of an integrated stripline narrowband filter for wireless applications," 2001 European Microwave Conference, London, England.
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- R. W. Ziolkowski, M. J. Hill, and J. Papapolymerou, "Reconfigurable electromagnetic bandgap resonant cavity filters for planar microwave circuits: modeling and experiments," 2001 URSI International Symposium on Electromagnetic Theory, Victoria, Canada, May 2001.
- C. Drouët d'Aubigny, C. Walker, B. Jones, C. Groppi and J. Papapolymerou, "Laser Micromachining Fabrication of THz Components," 12th International Symposium on Space Terahertz Technology, February 2001, San Diego, CA
- R. W. Ziolkowski, M. J. Hill, and J. Papapolymerou, "Reconfigurable electromagnetic bandgap filters: modeling and experiments," URSI Radio Science Meeting, Session B/D 1, Boulder, Colorado, January 2001.
- M. Hill, R. Ziolkowski and J. Papapolymerou, "Simulated and Measured Results from a Duroid-Based Planar MBG Cavity Resonator Filter," IEEE Microwave and Guided Wave Letters, Vol. 10, No. 12, pp. 528-530, December 2000.
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EXHIBIT X

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Administrative Law Judge Division
State of South Carolina

*1 CONSOLIDATED HYDRO SOUTHEAST, INC., PETITIONER
vs.
SOUTH CAROLINA DEPARTMENT OF REVENUE AND TAXATION, RESPONDENT

Docket No. 95-ALJ-17-0634-CC

May 13, 1996

APPEARANCES:

Cary H. Hall, Esquire for Petitioner

Jeffrey M. Nelson, Esquire for Respondent

ORDER AND DECISION

STATEMENT OF THE CASE

This matter comes before me pursuant to S.C. Code Ann. § 12-60-460 (Supp. 1995) on a request for a contested case hearing by Consolidated Hydro Southeast, Inc. (taxpayer) on the assessment by the Department of Revenue and Taxation (Department) for additional corporate license fees for the period June 30, 1990 through June 30, 1992.

After notice to the parties, a hearing was conducted on December 8, 1995. Based upon the testimony and evidence presented, I conclude that the taxpayer is liable for the license fees on gross receipts derived from supplying hydro-electric power to utilities in South Carolina. Any issues raised in the proceedings or hearing of this case but not addressed in this Order are deemed denied. ALJD Rule 29(B).

STIPULATED FACTS

At the hearing of this matter the parties stipulated to the following facts:

1. Consolidated Hydro Southeast, Inc. is a company which owns and operates several small hydro-electric power generation facilities in South Carolina and is engaged in the business of the production of electricity. These facilities are defined under federal law (the Public Utility Regulatory Policy Act of 1978, or "PURPA" [codified at 16 U.S.C. §§ 2601 *et seq.*] and 18 C.F.R. § 292.602) as "qualifying facilities".
2. PURPA requires public utility companies to purchase electrical power produced by qualifying facilities.
3. The South Carolina Public Service Commission (PSC) addressed certain provisions of PURPA, and the con-

tractual relationships between public service utilities and qualifying facilities in South Carolina in Order No. 85-347 issued by the PSC on August 2, 1985.

4. The taxpayer derives gross receipts from the sale of electrical power produced by its qualifying facilities. These receipts are from payments made by public utility companies. The public utilities pay the taxpayer for electrical power based on the terms of contracts between the public utility companies and the taxpayer.

5. The Department performed an audit of the taxpayer's corporate income tax returns for the period June 30, 1990 through June 30, 1992. Several adjustments were made to the taxpayer's returns as a result of this audit.

6. At issue in this case is whether the taxpayer owes additional license fees under S.C. Code Ann. §§ 12-19-100 and 12-19-110 [Supp. 1995]. The parties disagree on the meaning and intent of certain language contained in Section 12-19-110 and whether this section is applicable to gross receipts the taxpayer derived from the sale of electric power to public utilities.

7. Based on the taxpayer's gross receipts for the period of the audit, if Section 12-19-110 is applicable to the taxpayer, the amount of additional license fees owed by the taxpayer for the period June 30, 1990 through June 30, 1992 is \$11,115.00 plus current interest. On June 28, 1995, the taxpayer was assessed \$14,573.10 in tax and interest computed through September 16, 1994.

FINDINGS OF FACT

*2 Based upon the evidence presented, I make the followings of fact, taking into account the burden on the parties to establish their respective cases by a preponderance of the evidence and considering the credibility of the witnesses:

1. The taxpayer does not file reports with the South Carolina Public Service Commission (PSC).
2. The taxpayer does not obtain approval from the PSC to sell any of its affiliated businesses.
3. Federal Regulations promulgated pursuant to PURPA require electric utilities to purchase power from qualifying facilities at a rate reflecting the cost to the utilities to produce the power.
4. Contracts between the taxpayer and the electric utility are negotiated without PSC involvement.
5. The PSC requires that the contracts be submitted for review for compliance with PURPA.
6. The taxpayer may petition the PSC for relief when a dispute arises about the cost of supplying electric power to the electric utilities.

DISCUSSION

The taxpayer asserts that it is not liable for the payment of the additional license fee imposed under S.C. Code Ann. § 12-19-110 for two reasons: (1) it is not a "regulated business" encompassed in the statute; and (2) it does not provide or sell a "service".

The Department argues that although the taxpayer is not directly regulated by the PSC, the business it conducts and from which it derives revenue is regulated. Further, the Department asserts that even though electricity is defined as "tangible personal property" under portions of the tax code, it is also specifically recognized as a

"service" under S.C. Code Ann. § 12-36-60 (Supp. 1995) which provides that " 'tangible personal property' ... also includes services and intangibles, including ... furnishing ... sales of electricity." (Emphasis added)

At issue in this case is the interpretation of S.C. Code Ann. § 12-19-110 (Supp. 1995) which provides in pertinent part:

In addition to the license fee provided by Section 12-19-100 and all other license taxes and fees or taxes of whatever kind, there is levied an annual license fee of three mills upon the gross receipts derived from services rendered from regulated business within this State ... from every express company, street railway company, navigation company, waterworks company, power company, distribution electric cooperative, light company, gas company, telegraph company, and telephone company....

In particular, the phrase "gross receipts derived from services rendered from regulated business within the State" is the subject of inquiry. (emphasis added).

A. "Regulated Business"

The taxpayer claims that it is not a regulated business and therefore is not subject to the additional tax. For support, it relies on the evidence that it is not regulated by the PSC and PSC Order No. 85-347 interpreting provisions of federal regulations on the relationship between electric utilities and qualifying cogeneration facilities. In accordance with regulations promulgated by the Federal Electric Regulatory Commission (FERC) for the implementation of PURPA, an electric utility is required to purchase electric energy produced by qualifying facilities at a rate reflecting the cost that the purchasing utility can avoid as a result of obtaining energy from these sources instead of generating an equivalent amount of energy itself or purchasing from other suppliers. In order for the qualifying facilities to estimate the avoided costs, the FERC regulations require the utilities to furnish certain information to the appropriate regulatory authority relating to the costs of energy and capacity on their systems. In South Carolina, the regulatory agency is the PSC. The PSC may grant a waiver to the utilities of the obligation to provide additional services to qualifying facilities under certain conditions.^[FN1]

*3 As a result, the various contracts between the qualifying facilities producing the energy and the electric utilities purchasing the energy for resale to the consumer are affected. PURPA, and the regulations promulgated to implement it, provides for the states to exercise authority regarding regulation of various aspects of qualifying facility transactions. See Public Service Commission Order No. 85-347, August 2, 1985 p. 9. Under the Order, negotiated contracts between an affected utility and a qualifying facility should be submitted, upon execution, to the PSC for it to conduct a general review to determine whether the contract complies with the provisions of its Order No. 85-347 and the intent of PURPA. The PSC may, on its own motion, conduct a more detailed review of the contract by hearings or other proceedings. The PSC has the power to make adjustments as necessary to accomplish the purposes of PURPA and the federal regulations implementing the Act.

Although the qualifying facility is not directly controlled by the PSC, its business of producing and providing energy to affected electric utilities is subject to control by the PSC. Under PURPA, the qualifying facilities are created by federal law and controlled by the FERC. The business of producing and supplying electric energy to utilities and ultimately the consumer is a regulated business as that term is used in Section 12-19-110.

The term "regulated business" as used in the statute also refers specifically to the particular transaction occurring not the business entity. The license fee is not imposed upon businesses simply because they are regulated. Prior to 1985, the statute imposed a license fee upon the entire gross receipts from business within the State by a power company. The South Carolina Supreme Court construed this language to impose a license fee on power companies based upon entire gross receipts and not just receipts from customer charges. *Duke Power Co. v. S.*

C. Tax Comm'n, 292 S.C. 64, 354 S.E.2d 902 (1987). In that case, Duke Power excluded proceeds from the sale of a portion of its unfinished Catawba Nuclear Plant from the additional license tax. The Tax Commission included the transaction within the gross receipts from business in South Carolina. Duke Power brought an action to recover the taxes paid. The circuit court excluded the proceeds from the gross receipts on the basis that the license fees only applied to receipts from customer charges. The Supreme Court reversed the circuit court holding that the statute as written encompassed the proceeds from all business of a power company within the state not just its business relating to providing energy to customers.

While the *Duke Power* case was pending, the legislature amended the statute to its current form. It clarified the language by specifying that "business" means "regulated business" and the tax was limited to gross receipts of services. Until the Tax Commission was abolished in 1995, it interpreted this section to include only receipts derived from those activities that are regulated in some respect. See *Tax Commission Decision 91-41*. Even if a corporation engages in other business that is not regulated, only that portion of the corporate business that is regulated in some manner is subject to the provisions of Section 12-19-110. *Id.* The Department is the successor to the Tax Commission and it continues to interpret the statute in this manner. Long-standing agency construction is entitled to weight and should not be overruled without cogent reasons. *Etiwan Fertilizer Co. v. S. C. Tax Comm'n*, 217 S.C. 354, 60 S.E.2d 682 (1950).

*4 The taxpayer is a regulated business and the business of selling hydro-electric power to utilities for resale to consumers is a regulated business.

B. "Services Rendered"

The taxpayer asserts that the assessed transactions are not subject to the license fee under Section 12-19-110 because electricity is defined as "tangible personal property" under S.C. Code Ann. §§ 12-36-60 and 12-36-910. However, the specific language of these sections is contrary to this claim. Section 12-36-60 provides that "tangible personal property" under the sales and use tax statutes, "also includes services and intangibles, including communications, laundry and related service, furnishing and accommodations and sales of electricity." Thus, while electricity is included in the statutes discussing the application of sales tax on the sale of tangible personal property, the sale of electricity is specifically recognized and defined as a service.

Section 12-36-910(A) generally imposes on every person engaged in the business of selling tangible personal property at retail a sales tax on the gross proceeds of sales. Section 12-36-910(B) imposes the sales tax to "gross proceeds accruing or proceeding from the sale of electricity". Additional subsections also provide for the taxation of dry-cleaning, laundering and voice and message transmission services. By specifying that electricity and other services are also subject to sales tax, the statute indicates that these services are not tangible personal property within the meaning of the general definition but are services that are subject to the same sales tax imposed upon tangible personal property.

PalmettoNet, Inc. v. S. C. Tax Comm'n, ___ S.C. ___, 456 S.E.2d 385 (1995) supports this view. The facts of this case are somewhat analogous to the present situation. PalmettoNet operated a telecommunication system which carried long-distance telephone calls. It challenged the imposition of sales taxes imposed on transactions between it and carrier companies who, using PalmettoNet's facilities, provided long distance services to consumers. The circuit court held that telecommunication systems were wholesale services that were not subject to sales taxes. The Supreme Court affirmed reiterating that the transaction between PalmettoNet and the carrier constituted a service. For a charge, PalmettoNet provided everything necessary for the carrier to provide long distance service to consumers and PalmettoNet could not sell telecommunication services directly to the custom-

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ers. In the present case, the taxpayer provides all of the power necessary for the utilities to resell to consumers.

The sale of hydro-electric power to the electric utilities is the sale of services.

CONCLUSIONS OF LAW

Based upon the foregoing Findings of Fact and Discussion, I conclude as a matter of law:

1. S.C. Code Ann. § 12-60-460 (Supp. 1995) authorizes the Administrative Law Judge Division to conduct contested case hearings on tax assessments by the State through the Department of Revenue and Taxation.

*5 2. S.C. Code Ann. § 12-19-110 (Supp. 1995) imposes upon every power company a license fee upon the gross receipts derived from services rendered from regulated business in the state.

3. The term "regulated business", as used in Section 12-19-110, refers to transactions of entities as well as portions of business entities that are regulated by the PSC or by a federal regulatory agency.

4. The sale of hydro-electric power by a qualifying facilities to electric utilities is regulated by FERC and the PSC.

5. The sale of hydro-electric power constitutes the sale of services under Section 12-19-110.

ORDER

Based upon the Findings of Fact, Discussion, and Conclusions of Law, it is hereby

ORDERED, that for the period June 30, 1990 through June 30, 1992, Consolidated Hydro Southeast is liable for the additional license fee imposed pursuant to S.C. Code Ann. § 12-19-110 (Supp. 1995) in the amount of \$11,115.00 plus current interest totaling \$14,573.00 through September 16, 1994 due and payable to the Department of Revenue and Taxation.

AND IT IS SO ORDERED.

Alison Renee Lee
Administrative Law Judge

FN1. 18 C.F.R. § 292.305(b)2 provides for a waiver when the State authority or the FERC finds, after proper notice and an opportunity for a hearing, that compliance with the requirement would (a) impair the electric utility's ability to give adequate service to the rest of its customers, or (b) place an undue burden on the electric utility.

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END OF DOCUMENT

EXHIBIT Y



North Carolina Department of Revenue

Michael F. Easley
Governor

February 9, 2007

COPY

E. Norris Tolson
Secretary

Mr. Cam Brawley
ERNST & YOUNG
3200 Beechleaf Court, Suite 700
P.O. Box 40789
Raleigh, North Carolina 27629-0789

Re: Request for Private Letter Ruling – Nexus Issue

Dear Mr. Brawley:

This letter is in response to your letter dated January 12, 2007, wherein you requested that the North Carolina Department of Revenue ("Department") provide written guidance regarding its treatment for corporate income tax purposes of companies engaged in the sale of electricity or natural gas. The facts submitted for our consideration are as follows:

P.O. Box 871, Raleigh, North Carolina 27602-0871
State Courier 51-71-00
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Mr. Cam Brawley
February 14, 2007
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QUESTIONS/RULINGS REQUESTED

1. Does North Carolina consider the sale of electricity as the sale of tangible personal property, intangible personal property, or a service for income-tax purposes?

Department's Response: For corporate income tax purposes, North Carolina does not consider the sale of electricity as the sale of tangible personal property. Receipts from the sale of electricity by a generator are sourced for corporate income apportionment purposes as receipts from sales of a service. Although the Department is on record in some non-Department of Revenue publications as treating electricity as tangible property for corporate income tax purposes, this position is incorrect. The correct apportionment methodology, which treats the sale of electricity as a sale of a service, will apply.

2. Does the Company have a corporate income tax filing requirement under North Carolina statute? If so, why?

Department's Response: Yes. The company does have nexus in North Carolina for corporate income and franchise tax purposes since it has employees in this State engaged in non-protected activities on different occasions. However, if it is determined that the Company is a "public utility" as defined in G.S. 105-130.4(a)(6) and the Company's income producing activities take place completely outside of North Carolina, then the Company would not have an apportionment factor. Thus, Company does have a filing requirement, but its tax liability will most likely be limited to the minimum franchise tax of \$35.

3. If the Company were domiciled in North Carolina and its only connection/presence outside of North Carolina was similar to the activities described in this ruling request, would the Company have the

Mr. Cam Brawley
February 14, 2007
Page 3

right to apportion its income?

Department's Response: Yes. If the Company is engaged in unprotected activities outside of North Carolina, the Company would have the right to apportion its income pursuant to G.S. 105-130.4. However, if all of the Company's income producing activities take place in North Carolina, then 100% of the gross receipts should be attributed to this State and the numerator of the sales factor even though the Company may technically have the right to apportion.

4. If the Company has a filing requirement, would the sales factor only be used for apportionment?

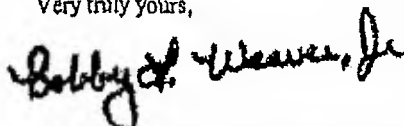
Department's Response: Yes. If the Company qualifies as a public utility under G.S. 105-130.4(a)(6) and has a filing requirement, then it would be required to utilize a single sales factor formula for apportionment purposes.

5. If the Company has a filing requirement, how are the sales of the Company sourced to the state under North Carolina statute?

Department's Response: The receipts from the sales of a service are in North Carolina if the income-producing activity is performed in the State. [G.S. 105-130.4(1)(3)(c)] The sale of gas is considered to be a sale of tangible personal property, therefore gas sales would be sourced to North Carolina if the gas is received in North Carolina.

This ruling is based solely on the facts submitted to the Department of Revenue for consideration of the transactions described. If the facts and circumstances given are not accurate, or if there are other facts that were not disclosed that might cause the Department to reach a different conclusion, then the taxpayer requesting this ruling may not rely on it. A letter ruling is not equivalent to a Technical Advice Directive that generally affects a large number of taxpayers. If a taxpayer relies on this ruling and the Department discovers, upon examination, that the fact situation of the taxpayer is different in any material aspect from the facts and circumstances given in this ruling, then the ruling will not afford the taxpayer any protection. It should be noted that this document is not to be cited as precedent and that a change in statute, a regulation, or case law could void this ruling.

Very truly yours,



Bobby L. Weaver, Administrative Officer
Corporate, Excise, and Insurance Tax Division
TEL: (919) 733-8510
FAX: (919) 733-1821

EXHIBIT Z

2002 WL 31153476 (Cal.St.Bd.Eq.)

State Board of Equalization
State of California

*1 IN THE MATTER OF THE APPEAL OF PACIFICORP

Not to be Cited as Precedent

Case No. 90027

September 12, 2002

Representing the Parties:

For Appellant:

Eric J. Coffill

Attorney at Law

Carley A. Roberts

Attorney at Law

For Respondent:

Craig Swieso

Tax Counsel

Counsel for Board of Equalization:

Charles D. Daly

Tax Counsel III

OPINION

This appeal is made pursuant to section 19045^[FN1] of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of PacifiCorp against proposed assessments of additional franchise tax in the amounts of \$498,412, \$517,835, \$58,523, \$151,313, \$359,742, and \$461,972 for the years ended December 31, 1984, 1985, 1986, 1987, 1988, and 1989, respectively.

The main issue in this appeal is whether sales of electricity to California entities during the appeal years were sales of tangible personal property for purposes of section 25135. That issue is a matter of first impression in California. An alternative issue is, if the sales of electricity were sales of tangible personal property, whether the sales occurred in Oregon rather than California.

Appellant is an Oregon power company that, through its predecessor corporation Pacific Power and Light ("PPL"), has been providing electricity to the Pacific Northwest since the beginning of the previous century. Over time, PPL expanded, through the acquisition of other corporations, both the geographic areas that it served and the kinds of businesses in which it was engaged. In 1982-1985, after acquiring a large number of companies,

PPL underwent a reorganization that apparently resulted in PPL becoming a division of appellant and appellant having primary responsibility for the management of the entire group of corporations affiliated with PPL.

The sales of the electricity at issue were made through the Pacific Northwest-Pacific Southwest Intertie ("Intertie"). The Intertie, which began operation in 1968, permits the transmission of excess power available in one region served by the Intertie to another region with power needs. Appellant states that, during the appeal years, the Intertie was owned by appellant, Portland General Electric,^[FN2] and the Bonneville Power Administration ("BPA").^[FN3] During most of the appeal years, the Intertie consisted of two alternating current ("AC") power lines and a direct current ("DC") power line. One AC power line ran from the Malin substation in Oregon south into California. Appellant alleges that the Western Area Power Authority^[FN4] owned this line. Appellant also alleges that appellant owned the other AC power line, which ran from the Malin substation south to Round Mountain, California. In addition, appellant alleges that appellant leased that AC line to Pacific Gas and Electric ("PG&E"), Southern California Edison ("SCE"), and San Diego Gas and Electric ("SDG&E").^[FN5] Finally, appellant alleges that the BPA owned the DC power line from Celilo near The Dalles, Oregon, to the Nevada-Oregon border and that the Los Angeles Department of Water and Power ("LADWP") owned that line from the Nevada-Oregon border through Nevada and into California until the line terminated in Los Angeles.^[FN6]

*2 Appellant filed a California combined report with its affiliates for the appeal years.^[FN7] On its Oregon corporate income tax returns for the appeal years, appellant had treated the sales of electricity to California entities as sales occurring in Oregon. Respondent's auditor in his final narrative report stated that appellant treated those sales as Oregon sales because the electricity was delivered at either the Malin substation in Oregon^[FN8] or the Oregon-Nevada border and ownership of electricity sold over the Intertie changed at the contractual points of delivery. Respondent's auditor also concluded that the electricity sold to its California customers was generated by appellant and that appellant had its own generation facilities in Oregon, Washington, Montana, Wyoming, and Utah. Respondent determined upon completion of its audit that sales of electricity by appellant, doing business as PPL, to a number of power companies, municipalities, and government agencies located in California were California sales that should been included in the numerator of appellant's sales factor.^[FN9]

At protest, respondent again concluded that the sales at issue were sales of tangible personal property for purposes of section 25135 and that those sales must be included in the numerator of appellant's sales factor under the then recently decided case of *McDonnell Douglas Corp. v. Franchise Tax Board* (1994) 26 Cal.App.4th 1789 ("*McDonnell Douglas*"). In *McDonnell Douglas*, the taxpayer delivered aircraft to purchasers owned by the taxpayer in California, and the purchasers then arranged for the transportation of the aircraft out of California. The court in *McDonnell Douglas* rejected the "delivery" rule adopted by respondent in its Legal Ruling 348 (Feb. 21, 1973) in favor of the "destination" rule adopted by courts in a number of jurisdictions outside of California. (*McDonnell Douglas Corp. v. Franchise Tax Board, supra*, 26 Cal.App.4th at pp. 1793-1796.) In respondent's view, the electricity that appellant sold was analogous to the aircraft in *McDonnell Douglas* and had an ultimate destination in California.

Subsequently, appellant petitioned respondent under section 25137 to assign appellant's sales of electricity to the locations at which the title to the electricity was contractually transferred. After respondent denied appellant's petition, this timely appeal followed.

Appellant's primary contention on appeal is that the sales of electricity at issue here are sales "other than sales of tangible personal property" for purposes of section 25136. Alternatively, appellant contends that, if the sales of electricity were sales of tangible personal property, the sales should be treated as having occurred in Oregon be-

cause a "contractual point of delivery" rule should be adopted for electricity rather the "destination" rule announced in *McDonnell Douglas*. Appellant argues that a "contractual point of delivery" rule should be adopted for electricity because of alleged difficulties in tracing electricity from one point to another.

*3 In support of its primary contention that electricity is an "intangible,"^[FN10] appellant relies heavily upon the California Supreme Court case of *Miller v. The City of Los Angeles* (1921) 185 Cal. 440 ("*Miller*") and the California Court of Appeal case of *Pierce v. Pacific Gas & Electric Co.* (1985) 166 Cal.App.3d 68 ("*Pierce*"). In *Miller*, the issue before the Court was whether electricity was "property" for purposes of a provision of the Los Angeles City charter that permitted the purchase of "property" by the city. (*Miller v. The City of Los Angeles, supra*, 185 Cal. at pp. 443-444.) After holding that electricity was "property" for purposes of the Los Angeles city charter, the Court stated that "[e]lectricity is rather an intangible asset, and the word 'property' is perhaps not the most apt word by which to describe the supply of electrical energy thus sought to be acquired for the use of the city." (*Miller v. The City of Los Angeles, supra*.)

In *Pierce*, the appellate court considered whether electricity that injured a consumer as the result of a transformer malfunction was a "product" rather than a service for purposes of strict liability in tort. (*Pierce v. Pacific Gas & Electric Co., supra*, 166 Cal.App.3d at p. 81.) Holding that the seller of electricity was strictly liable in tort to the consumer, the appellate court in *Pierce* stated that policy justifications for imposing strict liability in tort was more significant in reaching its holding than merely whether electricity should be labeled a "product." (*Pierce v. Pacific Gas & Electric Co., supra*, 166 Cal.App.3d at p. 82.) However, after observing that California and other courts "have not dwelled unduly on electricity's physical properties" in the "product" context, the appellate court quoted in a footnote the following statement suggesting that its observation might not be entirely correct: "[b]ecause electricity is intangible, it has been consistently argued by strict liability defendants in cases involving injury by electricity that the intangible force of electric current is not a 'product' within the meaning of [[the Restatement of Torts]....]" (*Elgin Airport Inn v. Commonwealth* (1980) 88 Ill.App.3d 477 [410 N.E.2d 620,623].") (*Pierce v. Pacific Gas & Electric Co., supra*, 166 Cal.App.3d at p. 82, note 6.) Appellant also cites a number of cases from other state courts that, like *Miller* and *Pierce*, do not address the tangibility or intangibility of electricity in the context of a corporate franchise or income tax.

In further support of its position that electricity is an "intangible," appellant points out that respondent itself treated electricity as "intangible property" in its Multistate Audit Technique Manual until 1986. In addition, appellant points out that respondent has characterized electricity as an "intangible" for purposes of Public Law 86-272^[FN11] in its "UDITPA Manual" (FTB Publication 1050 (Revised 10-83)) and in a letter to a commercial publisher. Appellant also notes that the Multistate Tax Commission ("MTC") considers electricity to be "intangible property" in its MTC Corporate Income Audit Procedure Guideline Manual. In addition, appellant notes that, in a 1999 report, the Federation of Tax Administrators stated that electricity should be considered a service, rather than tangible personal property, for purposes of establishing "nexus."^[FN12]

*4 Appellant also cites the *Appeal of Retail Marketing Services, Inc.* (91-SBE-003), decided by the Board on August 1, 1991, for the proposition that electricity can be distinguished from "tangible personal property." In *Retail Marketing Services*, we observed that there was no statutory definition of "tangible personal property" but that the taxpayer had correctly advanced the view that "the ordinary and necessary meaning of 'tangible' is that which can be felt by touch, having actual form and substance." However, we also observed that such a definition of "tangible" is much too broad to be used in determining whether the property at issue in that matter was "tangible personal property" for purposes of the property factor under section 25129. In the matter under consideration here, appellant has provided a declaration under penalty of perjury by Richard C. Dorf, Professor of

Electrical Engineering at the University of California at Davis, in which he concludes that "intangible personal property," under a definition allegedly consistent with *Retail Marketing Services*, encompasses electricity. [FN13] Appellant has also provided a list of cases from other states, including *Otte v. Dayton Power & Co.* (1988) 37 Ohio St. 3d 33 [523 N.E.2d 835] ("*Otte*"), to support the proposition that electricity is an "intangible" under *Retail Marketing Services*.

Finally, appellant characterizes respondent's change in position regarding the taxation of electricity as an invalid "underground regulation" whose purpose is merely to increase the collection of revenue. Appellant also expresses concern that treating electricity as tangible personal property might provide unanticipated nexus with California for companies engaged in electronic commerce.

Respondent continues to contend that electricity is tangible personal property whose sales occurred in California under the controlling authority of *McDonnell Douglas*. In support of that contention, respondent proposes a definition of "tangible personal property" as "the collective rights that are associated with things that exhibit physical attributes, which are not related to land." Respondent's proposed definition is distilled from a broad collection of sources that include dictionary definitions of "tangible personal property," a portion of a law review article [FN14] that discusses the distinction between the property law concepts of "choses in possession" and "choses in action," and respondent's apparent view that the rationale underlying the holding of *Retail Marketing Services* is that the property at issue in that matter was a "chose in action" and, therefore, was "intangible personal property." Respondent also takes the position that electricity is "tangible personal property" even under the definition of "tangible" that appellant advanced in *Retail Marketing Services*. Like appellant, respondent cites a number of cases from other jurisdictions in support of its position. However, like the cases cited by appellant, respondent's cases fail to address the tangibility or intangibility of electricity in the context of a corporate franchise or income tax.

*5 In a report submitted to us by respondent and that respondent characterizes as providing a necessary conceptual framework for discussing the scientific and technical aspects of electricity, Professor Joel Fajans, Professor of Physics at the University of California at Berkeley, states:

"Electricity is actually a catchall word encompassing many related concepts, each with a very specific definition. These concepts include *charge*, *current* (measured in amps), *voltage* (measured in volts) *power* (measured in watts) and *energy*.... [T]he flow of charge constitutes a *current*. Charge is usually made up of electrons, so current is typically the flow of electrons.... The ability of each charge to do something useful ... is related to voltage. Thus, the rate at which electricity performs useful services equals the product of the current (the number of charges) and the voltage (the work done by each electron.) This rate is called the *power*.... [¶] ... The total amount of power consumed over time is called the energy, which is measured in kilowatt-hours. [Fn. Omitted.] ... The power company bills users for the amount of energy that they consume....

The electric power distribution system is quite complicated. In essence, however, it can be reduced to a circuit consisting of a power source, a transmission line and a load.... The power source must be capable of supplying a current at a reasonable voltage, and can be, among other things, a battery, a hydroelectric plant, or a gas fired turbine generator. The transmission line can be as simple as a pair of wires like those in a household power cord. [Fn. Omitted.].... A load is the generic name for devices that use the electricity to perform a useful service."

(Resp. Br., exhibit B, p. 2.)

Later in his report, Professor Fajans further states:

"Electricity is physical and material because, microscopically, it consists of the flow and 'pressure' of a material entity, namely electrons, and macroscopically, it can be sensed (felt, tasted, seen, and heard), measured, weighed, and stored, and is subject to the universal laws of nature. The following sections discuss each of these properties in rough order of importance [¶] ... Without electrons, electricity cannot be transmitted. Though electrons themselves are very small and lightweight, they are one of the basic constituents of matter; common matter like hydrogen and iron consists of electrons, protons, and neutrons in roughly equal number. Thus, there is nothing more physical and material than an electron. Since electricity itself consists of the flow of a material object, electricity is physical and material."

(Resp. Br., exhibit B, p. 5.)

Respondent acknowledges that the term "other than tangible personal property" in section 25136 encompasses not only intangible personal property but also services. However, respondent argues that sales of electricity are not sales of services because electricity (1) does not essentially relate to activities conducted by individuals for the benefit of others and (2) is purchased for its "physical characteristics." From a comment in Professor Fajans' report regarding the capital required to generate and transmit electricity, respondent also argues that services performed by individuals are only incidental in comparison to generators and power lines. Other than a definition of "services" from a legal dictionary, respondent cites no authority directly in support of its arguments.

*6 With respect to the alternative issue here, respondent argues that appellant's position that the "destination" rule stated in *McDonnell Douglas* may not be applied to electricity because electricity cannot be traced from one point to another is wrong. In support of its argument, respondent points out that electricity is "fungible" and that it is irrelevant whether each electron sold by appellant can be traced to a destination in California as long as purchasers in California receive electricity equal to the amount of electricity sold by appellant. Respondent also argues that applying a "delivery" rule to electricity is inconsistent with the language in section 25135 that the f.o.b. point^[FN15] or other conditions of the sale must be disregarded.

Respondent concedes that if the sales of electricity at issue are sales of "other than tangible personal property" for purposes of section 25136, the sales were not in California under that section because a majority of the "income-producing activities" related to those sales were performed in other states, based on cost of performance.

Section 25128 provides that all business income shall be apportioned to California by multiplying such income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three. Section 25134 defines the sales factor as a fraction, the numerator of which is the total number of sales of the taxpayer in California during the income year, and the denominator of which is the total sales of the taxpayer everywhere during the income year.

Section 25135 provides that sales of tangible personal property are in California if: (a) the property is delivered or shipped to a purchaser, other than the United States Government, within California regardless of the f.o.b. point or other conditions of the sale; or (b) the property is shipped from an office, store, warehouse, factory, or other place of storage in California and (1) the purchaser is the United States government or (2) the taxpayer is not taxable in the state of the purchaser. Section 25136 provides that sales, other than sales of tangible personal property, are in California if: (a) the income-producing activity is performed in California; or (b) the income-producing activity is performed both in and outside California and a greater proportion of the income-producing

activities is performed in California than in any other state, based on costs of performance.

California Code of Regulations, title 18, section 25136, subdivision (b), ("Regulation section 25136, subdivision (b)") provides as follows:

"The term 'income producing activity' applies to each separate item of income and means the transactions and activity directly engaged in by the taxpayer in the regular course of its trade or business for the ultimate purpose of obtaining gains or profit. Such activity does not include transactions and activities performed on behalf of a taxpayer, such as those conducted on its behalf by an independent contractor. Accordingly, income producing activity includes but is not limited to the following:

*7 1. The rendering of personal services by employees or the utilization of tangible and intangible property by the taxpayer in performing a service.

2. The sale, rental, leasing, licensing, or other use of real property.

3. The rental, leasing, licensing or other use of tangible personal property.

4. The sale, licensing or other use of intangible personal property.

"The mere holding of intangible personal property is not, of itself, an income producing activity."

We agree with appellant's primary contention that the sales of electricity here are "other than sales of tangible personal property" for purposes of section 25136. Because their discussions of the tangibility or intangibility of electricity are not in the context of a corporate franchise or income tax and are sometimes, as in *Miller* and *Pierce*, mere dictum, the cases and other authority upon which appellant relies are not controlling here. However, discussions of electricity in some of those cases are nonetheless helpful in resolving the main issue in the instant matter. For example, in the *Otte* case cited by appellant, the Ohio Supreme Court distinguished electricity from a "product" in the context of strict liability in tort by stating as follows:

"A 'product' is anything made by human industry or art. electricity appears to fall outside this definition.

This is so because electricity is the flow of electrically charged particles along a conductor. [The power company] does not manufacture electrically charged particles, but rather, sets in motion the necessary elements that allow the flow of electricity. What we have here is a purported defect in the distribution system.

Such a system is, in our view, a service."

(*Otte v. Dayton Power & Co.*, *supra*, 37 Ohio St. 3d at p. 37.)

Like the court in *Otte*, we conclude that the sales of electricity here are sales of services that essentially consisted of appellant's setting and keeping in motion, through its generation and transmission facilities, electrically charged particles. Also as in *Otte*, we further conclude that the basic reason the generation and transmission process employed by appellant is appropriately characterized as a service is that the process does not result in either (1) the "creation" in its generation facilities of any such arguably tangible particles or (2) the "injection" of those particles into its transmission facilities.

At this juncture in our analysis, it is necessary to point out that exactly what constitutes the "sales of electricity" at issue here is not well specified in the record. For example, appellant has not presented us with financial or other records that segregate its "sales of electricity" to California entities into such components as sales resulting from the generation of electricity and sales resulting from the transmission of electricity. However, the final narrative report of respondent's auditor notes that when a California entity purchases "power" from appellant, appellant "turns up" its generator to put more power into the Intertie. In addition, the auditor's report notes that there were "wheeling" charges for transmitting electricity over power lines. In view of the auditor's notations, we infer that the generation and transmission of electricity by appellant are the components of the "sales of electricity" that we need to consider here. The auditor's report also states that a California entity would pay a "use of

facilities" charge to use power lines owned by another entity. However, as indicated in footnote 5, it appears that rental payments for the California portion of those lines are not at issue here because appellant has already included them in the numerator of its sales factor under Regulation section 25136, subdivision (b)(2).

*8 Even though respondent seems to argue that the generation and transmission of electricity are not properly treated as services under section 25136 because they are not personal services, Regulation section 25136, subdivision (b)(1), explicitly states that "income producing activity" is not limited to personal services by employees but includes the use of tangible and intangible property in performing a service. In addition, we concluded in the *Appeal of Mark IV Metal Products, Inc.* (82-SBE-181), decided by the Board on August 17, 1982, that the fabrication in California of metal owned by a Texas customer into seat parts for that customer, through the use of the taxpayer's "own labor and machinery," was a service that was includable in the numerator of a taxpayer's sales factor under section 25136. For those reasons, we reject respondent's argument that the generation and transmission of electricity are not properly treated as services under section 25136 because they are not personal services.

Respondent appears to predicate its argument that electricity is not a service because it is purchased for its "physical characteristics" on the assumption that the generation and transmission of electricity are inseparable from, and incidental to, its "physical characteristics." However, as suggested by *Otte*, the "physical characteristics" of electricity in the instant matter are essentially the electrons already in the power lines that have been set and kept in motion by appellant's generation and transmission system.^[FN16] Because appellant has apparently already paid for the use of the electrons in the power lines by payment of the "use of facilities" charge in transactions that are separate from, and independent of, those regarding the generation and transmission of electricity, we conclude that the generation and transmission of electricity here are neither inseparable from, nor incidental to, its "physical characteristics." Because we disagree with respondent's underlying assumption, we also disagree with its argument that electricity is not a service because it is purchased for its "physical characteristics."

With regard to respondent's argument that the services performed by appellant in the generation and transmission of electricity were merely incidental in comparison to generators, *Mark IV Metal Products* clearly supports the view that the use of equipment, such as a generator, by a taxpayer as part of the process by which a service is performed does not detract from the conclusion that the taxpayer is performing a service for purposes of section 25136. As discussed above, respondent's argument that the generation and transmission of electricity were merely incidental in comparison to power lines also fails because the rentals of the power lines are transactions that are separate from, and independent of, those relating to the generation and transmission of the electricity.

Although Professor Fajan's discussion of electricity in his report seems intended to support respondent's position that electricity is "tangible personal property" by emphasizing the "physical and material" nature of electrons, his discussion is also consistent with the definition of electricity in *Otte* as a "flow of electrically charged particles along a conductor." In addition, Professor Fajan's discussion of electricity is also consistent with the conclusion of the court in *Otte* that the "distribution system" with respect to electricity there was a service. In our view, just as the "distribution system" by which the flow of electrically charged particles occurred in *Otte* was a service, appellant's generation and transmission of electricity were also services under section 25136.

*9 Because we conclude that sales of the generation and transmission of electricity here were sales of services performed for the most part outside of California, we further conclude that those sales were sales of "other than tangible personal property" and were properly excluded from the numerator of appellant's sales factor. Therefore, based upon the foregoing discussion, we conclude that, for purposes of California tax law, electricity is in-

tangible. In view of our conclusions, we need not address the alternative issue in this matter.

Accordingly, respondent's action is hereby reversed.

ORDER

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED, AND DECREED, pursuant to section 19047 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of PacifiCorp against proposed assessments of additional franchise tax in the amounts of \$498,412, \$517,835, \$58,523, \$151,313, \$359,742, and \$461,972 for the years ended December 31, 1984, 1985, 1986, 1987, 1988, and 1989, respectively, be and the same is hereby reversed.

Done at Sacramento, California, this 12 day of September, 2002, by the State Board of Equalization, with Board Members Dean Andal, Claude Parrish and *Marcy Jo Mandel present.

FN1. Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the years in issue.

FN2. Portland General Electric is an Oregon subsidiary of Enron Corporation.

FN3. The BPA is an agency of the United States government. Apparently, a major purpose of Congress in authorizing the construction of the Intertie was to provide an additional market for surplus power provided by the BPA so that the BPA would have greater financial resources to repay the United States Treasury for its investment in the Pacific Northwest power system.

FN4. We assume that the "Western Area Power Authority" is the same entity as the entity designated as WAPA in footnote 9.

FN5. Apparently, appellant included rental income from the portion of the line that ran from the Oregon-California border to Round Mountain, California, in the numerator of its sales factor. Appellant's treatment of that rental income does not seem to be in dispute.

FN6. We note that appellant does not attempt to reconcile seeming inconsistencies between its statement that appellant, Portland General Electric, and the BPA were co-owners of the Intertie with its allegations regarding the ownership of the AC and DC power lines that comprised the Intertie. However, we also note that respondent does not seem to object to such inconsistencies. Therefore, we conclude that they are of little significance here.

FN7. At protest, respondent determined that appellant was unitary, and therefore should be combined, with only some of the affiliates that were included in its California combined report.

FN8. The audit report also stated that some of appellant's contracts with its California purchasers provided that the sales of electricity would occur at the Oregon-California border because of the possibility that an additional AC power line would be constructed that would not pass through the Malin substation.

FN9. Of appellant's sales of electricity to the California entities during the appeal years, approximately 47 per-

cent (\$224,919,960) were made to SCE, 20 percent (\$92,765,217) to PG&E, 18 percent (\$85,684,193) to LADWP, Sacramento Municipal Utility District, and various California municipalities, and 14 percent (\$66,209,039) to the California Department of Water Resources. Appellant also made sales of electricity of \$4,237,171 to SDG&E during the appeal years and of \$16,036,408 to the Western Area Power Administration ("WAPA") during the 1984-1986 appeal years. Because respondent apparently has concluded that the sales to WAPA may have been, in effect, sales to purchasers that were not located in California, respondent concedes that those sales should not be included in the numerator of appellant's sales factor. The record contains no additional information regarding the functions of WAPA or its constituent parts.

FN10. Like respondent, appellant sometimes uses the term "an intangible" or other similar designation as synonymous with the term "other than sales of tangible personal property" under section 25136.

FN11. Public Law 86-272 provides, in pertinent part, that no state shall have the power to impose a net income tax on income derived within the state if the only business activity within the state is the solicitation of orders for sale of tangible personal property, which orders are sent outside the state for approval or rejection and, if approved, are filled by shipment or delivery from a point outside the state. (15 U.S.C.A., § 381(a)(1).)

FN12. "Nexus," in this context, is another way of saying that a corporate taxpayer has sufficient connections with a state to justify, for constitutional purposes, taxation of the taxpayer by that state.

FN13. Professor Dorf's testimony at the hearing in this matter was to the same effect.

FN14. Cowdrey, *Software and Sales Taxes: The Illusory Intangible* (1983) 63 B.U. L.Review 181, 197-209.

FN15. With regard to the term "f.o.b. point," California Commercial Code section 2319 (1) provides, in pertinent part, that "(a) [w]hen the [delivery] term is F.O.B. [an abbreviation for "free on board"] the place of shipment, the seller must at that place ship the goods in the manner provided in this division (Section 2504) and bear the expense and risk of putting them in the possession of the carrier; or (b) [w]hen the term is F.O.B. the place of destination, the seller must at his own expense and risk transport the goods to that place and there tender delivery of them in the manner provided in this division Section 2503."

FN16. For a more complete discussion of the generation of electricity in modern power plants, see Serway, *Physics for Scientists and Engineers with Modern Physics* (1990), pp. 886-888.

2002 WL 31153476 (Cal.St.Bd.Eq.)

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AA

EXHIBIT AA

P

Supreme Judicial Court of Massachusetts, Suffolk.
WESTINGHOUSE BROADCASTING COMPANY,
INC.

v.

COMMISSIONER OF REVENUE.

Argued Dec. 1, 1980.

Decided Jan. 23, 1981.

State Tax Commission denied broadcasting company classification as a manufacturing corporation, and its decision was affirmed by the Appellate Tax Board. Broadcasting company appealed. The Supreme Judicial Court, Kaplan, J., held that: (1) broadcasting company was not a manufacturing corporation, and (2) denial of manufacturing corporation status was not denial of equal protection of laws, though two corporations which published newspapers were so classified.

Affirmed.

West Headnotes

[1] Taxation 371 2333

371 Taxation

371III Property Taxes

371III(F) Exemptions

371III(F)1 In General

371k2331 Manufacturing Companies

371k2333 k. Machinery, Materials,

and Other Property. Most Cited Cases

(Formerly 371k237)

Manufacturing for purpose of statute exempting manufacturing corporation from taxation upon its machinery, denotes process of transforming raw or finished materials by hand or machine, and through human skill and knowledge, into something possessing new nature and name and adapted to a new use. M.G.L.A. c. 58, § 2; c. 59, § 5; c. 63, §§ 38C, 42B.

[2] Taxation 371 2333

371 Taxation

371III Property Taxes

371III(F) Exemptions

371III(F)1 In General

371k2331 Manufacturing Companies

371k2333 k. Machinery, Materials,

and Other Property. Most Cited Cases

(Formerly 371k237)

Foreign corporation which owned and operated television and radio station was not involved in manufacturing but rather in transmission of intelligence, and did not qualify for exemption from local taxation of machinery, granted to manufacturing corporation. M.G.L.A. c. 58, § 2; c. 59, § 5; c. 63, §§ 38C, 42B.

[3] Constitutional Law 92 3560

92 Constitutional Law

92XXVI Equal Protection

92XXVI(E) Particular Issues and Applications

92XXVI(E)6 Taxation

92k3560 k. In General. Most Cited

Cases

(Formerly 92k283)

Taxation 371 2126

371 Taxation

371III Property Taxes

371III(B) Laws and Regulation

371III(B)4 Constitutional Regulation and Restrictions Concerning Equality and Uniformity

371k2126 k. Mode or Form of Discrimination in General. Most Cited Cases

(Formerly 371k40(6))

Denial to broadcasting company which owned and operated television and radio station of status as manufacturing corporation, and related tax benefits, while granting such classification to corporations publishing newspapers did not deny broadcasting company equal protection of the law, regardless of the First Amendment activities in which both corporations were engaged. M.G.L.A. c. 58, § 2; c. 59, § 5; c. 63, §§ 38C, 42B; U.S.C.A. Const. Amend. 1.

382 Mass. 354, 416 N.E.2d 191, 7 Media L. Rep. 1066
(Cite as: 382 Mass. 354, 416 N.E.2d 191)

****191 *354** Joseph L. Kociubes, Boston, for plaintiff.

Stephen S. Ostrach, Asst. Atty. Gen., for defendant.

Before HENNESSEY, C. J., and BRAUCHER,
KAPLAN, WILKINS and ABRAMS, JJ.

KAPLAN, Justice.

In August, 1976, Westinghouse Broadcasting Company, Inc., an Indiana corporation which owns and operates a television and radio station in Boston (WBZ-TV; WBZ, AM and FM) found itself on the Commissioner of Revenue's list of the corporations liable to taxation as of January 1, 1976, but not classified thereon as a manufacturing corporation. The company applied to the State Tax Commission under G.L. c. 58, s 2, for manufacturing classification, so that it would then qualify under the provisions of G.L. c. 63, s 42B, and G.L. c. 59, s 5, Sixteenth, for exemption of its machinery, of an estimated value of \$1.3 million, *355 from local taxation. [FN1] No relief was forthcoming from the Commission, and an appeal to the Appellate Tax Board (G.L. c. 58, s 2) also failed.[FN2] The company appeals the Board's decision to this court pursuant to G.L. c. 58A, s 13.

FN1. For the similar exemption for domestic manufacturing corporations, see G.L. c. 63, s 38C, and G.L. c. 59, s 5, Sixteenth.

FN2. The step of an application to the State Tax Commission was eliminated by St. 1978, c. 514, s 35, amending G.L. c. 58, s 2 (and the State Tax Commission was reorganized under the name Department of Revenue by St. 1978, c. 514, s 5).

****192 1.** The record made before the Board consisted of a "joint stipulation of facts" (dated in October, 1979) and brief additional evidence. Emerging from the record was a picture of operations that is apparently familiar in television and radio broadcast.

We sketch the television side, which accounted for 80% of the company's combined television and radio income. Some 33% of air time consisted of programs produced by the company a miscellany of news, sports, and other material largely of a local character. The balance of time was given over to ma-

terial supplied by the network and others. Ninety-four per cent of TV income was derived from the sale of advertising displayed during the broadcasts; [FN3] less than 5% was compensation for carrying network programs.

FN3. The record indicates that 67% of the 94% came from advertising aired during the company-produced programs.

With respect to the technique of accomplishing the broadcast of the visual element of the programs, the stipulation found it convenient to mention five chief sources or components. (i) Live programs. TV cameras receive light waves reflected from the studio subjects; these are transformed by the cameras into electrical impulses. (ii) Films or slides. Light is projected through these transparencies and similarly transformed into electrical impulses. (iii) Video tapes. Magnetic impulses (themselves resulting from transformation of electrical impulses derived from light) are stored on the tapes; these are transformed back into electrical impulses. The electrical signal from sources (i), (ii), *356 and (iii), after a complicated process, reaches the television transmitting station in the form of a microwave signal. The microwave signal is changed into a one-volt electrical impulse which is built into a 60,300 watt signal; this is transformed into electromagnetic waves which, after modulation (superimposition on WBZ's frequency carrier wave), are radiated by the transmitter and received by the antennas of television receiving sets. (iv) Mobile units. The electrical impulses in the TV cameras are transformed by equipment in the mobile units into microwave signals; these emerge from further processing as a one-volt electrical signal with a sequence as above. (v) Network. These programs are received over telephone lines as electrical impulses; the signals are improved and converted into a microwave signal for treatment and broadcast by the transmitter as indicated above. [FN4]

FN4. A sixth source or component is "character generator," a machine with a keyboard on which text is typed. As converted into electrical impulses, the text is mixed into the relevant transmissions.

The handling of sound for radio broadcast may be taken as comparable to the treatment of the element of sound for TV broadcast and is sketched briefly in the

record thus. Sound live or from records or audio tapes is "shaped" and converted into electrical impulses which are sent over telephone lines to a transmitter. Through a process of modulation similar to that for the TV visual element, WBZ's radio signal is impressed on its carrier wave for transmission to the receiving sets. As to the company's radio operations, the stipulation adds that 98% of the programming was produced by the company, and 95% of the income was derived from advertising aired during that programming.

The names of the company's departments are indicative of the range of work, from preparing programs to the final broadcasts, carried out by the 317 company employees; news, technical, programming, prop, art, retail production, sales, administrative.[FN5]

FN5. The company fabricates stage sets, and so forth, on which it mounts the programs it produces, but this kind of activity is no more "manufacture" than the production of a play in the theatre. The claim of manufacture concentrates on the transformations culminating in the radiation of the signals to the receiving sets.

*357 2. The State Tax Commission's form of "Application for Classification of Corporation" asked for a description of the "actual manufacturing process or activity performed," and the company's answer, which may stand as an encapsulation of the **193 present record, was the following. "TV broadcasting: optical information is changed into an electrical signal which is modified in many ways by the application of extremely complex technology, encoded and placed on the broadcaster's carrier and sent out to be received by a receiving set at a great distance. Radio broadcasting: acoustical energy is changed into an electrical signal and beamed through the broadcaster's carrier to receiving stations." We think the Appellate Tax Board cannot be held wrong as a matter of law (see Hopkinton LNG Corp. v. State Tax Comm'n, 372 Mass. 286, 288, 362 N.E.2d 205 (1977)) in deciding on the basis of such a submission that the company was not a manufacturer in the statutory sense.

[1] We quote from First Data Corp. v. State Tax Comm'n, 371 Mass. 444, 357 N.E.2d 933 (1976): "As the statute does not itself effectively define 'manu-

facturing,' we have said that the Legislature should be supposed to have adopted the common meaning of the word, as assisted by a consideration of the historical origins of the enactment." Id. at 447, 357 N.E.2d 933. Popular understanding, we suggest, is approximated by the expression in Commissioner of Corps. & Taxation v. Assessors of Boston, 321 Mass. 90, 94, 71 N.E.2d 874 (1947): "Manufacture ordinarily and commonly denotes the process of transforming raw or finished materials by hand or machinery, and through human skill and knowledge, into something possessing a new nature and name and adapted to a new use." This statement can apply to the broadcasting process only by a considerable distortion of the meaning; the process is more naturally and more aptly described, in distinction to manufacture as a transmission of intelligence. That is how we characterized the operation of the "commercial on-line, *358 real-time computer time-sharing system" involved in the First Data case, to which the present case bears much resemblance, as do the cases indicating that the telephonic process, by which human sound is transformed into electrical impulses and those impulses changed back into cognizable sound, is not a process of manufacture. See Assessors of Boston v. Commissioner of Corps. & Taxation, 323 Mass. 730, 741, 84 N.E.2d 129 (1949); Assessors of Springfield v. Commissioner of Corps. & Taxation, 321 Mass. 186, 190-192, 75 N.E.2d 528 (1947). The Board in the present case did indeed allow a request for a ruling that "Westinghouse may not be denied manufacturing status merely because its end product is intangible." That proposition conformed to our view that the production of electricity may entail manufacture (see Boston Gas Co. v. Assessors of Boston, 334 Mass. 549, 565, 137 N.E.2d 462 (1956); Boston & Me. R.R. v. Billerica, 262 Mass. 439, 449, 160 N.E. 419 (1928)), but it does not go far enough to resolve the question of manufacture here.

[2] As to the historical origin of the legislation, we have pointed out that the exemption arose from an attempt to save the factories that had fallen into a distressed condition in the Commonwealth around 1936. Broadcasting is outside this matrix of intention and expectation. Cf. Charles River Breeding Laboratories, Inc. v. State Tax Comm'n, 374 Mass. 333, 336, 372 N.E.2d 768 (1978).

Decisions of other jurisdictions are not likely to have direct bearing because of peculiarities of the various taxing schemes. Yet it may be recorded as

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suggestive that Pennsylvania has lately held that the same company, in respect to its television and radio broadcasting in Pittsburgh through station KDKA, was not exempted by a provision of a "local tax enabling act" which barred municipalities from levying tax "on any privilege, act or transaction related to the business of manufacturing." Golden Triangle Broadcasting, Inc. v. Pittsburgh, 483 Pa. 525, 397 A.2d 1147 (1979). See also Commonwealth ex rel. Luckett v. WLEX-TV, Inc., 438 S.W.2d 520 (Ky.1968); [FN6] **1*359 Meredith Corp. v. State Tax Comm'n, 23 Ariz.App. 152, 531 P.2d 197 (1975). But cf. Tabulating Serv. Bureau, Inc. v. Commissioner of Taxation, 295 Minn. 562, 204 N.W.2d 442 (1973).

[FN6. This case uses an interesting image: "In the last analysis, the function of television is to transmit a message or communication. It manufactures messages in about the same sense that a common carrier manufactures travel." 438 S.W.2d at 523.

[3] The company attempts a constitutional argument based on the fact that two corporations publishing newspapers in Boston, with which the company competes for advertising, were classified by the Commissioner as manufacturing corporations. This is said to involve a breach of the guaranty of equal protection of the laws, the guaranty being perhaps the more sensitive here, it is suggested, because broadcasting and newspaper publishing are First Amendment activities. That the company is engaged in communication as a business of course does not exempt it constitutionally from local or other taxation. See Opinion of the Justices, -- Mass. --, --, [FN7] 392 N.E.2d 849 (1979). As to the claim of invidious discrimination because certain corporations publishing newspapers received the manufacturing classification while the company did not, we are unable on the present record to make any judgment because what, precisely, the entire business of the publisher corporations consisted of was not presented in any detail. Tax statutes customarily make narrow distinctions without running into trouble on a constitutional level, and application of a concept like "manufacture" necessarily involves close line-drawing. [FN7] The case of Grosjean v. American Press Co., 297 U.S. 233, 56 S.Ct. 444, 80 L.Ed. 660 (1936), cited by the company, is not in point: the Court recognized and *360 condemned a design to put the clamps on expression by newspapers "a deliberate and calculated device in the

guise of a tax to limit the circulation of information to which the public is entitled in virtue of the constitutional guaranties." At 250, 56 S.Ct. at 449.

[FN7. Mass.Adv.Sh. (1979) 1773, 1779.

[FN7. Golden Triangle Broadcasting, Inc. v. Pittsburgh, cited in text, affirmed a judgment of the Pennsylvania Commonwealth Court, 31 Pa.Cmwlth. 547, 377 A.2d 839 (1977). The opinion of the latter court reconciled its denial of exemption to the company, engaged in broadcasting, with its previous decision in Pittsburgh v. Pittsburgh Press Co., 14 Pa.Cmwlth. 551, 322 A.2d 390 (1974), allowing exemption to the publisher of a newspaper using its own presses and other machinery. See Federal Communication Comm'n v. Pacifica Foundation, 438 U.S. 726, 748, 98 S.Ct. 3026, 3039, 57 L.Ed.2d 1073 (1978). Cf. Assessors of Boston v. Commissioner of Corps. & Taxation, 323 Mass. 730, 739, 84 N.E.2d 129 (1949); Hearst Corp. (News American Div.) v. State Dep't of Assessments & Taxation, 269 Md. 625, 308 A.2d 679 (1973).

We add, what we have had occasion to say before, [FN8] that the criterion of manufacture, as defined in the light of its historical provenience, may not serve the needs of the year 1981. But redefinition is for the Legislature.

[FN8. See First Data Corp. v. State Tax Comm'n, 371 Mass. 444, 448, 357 N.E.2d 933 (1976); Charles River Breeding Laboratories, Inc. v. State Tax Comm'n, 374 Mass. 333, 336, 372 N.E.2d 768 (1978).

The decision of the Appellate Tax Board is affirmed.

So ordered.

Mass., 1981.
Westinghouse Broadcasting Co., Inc. v. Commissioner of Revenue
382 Mass. 354, 416 N.E.2d 191, 7 Media L. Rep. 1066

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416 N.E.2d 191
382 Mass. 354, 416 N.E.2d 191, 7 Media L. Rep. 1066
(Cite as: 382 Mass. 354, 416 N.E.2d 191)

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EXHIBIT BB

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Supreme Judicial Court of Massachusetts,
 Suffolk.

COMMISSIONER OF REVENUE
 v.
 HOUGHTON MIFFLIN COMPANY.

Argued Nov. 9, 1995.
 Decided June 24, 1996.

Book publisher sought tax abatement equal to investment tax credit. The Appellate Tax Board granted abatement, 1995 WL 108711, and commissioner of revenue appealed. Application for direct appellate review was granted. The Supreme Judicial Court, Liacos, C.J., held that publisher qualified for investment tax credit available to manufacturing corporations.

Affirmed.

West Headnotes

[1] Statutes 361 ⚡ 212.6

361 Statutes

361VI Construction and Operation

361VI(A) General Rules of Construction

361k212 Presumptions to Aid Construction

361k212.6 k. Words Used. Most Cited

Cases

Statutes 361 ⚡ 217.1

361 Statutes

361VI Construction and Operation

361VI(A) General Rules of Construction

361k213 Extrinsic Aids to Construction

361k217.1 k. History of Act in General.

Most Cited Cases

Where dominant statutory term is undefined, legislature should be supposed to have adopted common meaning of word, as assisted by considera-

tion of historical origins of enactment.

[2] Taxation 371 ⚡ 3517

371 Taxation

371VIII Income Taxes

371VIII(E) Deductions, Credits, and Exemptions

371k3517 k. Credits. Most Cited Cases
 (Formerly 371k1047)

Although activity at issue must constitute more than merely providing raw materials to another to be processed to qualify as "manufacturing," for purposes of investment tax credit available to manufacturing corporations, processes which do not in themselves produce finished product are nonetheless manufacturing if they comprise essential and integral part of total manufacturing process. M.G.L.A. c. 63, § 38C.

[3] Taxation 371 ⚡ 3517

371 Taxation

371VIII Income Taxes

371VIII(E) Deductions, Credits, and Exemptions

371k3517 k. Credits. Most Cited Cases
 (Formerly 371k1047)

Book publisher that hired independent contractors to print and bind finished books nevertheless engaged in "manufacturing," and thus qualified for investment tax credit available to manufacturing corporations, where publisher transformed ideas, art, information, and photographs, by application of human knowledge, intelligence, and skill, onto computer disks, ready for use by independent printers, containing immense amount of information in highly organized form; publisher's activities transcended mere manipulation of information and constituted substantial and integral step in process of manufacturing books. M.G.L.A. c. 63, § 38C.

[4] Taxation 371 ⚡ 3425

371 Taxation

371VIII Income Taxes

371VIII(B) Regulation
371k3422 Statutory Provisions and Ordinances
371k3425 k. Construction and Operation in General. Most Cited Cases
(Formerly 371k965.4)

Decisions of other jurisdictions are not likely to have direct bearing in tax cases because of peculiarities of various taxing schemes.

****492 *42 Thomas A. Barnico**, Assistant Attorney General, for plaintiff.

Harold Hestnes (Michael J. Nathanson, with him), Boston, for defendant.

Before LIACOS, C.J., and WILKINS, ABRAMS, O'CONNOR and GREANEY, JJ.

LIACOS, Chief Justice.

The Commissioner of Revenue (commissioner) has appealed from a decision of the Appellate Tax Board (board), given under the formal procedure, granting Houghton Mifflin Company (Houghton) an abatement equal to Houghton's 1988 investment tax credit. See G.L. c. 63, § 31A (1994 ed.). We allowed the commissioner's application for direct appellate review.

The board concluded that Houghton was eligible for the credit because it was a "manufacturing corporation" as that term is used in G.L. c. 63, § 38C (1994 ed.). Such classification allows a corporation to take advantage of an investment ^{*43} tax credit, see G.L. c. 63, § 31A(a), ^{FN1} and certain exemptions from local taxes on machinery. See G.L. c. 59, § 5, Sixteenth (3) (1994 ed.). Decisions of the board are final as to findings of fact. G.L. c. 58A, § 13 (1994 ed.). Thus, the sole question before us is whether the board erred as a matter of law. See First Data Corp. v. State Tax Comm'n, 371 Mass. 444, 446, 357 N.E.2d 933 (1976). "[O]therwise stated, the question is whether a contrary conclusion is not merely a possible but a necessary inference from the findings." *Id.* We conclude that the board did not err. We affirm the board's decision. ^{FN2}

FN1. General Laws c. 63, § 31A (a) (1994 ed.), allows a manufacturing corporation to take a credit against its corporate excise due

equal to "one percent of the cost or other basis for Federal income tax purposes of qualifying tangible property acquired, constructed, reconstructed, or erected during the taxable year ... including buildings and structural components of buildings acquired by purchase, as defined under [26 U.S.C. § 179(d)]."

FN2. We acknowledge the assistance to the court of the amicus brief of the Associated Industries of Massachusetts.

The essential facts are not in dispute. We recite these facts as found by the board in its decision. Houghton is a Massachusetts corporation and a well-known publisher of elementary, secondary, and college textbooks, as well as trade, reference, fiction, and nonfiction books. Its book-production process was described by the board as follows: "Initially, editors, ordinarily employed by [Houghton], engage in extensive research and development activities regarding a proposed book. These activities include researching the probable marketability and developing the content and format of a proposed book. [Houghton's] employees then design, write, and produce a manuscript to serve as the content of a proposed book. Various writers and editors working on different portions and aspects of a proposed book combine their work on a network.

"Next, [Houghton's] employees produce and then circulate among the company's marketing, production, and editing personnel thumbnail sketches for further processing and refinement. After that step, electronic-production specialists transform the manuscript and thumbnail sketches into templates which are analogous to blueprints or page outlines without any text. [Houghton's] art department then creates drawings, develops charts and graphs, and creates line art for inclusion in the ultimate product. The art department also ^{*44} selects, retrieves, and transforms photographs for incorporation into the ultimate product.

"Following these steps, all of the aforementioned items are assembled into layouts. First proofs are subsequently produced and marked for changes and corrections, resulting in the production of second proofs which further refine the product. The second proofs are then converted into color proofs. Throughout this process, [Houghton] uses, among

other things, human skill and knowledge as well as various implements, materials, and machines or machinery such as computers, digital modems, printers, photocopiers, writing utensils, lighting machines, drawing equipment and materials, graphic **493 art tools, electronic graphic equipment, electronic color collection equipment, photo-retrieval equipment, sophisticated software, and scanners.

"From the color proof stage of the process, [Houghton] either produces CD ROM tapes which are then sent to independent contractors for final packaging in compact disks, or it sends the proofs (usually on computer diskettes) to independent contractors for printing and binding into conventional books."

A "manufacturing corporation" is defined by G.L. c. 63, § 38C, as a corporation "engaged in manufacturing." This "less than illuminating" definition, *William F. Sullivan & Co. v. Commissioner of Revenue*, 413 Mass. 576, 579, 602 N.E.2d 188 (1992), combined with the desirability of the classification,^{FN3} has spawned a great body of caselaw,^{FN4} in which we have concluded that "[t]he words 'engaged in manufacturing' as *45 used in [G.L. c. 63, § 38C.] ... are words of flexible meaning." *Commissioner of Corps. & Taxation v. Assessors of Boston*, 324 Mass. 32, 36, 84 N.E.2d 531 (1949) (*Assessors of Boston II*). Accord *William F. Sullivan & Co. v. Commissioner of Revenue*, *supra* at 578-579, 602 N.E.2d 188; *Tilcon-Warren Quarries, Inc. v. Commissioner of Revenue*, 392 Mass. 670, 672, 467 N.E.2d 472 (1984); *Southeastern Sand & Gravel, Inc. v. Commissioner of Revenue*, 384 Mass. 794, 795, 429 N.E.2d 714 (1981); *Joseph T. Rossi Corp. v. State Tax Comm'n*, 369 Mass. 178, 181, 338 N.E.2d 557 (1975). "The undefinable nature of the operative terms ... necessitates case-by-case, analogical development of their meaning. Absent legislative instruction, we know of no better direction in which to proceed." *William F. Sullivan & Co. v. Commissioner of Revenue*, *supra* at 581, 602 N.E.2d 188.

FN3. In addition to eligibility for the investment tax credit, classification as a manufacturing corporation under G.L. c. 63, § 38C, also exempts the corporation from local property tax under G.L. c. 59, § 5, Sixteenth (3) (1994 ed.). See, e.g., *York Steak House Sys., Inc. v. Commissioner of Revenue*, 393 Mass. 424, 424-425, 472 N.E.2d 230 (1984);

Letter Ruling 90-5 (Nov. 3, 1990), 3 Official MassTax Guide 1995 at 594-596 (West 1995). Liability for local tax is not at issue in this case.

FN4. See *William F. Sullivan & Co. v. Commissioner of Revenue*, 413 Mass. 576, 602 N.E.2d 188 (1992) (scrap metal processor is manufacturer); *York Steak House Sys., Inc. v. Commissioner of Revenue*, *supra* (converting frozen steak to cooked steak is not manufacturing); *Tilcon-Warren Quarries, Inc. v. Commissioner of Revenue*, 392 Mass. 670, 467 N.E.2d 472 (1984) (stone crushing is not manufacturing); *Southeastern Sand & Gravel, Inc. v. Commissioner of Revenue*, 384 Mass. 794, 429 N.E.2d 714 (1981) (same); *Westinghouse Broadcasting Co. v. Commissioner of Revenue*, 382 Mass. 354, 416 N.E.2d 191, appeal dismissed, 452 U.S. 933, 101 S.Ct. 3071, 69 L.Ed.2d 948 (1981) (television and radio broadcasting is not manufacturing); *Charles River Breeding Lab., Inc. v. State Tax Comm'n*, 374 Mass. 333, 372 N.E.2d 768 (1978) (raising partially uncontaminated laboratory animals is not manufacturing); *Hopkinton LNG Corp. v. State Tax Comm'n*, 372 Mass. 286, 362 N.E.2d 205 (1977) (liquefaction and vaporization of natural gas is not manufacturing); *First Data Corp. v. State Tax Comm'n*, 371 Mass. 444, 357 N.E.2d 933 (1976) (data processing corporation is not manufacturer); *Fernandes Super Mkts., Inc. v. State Tax Comm'n*, 371 Mass. 318, 357 N.E.2d 296 (1976) (grocery store chain whose own baked goods account for 7.5 per cent of total gross profits is not manufacturer); *Joseph T. Rossi Corp. v. State Tax Comm'n*, 369 Mass. 178, 338 N.E.2d 557 (1975) (converting standing timber into cut lumber is manufacturing); *Franki Found. Co. v. State Tax Comm'n*, 361 Mass. 614, 281 N.E.2d 865 (1972) (making "pressure injected footings" is not manufacturing); *Commissioner of Corps. & Taxation v. Assessors of Boston*, 324 Mass. 32, 84 N.E.2d 531 (1949) (converting mahogany logs into veneer and producing tea bags are both manufacturing); *Assessors of Boston v. Commissioner of Corps. & Taxation*, 323 Mass. 730, 84 N.E.2d 129 (1949) (roasting and grinding

coffee, producing soft drinks and juice, producing chocolate milk and ice cream mix, scouring wool, cutting and setting glass in frames, producing candy packaging, and book and magazine binding all constitute manufacturing); Assessors of Springfield v. Commissioner of Corps. & Taxation, 321 Mass. 186, 72 N.E.2d 528 (1947) (telephonic transmission of sound is not manufacturing); Commissioner of Corps. & Taxation v. Assessors of Boston, 321 Mass. 90, 71 N.E.2d 874 (1947) (commercial baking, producing jams and jellies, making sausages, curing and smoking bacon and ham, and printing books are all manufacturing; laundering soiled clothes is not manufacturing); Boston & Me. R.R. v. Billerica, 262 Mass. 439, 160 N.E. 419 (1928) ("machinery used in the generation of electricity ... constituted employment in a branch of manufacture").

[1] Our lodestar in these cases has been the rule that, where a dominant statutory term is undefined, "the Legislature should be **494 supposed to have adopted the common meaning of the word, as assisted by a consideration of the historical origins of the enactment." Westinghouse Broadcasting Co. v. Commissioner of Revenue, 382 Mass. 354, 357, 416 N.E.2d 191, appeal dismissed, 452 U.S. 933, 101 S.Ct. 3071, 69 L.Ed.2d 948 (1981), quoting First Data Corp. v. State Tax Comm'n, 371 Mass. 444, 447, 357 N.E.2d 933 (1976). *46 Accord William F. Sullivan & Co. v. Commissioner of Revenue, *supra* at 579, 602 N.E.2d 188; Charles River Breeding Lab., Inc. v. State Tax Comm'n, 374 Mass. 333, 335-336, 372 N.E.2d 768 (1978); Franki Found. Co. v. State Tax Comm'n, 361 Mass. 614, 617-618, 281 N.E.2d 865 (1972). As to the term's common meaning, "our decisions have embraced the basic concept of manufacturing articulated in Boston & Me. R.R. v. Billerica, 262 Mass. 439, 444-445, 160 N.E. 419 (1928): '[C]hange wrought through the application of forces directed by the human mind, which results in the transformation of some preexisting substance or element into something different, with a new name, nature or use.' " William F. Sullivan & Co. v. Commissioner of Revenue, *supra*. Accord Tilcon-Warren Quarries, Inc. v. Commissioner of Revenue, *supra* (quoting same language); Joseph T. Rossi Corp. v. State Tax Comm'n, *supra* at 180, 338 N.E.2d 557 (quoting same language).

General Laws c. 63, § 38C, first appeared in § 5 of St.1930, c. 220. It was subsequently incorporated in St.1936, c. 362, § 1, and it is to the 1936 act that we have looked for guidance regarding legislative intent. See, e.g., Fernandes Super Mkts., Inc. v. State Tax Comm'n, 371 Mass. 318, 321, 357 N.E.2d 296 (1976); Franki Found. Co. v. State Tax Comm'n, *supra*; Commissioner of Corps. & Taxation v. Assessors of Boston, 321 Mass. 90, 95-96 & n. 1, 71 N.E.2d 874 (1947) (Assessors of Boston I). It was enacted pursuant to 1936 House Doc. No. 143, entitled "Report of the Special Commission Relative to Taxation of Tangible and Intangible Property and Certain Related Matters." Franki Found. Co. v. State Tax Comm'n, *supra*. The commission reported, in part, as follows: "Long regarded as a great industrial State, in which prosperous cities and thriving towns found their inhabitants busily employed in mills and factories, few there were who ever conceived the possibility of such a decline in industrial manufacturing as has occurred.... Idle factories and abandoned mills are the silent and convincing evidence of the disaster that has come upon our people. We do not attempt to give all the reasons for the loss of this industry, but it is clear that among the many causes high taxes play an important part.... It is imperative, therefore, that the State shall provide sufficient relief to save the factories and mills now operating from closing their doors and seeking locations in other States.... The effect of such [tax relief] undoubtedly will be to retain within the State *47 the factories now operating, the possible reopening of factories now closed, and the attracting of new industries to locations within our borders." *Id.* at 618 n. 1, 281 N.E.2d 865, quoting 1936 House Doc. No. 143 at 5-6.

Although "[t]he statutory goal was not to encourage and preserve all industry in the Commonwealth but only that portion of industry represented by manufacturing corporations," Charles River Breeding Lab., Inc. v. State Tax Comm'n, *supra* at 336, 372 N.E.2d 768, we have nevertheless stressed that the words "engaged in manufacturing" are not to be given a narrow or restricted meaning" and that "the statute should be construed, if reasonably possible, to effectuate th[e] legislative intent [of fostering industrial expansion]." Joseph T. Rossi Corp. v. State Tax Comm'n, *supra* at 181, 338 N.E.2d 557, quoting Assessors of Boston v. Commissioner of Corps. & Taxation, 323 Mass. 730, 741, 84 N.E.2d 129 (1949). Accord William F. Sullivan & Co. v. Commissioner of Revenue, 413 Mass. 576, 579, 602 N.E.2d 188 (1992);

Assessors of Boston II, supra; Assessors of Boston I, supra at 97, 71 N.E.2d 874.

[2] Our past cases in this area have focused on whether the processes under study “effect[ed] the kind of change and cause[d] a correlative degree of refinement to the source material” sufficient to qualify as “manufacturing.” *William F. Sullivan & Co. v. Commissioner of Revenue, supra* at 581, 602 N.E.2d 188. Accord ***495 York Steak House Sys., Inc. v. Commissioner of Revenue*, 393 Mass. 424, 426, 472 N.E.2d 230 (1984); *Hopkinton LNG Corp. v. State Tax Comm’n*, 372 Mass. 286, 287, 288, 362 N.E.2d 205 (1977). Although the activity at issue must constitute more than merely providing raw materials to another to be processed, see *Tilcon-Warren Quarries, Inc. v. Commissioner of Revenue, supra* at 674, 467 N.E.2d 472, processes which do not in themselves produce a finished product are nonetheless “manufacturing” if they comprise an “essential and integral part of a total manufacturing process.” *William F. Sullivan & Co. v. Commissioner of Revenue, supra* at 580, 602 N.E.2d 188, quoting *Joseph T. Rossi Corp. v. State Tax Comm’n, supra* at 181-182, 338 N.E.2d 557.^{FN5}

FN5. Of similar import is the commissioner’s regulation, 830 Code Mass. Regs. § 58.2.1(6)(b) 8 (1993), which states: “A process which does not produce a finished product, but constitutes an essential and integral part of a total manufacturing process, is manufacturing. A process which is a practical and necessary step in the production of a finished article for sale is an essential and integral part of a total manufacturing process.”

In *William F. Sullivan & Co. v. Commissioner of Revenue, supra* at 581, 602 N.E.2d 188, *48 we held that the taxpayer’s business of converting cast off pipe, boilers, plumbing fixtures, automobile parts, refrigerators, and other metal items into compressed and baled scrap metal of various grades involved sufficient change and refinement to constitute manufacturing. Similarly, we have held the scouring of raw waste wool into wool ready to be spun into thread, cloth, or rugs to be an essential and integral part of the manufacturing of textiles, *Assessors of Boston v. Commissioner of Corps. & Taxation, supra* at 748, 84 N.E.2d 129, as was the processing of raw wood into cut lumber, “a product more refined and specialized in use

than the raw material.” *Joseph T. Rossi Corp. v. State Tax Comm’n, supra* at 182, 338 N.E.2d 557. Further, we have held the production of electricity to involve “manufacture.” *Boston Gas Co. v. Assessors of Boston*, 334 Mass. 549, 565, 137 N.E.2d 462 (1956).

In *Tilcon-Warren Quarries, Inc. v. Commissioner of Revenue*, 392 Mass. 670, 673, 467 N.E.2d 472 (1984), on the other hand, we held that the taxpayer’s business of extracting pieces of rock from the ground and crushing them into usable sizes was not manufacturing, because the process did not transform the source material “into an article or a product of substantially different character ... even though the processing increase[d] the value [and] usefulness of the product.” *Id.*, quoting *Solite Corp. v. County of King George*, 220 Va. 661, 665, 261 S.E.2d 535 (1980). We have also held that a computer time-sharing system, whereby information provided by a customer is manipulated by computer software, is “the transmission or manipulation of knowledge or intelligence,” and properly classified as a service rather than a manufacturing process. *First Data Corp. v. State Tax Comm’n*, 371 Mass. 444, 448, 357 N.E.2d 933 (1976). Similarly, the transformation of sound waves over telephone lines, *Assessors of Springfield v. Commissioner of Corps. & Taxation*, 321 Mass. 186, 191, 72 N.E.2d 528 (1947), and light waves to television transmitters, *Westinghouse Broadcasting Co. v. Commissioner of Revenue*, 382 Mass. 354, 357, 416 N.E.2d 191 (1981), does not constitute “manufacturing.”

[3] Houghton transforms ideas, art, information, and photographs, by application of human knowledge, intelligence, and skill, into computer disks, ready for use by independent printers, containing an immense amount of information in a highly organized form. We have never required that source materials be tangible. See *First Data Corp. v. State Tax Comm’n, supra* at 446, 357 N.E.2d 933, *49 and cases cited (“If it be objected that the definition [of manufacturing] contemplates corporeal or tangible input and output, the taxpayer can cite cases that may read to the contrary—those which consider the production of electricity to involve manufacture”). Cf. *Westinghouse Broadcasting Co. v. Commissioner of Revenue, supra* at 358, 416 N.E.2d 191 (quoting the Appellate Tax Board: “Westinghouse may not be denied manufacturing status merely because its end product is intangible”). The work Houghton does approaches, to the extent

humanly possible, creation ex nihilo; it is quite different from the mere manipulation of information**496 and electric currents that we discussed in *First Data Corp. v. State Tax Comm'n*, *supra* at 447-448, 357 N.E.2d 933 (manipulation of computer data), *Westinghouse Broadcasting Co. v. Commissioner of Revenue*, *supra* at 355-356, 416 N.E.2d 191 (transformation of light into television signals), and *Assessors of Springfield v. Commissioner of Corps. & Taxation*, *supra* at 189, 191, 72 N.E.2d 528 (transmission of sound waves). We agree with the board's conclusion that Houghton's operations "produce a significant degree of change and refinement to the materials involved and that these are essential and integral steps in the manufacture of conventional books."

The commissioner argues that Houghton's activities to some extent resemble those of a furniture designer who produces designs used by others to build furniture, or an author who writes and sells a manuscript to a publisher. In each case there is a creative process constituting a sine qua non of subsequent production, yet no one would argue that the author or designer should be classified as a manufacturer. While we agree, in principle, with this general statement, there is a reasonable basis for distinguishing Houghton's activities. The documents produced by the author and designer are valued solely for their artistic and intellectual content. Houghton's completed computer disks and CD ROM tapes, on the other hand, although having intellectual content, are valuable principally because they are physically useful in making the finished product. Houghton's activity is similar to the dress cutting "markers" which we said were (albeit in the context of the sales and use tax) used "directly and exclusively" in the manufacture of dresses in *Commissioner of Revenue v. Fashion Affiliates, Inc.*, 387 Mass. 543, 545-546, 441 N.E.2d 520 (1982), the "composition proofs" we held exempt from sales and use tax in *Houghton Mifflin Co. v. State Tax Comm'n*, 373 Mass. 772, 773, 776, 370 N.E.2d 441 (1977), *50 and the linotype we held similarly exempt in *Courier Citizen Co. v. Commissioner of Corps. & Taxation*, 358 Mass. 563, 572-573, 266 N.E.2d 284 (1971). Indeed, the commissioner does not argue that the maker of corporeal printing plates of the type discussed in *Courier* would not be a manufacturer. We believe that the difference between printing plates and the printer-ready computer disks produced by Houghton is one of kind, not of quality. Therefore, we conclude that Houghton's activities constitute "man-

ufacturing" within the "matrix of intention and expectation" of G.L. c. 63, § 38C, *Westinghouse Broadcasting Co. v. Commissioner of Revenue*, *supra* at 358, 416 N.E.2d 191, and that Houghton is entitled to the manufacturer's investment tax credit of G.L. c. 63, § 31A, so long as its manufacturing operations are " 'important and material' ... when measured against the entire operations of the corporation." *Fernandes Super Mkts., Inc. v. State Tax Comm'n*, 371 Mass. 318, 322, 357 N.E.2d 296 (1976), quoting *Assessors of Boston v. Commissioner of Corps. & Taxation*, 323 Mass. 730, 746, 84 N.E.2d 129 (1949).

[4] The commissioner draws our attention to a Maryland case, *H.M. Rowe Co. v. State Tax Comm'n*, 149 Md. 251, 131 A. 509 (1925). "Decisions of other jurisdictions are not likely to have direct bearing because of the peculiarities of the various taxing schemes." *Westinghouse Broadcasting Co. v. Commissioner of Revenue*, *supra*.^{FN6}

FN6. The commissioner further relies on two decisions of the board. In *Assessors of Sudbury v. Commissioner of Corps. & Taxation*, 1 Mass.App.Tax Bd.Rep. 21, 1981 WL 11711 (1981), the board held that a taxpayer who received, edited, and retyped advertisements for its "want-advertiser" before sending the manuscript to a printer was not a manufacturer. The basis for its conclusion was that the preparation of the advertisements for publishing did not significantly change any material and did not constitute a substantial and integral part of any manufacturing operation. Similarly, in *Beckler Press, Inc. v. Commissioner of Revenue*, 4 Mass.App.Tax Bd.Rep. 87, 1984 WL 16045 (1984), the taxpayer arranged typed manuscripts into proper format for a printer, but did not edit or significantly change the material. We agree with the board that the nature of Houghton's complex transformation of ideas, text, and artwork into computer discs and CD ROMs is significantly different from the services provided by the taxpayers in the above cases.

Houghton's compilation of information, photographs, and text, into proofs, edited, refined, and ultimately transferred to disk or **497 CD ROM, transcends the mere manipulation of information and

666 N.E.2d 491
423 Mass. 42, 666 N.E.2d 491
(Cite as: 423 Mass. 42, 666 N.E.2d 491)

Page 7

constitutes a substantial and integral step in the process of manufacturing books. The disks and CD ROMs *51 possess a new nature and are adapted for a new use, namely the printing and binding of books. The board did not err as a matter of law.

Decision of the Appellate Tax Board affirmed.

Mass., 1996.
Commissioner of Revenue v. Houghton Mifflin Co.
423 Mass. 42, 666 N.E.2d 491

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EXHIBIT CC

COMMONWEALTH OF MASSACHUSETTS

APPELLATE TAX BOARD

EUA OCEAN STATE CORPORATION, et al.¹ v. COMMISSIONER OF REVENUE

Docket Nos. C258405-406,
C258424-425, C258882-883
C259158-159, C259653 & C262566-568

Promulgated:
April 24, 2006

These are appeals under the formal procedure pursuant to G.L. c. 58A, § 7 and G.L. c. 62C, § 39, from the refusal of the appellee Commissioner of Revenue ("Commissioner") to abate corporate excises assessed against appellants under G.L. c. 62C, § 26 and G.L. c. 63, §§ 32 and 39, for tax years ranging from 1994 through 1998.

Commissioner Scharaffa heard these appeals and was joined in the decision for appellants by Commissioners Gorton, Egan, and Rose. Chairman Foley took no part in the deliberation or decision of these appeals.

These findings of fact and report are promulgated at the request of both appellants and the Commissioner pursuant to G.L. c. 58A, § 13 and 831 CMR 1.32.

¹ The other appellants are National Grid USA Service Company, Inc. (formerly known as New England Power Service Company), TCPL OSP Ltd. (formerly known as Narragansett Energy Resources Company), TCPL OSL, Ltd. and TCPL Power Ltd.

John S. Brown, Esq., Joseph L. Kociubes, Esq., George P. Mair, Esq., Donald-Bruce Abrams, Esq., Darcy A. Ryding, Esq., and Matthew D. Schnall, Esq. for the appellants.

Daniel A. Shapiro, Esq., and Thomas W. Hammond, Esq., for the appellee.

FINDINGS OF FACT AND REPORT

I. INTRODUCTION

On the basis of the parties' Statement of Agreed Facts, the testimony of witnesses at the two-day hearing before the Appellate Tax Board ("Board"), and documents submitted at the hearing, the Board made the following findings of fact.

Appellants EUA Ocean State Corporation ("EUA"), National Grid USA Service Company, Inc. ("National Grid"), TCPL OSP Ltd. ("TCPL OSP"), TCPL OSL Ltd. ("TCPL OSL"), and TCPL Power Ltd. ("TCPL Power") appeal from the refusal of the Commissioner to abate approximately \$1.3 million in corporate excises assessed against them for various tax periods between 1994 and 1998.² Appellants are partners in two Rhode Island general partnerships, Ocean State Power ("OSP") and Ocean State Power II ("OSP II" and, together

² The periods at issue for each appellant are as follows:

EUA, tax years 1994 through 1998;
TCPL OSP, tax years 1994 and 1996 through 1998;
National Grid, tax years 1994, 1997 and 1998;
TCPL OSL, tax years 1997 and 1998;
TCPL Power, tax years 1994 through 1998.

with OSP, the "Partnerships"), that generated and sold electricity during the periods at issue.

The principal issue raised in these appeals is whether any of the Partnerships' sales of electricity should be treated as Massachusetts sales includible in the numerator of appellants' sales factors under G.L. c. 63, § 38(f).³ If, as the Commissioner maintains, electricity is tangible personal property, the sales are considered to have occurred in the state where title and possession of the electricity passed and appellants' sales factors would include their Massachusetts sales in the numerator and all electricity sales in the denominator. If, however, electricity is not tangible personal property, the sales are attributed to the state in which appellants incurred the greatest proportion of the costs of performing their income-producing activity. It is not disputed that under the non-tangible property attribution rule, all of the Partnerships' sales would be attributed to Rhode Island and not Massachusetts because they incurred all of their costs of performance in Rhode Island.

On their Massachusetts corporate excise returns, appellants did not report any of the Partnerships' sales of

³ A second issue, which is moot if appellants prevail on the sales factor issue, is whether appellants should be taxed as utility corporations under G.L. c. 63, § 52A, rather than as business corporations under G.L. c. 63, §§ 32 and 39.

electricity as Massachusetts sales includible in the numerator of their sales factors. On audit, however, the Commissioner treated more than seventy-five percent of those sales as Massachusetts sales.

II. IDENTIFICATION OF APPELLANTS AND JURISDICTION

A. EUA

EUA is a Rhode Island corporation that was formed as a special purpose subsidiary of Eastern Utility Associates for the purpose of being a partner in the Partnerships. EUA was a general partner in the Partnerships and held a twenty-nine percent interest in each of the Partnerships throughout the period from 1994 through 1998. EUA's sole business activity during this time was to act as a general partner in the Partnerships.

As a result of his adjustments to the Partnerships' sales factors, the Commissioner made additional assessments against EUA with respect to both the net income and the net worth components of its corporate excise for each of the tax years 1994 through 1998. EUA is contesting approximately \$355,000 of additional assessments for these periods. On the basis of the Statement of Agreed Facts and accompanying exhibits, the Board found that EUA timely filed its returns, Applications for Abatement, and petitions for the tax years at issue. Accordingly, the

Board found and ruled that it had jurisdiction over EUA's appeals (Docket Numbers C258406, C259159, and C259653).

B. TCPL OSP/NERC

TCPL OSP is a Rhode Island corporation that was formed as a special purpose subsidiary of New England Electric System for the purpose of being a partner in the Partnerships. TCPL OSP was a general partner in each of the Partnerships and held a twenty percent interest in each of the Partnerships during 1994 and throughout the period from 1996 through 1998. During those periods, TCPL OSP's sole business activity was to act as a general partner of the Partnerships. TCPL OSP was formerly known as Narragansett Energy Resources Company ("NERC").

As a result of his adjustments to the Partnerships' sales factors, the Commissioner made additional assessments against TCPL/NERC with respect to the net worth component of its corporate excise for the tax years 1994, 1996, and 1997. In addition, the Commissioner made assessments against TCPL OSP with respect to both the net worth and net income components of its corporate excise for the portion of the 1998 taxable year for which TCPL OSP filed a separate return (September 2 through December 31, 1998). TCPL OSP is contesting approximately \$36,000 in additional assessments for these periods. On the basis of the

Statement of Agreed Facts and accompanying exhibits, the Board found that TCPL OSP/NERC timely filed its returns, Applications for Abatement, and petitions for the tax years at issue. Accordingly, the Board found and ruled that it had jurisdiction over TCPL OSP/NERC's appeals (Docket Numbers C258424, C258882, and C262568).

C. NATIONAL GRID/NEPSC

During 1994 and the period from January 1, 1997 through September 1, 1998, National Grid, then known as New England Power Service Company ("NEPSC"), was the principal reporting corporation for an affiliated group that included TCPL OSP. National Grid is a party to this appeal solely as the principal reporting corporation for this affiliated group.

For tax year 1994, TCPL OSP, then known as NERC, was part of the affiliated group for which NEPSC filed a combined return. NERC's income was included in computing the tax assessed against NEPSC with respect to the group's combined net income pursuant to G.L. c. 63, § 32B. As a result of his adjustments to the Partnerships' sales factors and adjustments to the income of another member of the group, the Commissioner made an additional assessment of \$65,784 against NEPSC with respect to the combined net income for tax year 1994. The parties agree that, as a

result of the Board's decision in *New England Power Service Co. v. Commissioner of Revenue*, ATB Findings of Fact and Reports 2000-56, National Grid/NEPSC is entitled to an abatement of \$65,784 for 1994, regardless of the resolution of the contested issue regarding the Partnerships' sales factors and the treatment of NERC as a business corporation rather than a utility corporation.

On the basis of the Statement of Agreed Facts and accompanying exhibits, together with the Commissioner's concession at the hearing that NEPSC had not received a Notice of Abatement Determination dated June 7, 2000 until after it had filed its petition, the Board found that NEPSC timely filed its return, Application for Abatement, and petition for tax year 1994. Accordingly, the Board found and ruled that it had jurisdiction over NEPSC's 1994 appeal (Docket Number C258405).

During the period from January 1, 1997 through September 1, 1998, NERC was also part of the affiliated group for which NEPSC filed a combined return pursuant to § 32B for tax years 1997 and 1998. As a result of his adjustments to the Partnerships' sales factors, the Commissioner reduced the amount of refund that he determined to be due to NEPSC for tax year 1997 and made an

additional assessment against NEPSC with respect to NERC's income for tax year 1998.

National Grid/NEPSC is contesting approximately \$105,000 in additional assessments for tax years 1997 and 1998. On the basis of the Statement of Agreed Facts and accompanying exhibits, the Board found that National Grid/NEPSC timely filed its returns, Applications for Abatement, and petitions for the tax years 1997 and 1998. Accordingly, the Board found and ruled that it had jurisdiction over National Grid/NEPSC's 1997 and 1998 appeal (Docket Number C262566).

D. TCPL OSL

TCPL OSL is a Rhode Island corporation that was formed for the purpose of being a partner in the Partnerships. TCPL OSL was a general partner in each of the Partnerships and held a ten and one-tenth percent interest in each of the Partnerships during 1994 and throughout 1997 through 1998. During those periods, TCPL OSL's sole business activity was to act as a general partner of the Partnerships. TCPL OSL was formerly known as JMC Ocean State Corporation.

As a result of his adjustments to the Partnerships' sales factors, the Commissioner made additional assessments against TCPL OSL with respect to the net worth component of

its corporate excise for tax year 1997. In addition, the Commissioner made assessments against TCPL OSL with respect to both the net worth and net income components of its corporate excise for the portion of the 1998 taxable year for which TCPL OSL filed a separate return (July 3 through December 31). TCPL OSL is contesting approximately \$14,500 in additional assessments for the tax years 1997 and 1998. On the basis of the Statement of Agreed Facts and accompanying exhibits, the Board found that TCPL OSL timely filed its returns, Applications for Abatement, and petitions for tax years 1997 and 1998. Accordingly, the Board found and ruled that it had jurisdiction over TCPL OSL's appeals (Docket Numbers C259158 and C262567).

E. TCPL POWER

Like EUA, TCPL OSP, and TCPL OSL, TCPL Power is a Rhode Island corporation that was formed for the purpose of being a partner in the Partnerships. TCPL Power was a general partner in each of the Partnerships and held a forty percent interest in each of the Partnerships during the tax years 1994 through 1998. During those years, TCPL Power's sole business activity was to act as a general partner of the Partnerships.

As a result of his adjustments to the Partnerships' sales factors, the Commissioner made additional assessments

against TCPL Power with respect to both the net worth and net income components of its corporate excise for each of the tax years 1994 through 1998. TCPL Power is contesting approximately \$670,000 in additional assessments for these periods. On the basis of the Statement of Agreed Facts and accompanying exhibits, the Board found that TCPL Power timely filed its returns, Applications for Abatement, and petitions for the years at issue. Accordingly, the Board found and ruled that it had jurisdiction over TCPL Power's appeals (Docket Numbers C258425 and C258883).

III. THE PARTNERSHIPS' BUSINESS ACTIVITIES

At all material times, each of the Partnerships owned and operated an electric generating plant in Burrillville, Rhode Island, near the Massachusetts border (the "Plants"). OSP owned and operated an approximately 249 megawatt, natural-gas fired, combined-cycle electric generating plant that included two General Electric MS-7000 EA gas turbines and one General Electric condensing steam turbine-generator ("Unit I"). OSP II owned and operated an approximately 243 megawatt, natural-gas fired, combined-cycle generating plant that, like Unit I, also included two General Electric MS-7000 EA gas turbines and one General Electric condensing steam turbine-generator ("Unit II" and, together with Unit I, the "Units"). The Partnerships derived the bulk of

their revenue, roughly \$100 million per year for each Partnership, from the sale of electricity generated by the Units and the sale of "capacity," the right to purchase a portion of the electricity that the Units could generate.

The Partnerships also sold excess natural gas during periods when the Units were not operating. Revenues from these natural-gas sales ranged from \$800,000 to nearly \$10 million per year during the periods at issue. The Partnerships sold no natural gas to Massachusetts customers.

The Partnerships owned various residential properties in Massachusetts and Rhode Island that were located within a half-mile radius of the Plants. The Partnerships purchased these properties from their prior owners under a so-called "property value stabilization program." The program was instituted as part of the process by which the Partnerships gained the necessary governmental approvals for constructing the Plants in response to objections from owners who did not want to have the Plants located near their homes. During the periods at issue, the Partnerships either sold the residential properties to new owners or leased the properties. The Partnerships did not use the properties in the operation of the Plants. As the Partnerships sold the residential properties during the

periods at issue, revenues decreased from \$87,286 in 1994 to \$25,033 in 1998.

The assessments at issue concern only the Partnerships' sale of electricity. The Commissioner made no adjustments concerning receipts from the Partnerships' Massachusetts real estate or the sale of "capacity" and natural gas.

IV. COMMISSIONER'S ALLOCATION OF SALES TO MASSACHUSETTS

For the majority of the tax years at issue, the utilities purchasing electricity from the Partnerships were: Boston Edison Company ("BECO"); Montaup Electric Company ("Montaup"); and New England Power Company ("NEP") (together, "Purchasers"). TransCanada Power Marketing Ltd. ("TCPM") replaced both Montaup and NEP as a purchaser during the end of the periods at issue.⁴ During the tax years at issue, the Purchasers were engaged in the wholesale and/or retail sale of electricity.

One of the Purchasers, BECO, was primarily engaged in the retail sale of electricity in Massachusetts. However, over ten percent of BECO's sales were sales to other electricity distributors for resale. These distributors included utilities located in other New England states and

⁴ Each of the Purchasers also purchased electricity from other sources and each of the Purchasers other than TCPM also generated electricity.

power marketing and trading companies that operated throughout the United States.

Another purchaser, NEP, was engaged almost exclusively in the wholesale transmission and resale of electricity, including sales to affiliates based in Massachusetts (Massachusetts Electric Company), Rhode Island (The Narragansett Electric Company), and New Hampshire (Granite State Electric Company). NEP also sold power to unaffiliated customers during the years at issue, including power companies and municipal light departments in various states, and marketing and trading companies selling power throughout the United States. NEP also entered into system power contracts in which it sold specified quantities of power during specific periods to other wholesalers and unit power contracts in which it sold specified quantities of power.

NEP also transferred a portion of its right and obligation to purchase electricity from the Partnerships during the periods at issue. NEP transferred between two and eight percent of the total output of the Partnerships' Units during the period at issue to Unitil Power Corporation ("Unitil"), a New Hampshire utility.

A third purchaser, Montaup, was engaged primarily in the wholesale transmission of power. Montaup's customers

included NEP, BECO, and Montaup's affiliates, Eastern Edison Company (based in Massachusetts), BE (based in Rhode Island), and Newport Electric Company (also based in Rhode Island). Its other customers included utilities based in Massachusetts, Rhode Island, Connecticut, a Rhode Island municipal light district, and trading companies doing business throughout New England.

The Commissioner audited appellants' Massachusetts corporate excise returns and determined that appellants' treatment of all electricity sales as non-Massachusetts sales was in error. The auditor initially treated all sales of electricity and capacity as sales of tangible personal property and relied on the "reverse dock sale rule" found in 830 CMR 63.38.1(9)(c) to treat these sales as Massachusetts sales because the electricity was "transshipped" from Rhode Island to Massachusetts customers via the "common carrier" of the New England electricity distribution system known as the "NEPOOL grid," which is described in Section V(B) below. Because for most of the tax years at issue, the Purchasers were all based in Massachusetts, the auditor assumed that the destination of all the Partnerships' sales of electricity during that period was Massachusetts.

Appellants appealed this determination to the Department of Revenue's Appeal and Review Bureau ("A&R"). A&R revised the auditor's determination and concluded that it was the location of the "residential, commercial, and industrial end-users" of the electricity, and not the location of the "intervening purchaser or supplier," that determined whether the sale was a Massachusetts sale. Accordingly, A&R determined that sales of electricity were includible in the numerator of appellants' sales factors "to the extent that the electricity [was] consumed and used by the Purchasers' ultimate retail customers in Massachusetts."

The auditor then prepared a revised set of workpapers based on his understanding of the A&R decision. To determine the identity of the Purchasers' customers, the auditor reviewed certain filings made by the Purchasers to the Federal Energy Regulatory Commission ("FERC"). He then made assumptions, based on the name of the customer or other information he was told, concerning the locations of the ultimate retail consumers of the electricity.

For example, the auditor treated all sales to Massachusetts Electric, but no sales to Narraganset Electric, as Massachusetts sales, solely based on their names. Similarly, he treated all sales to Eastern Edison,

but no sales to Granite State Electric, as Massachusetts sales, because he was told that "Eastern Edison was 100 percent Mass." and that Granite State "does business in New Hampshire."

He did not attempt to determine the identity or location of the retail customers of those entities that purchased electricity from the Purchasers. Rather, he used an "all-or-nothing" approach, classifying either all, or none, of the sales made by the Purchasers' customers as Massachusetts sales strictly based on the name of the Purchasers' customer or other information relayed to him. For example, all of BECO's sales were considered to be Massachusetts sales because the auditor "assumed [BECO] was 100 percent Mass.," even though the A&R determination acknowledged that BECO "did make some wholesale sales to other utilities such as EUA's parent, Eastern Utility Associates, which conducts a substantial portion of its operations in Rhode Island."

To determine the percentage of the Partnerships' total electricity sales attributable to Massachusetts, the auditor first determined the Partnerships' total electricity sales to each purchaser, and then computed a "Massachusetts Sales Percentage" that he applied to the Partnerships' electricity sales to each purchaser. The

auditor arrived at the Massachusetts Sales Percentage by dividing what he determined to be each purchaser's sales to Massachusetts customers by the Purchasers' total sales.

Using 1994 as an example, the auditor first broke down the Partnerships' total electricity sales of \$30,245,388 among Montaup (\$11,009,196), NEP (\$19,069,501) and BECO (\$9,239,861). For Montaup, he derived a Massachusetts Sales Percentage of 61.9012 percent from an excerpted page from Montaup's 1994 FERC filings. He arrived at this percentage by first treating all \$41,466,446 of Montaup's sales to Eastern Edison Company as Massachusetts sales. He then added the Eastern Edison sales to \$20,423,209 of sales to Blackstone Valley Electric and \$5,109,429 of sales to Newport Electric to arrive at a total sales figure of \$66,988,084. The Massachusetts Sales Percentage of 61.9012 percent is equal to the Eastern Edison Sales divided by the sum of the Eastern Edison, Blackstone Valley Electric, and Newport Electric sales. The auditor disregarded all other Montaup sales, including all sales to non-affiliates.

The auditor used a similar approach to arrive at a Massachusetts Sales Percentage of 74.4157 percent for NEP for 1994. He treated all of NEP's sales to Massachusetts Electric, totaling \$357,642,672, as Massachusetts sales. He then treated \$16,044,384 in sales to Granite State

Electric and \$106,914,299 in sales to Narragansett Electric as non-Massachusetts sales. Dividing the sales to Massachusetts Electric by all NEP sales, he arrived at the 74.4157 Massachusetts Sales Percentage for NEP.

For BECO, the auditor assumed that all of BECO's electricity sales were to Massachusetts customers. Accordingly, he used a Massachusetts Sales Percentage of one hundred percent.

The auditor then determined the Massachusetts sales for each of the Partnerships by multiplying the Partnerships' sales to each purchaser by the Massachusetts Sales Percentage that he had calculated for each of the Purchasers, adding the results together, and allocating the total between the two Partnerships. He then adjusted the apportionment formulas for each of the partners by adding the amounts he determined to be Massachusetts sales to the numerator of the sales factor.

The auditor acknowledged that there were difficulties in applying the methodology described in the A&R Determination letter. First, the Partnerships could not tell from their own records the location of "the ultimate retail customers" as required by the A&R Determination Letter. Moreover, because NEP's and Montaup's customers were also engaged in the transmission, distribution and

wholesaling of electricity, and were therefore not the "ultimate consumers" of the electricity purchased, the FERC filings made by NEP and Montaup could not establish the location of the ultimate consumers because these records would not show whether a transmission or distribution purchaser located outside of Massachusetts resold electricity back into Massachusetts or vice versa.

Further, although it does not appear to be a relevant factor for applying the A&R method, the auditor also testified that the Massachusetts "headquarters" of the Purchasers also supported the assessment. The auditor testified that because the three principal Purchasers - BECO, Montaup, and NEP - were all "headquartered" in Massachusetts and headquarters is where the "retail obligation is," the actual "possession and control" of the electricity sold to them passes in Massachusetts.

The Commissioner's allocation of electricity sales to Massachusetts and the resulting assessments against appellants are premised on his determination that sales of electricity are "sales of tangible personal property" for purposes of G.L. c. 63, § 38(f). Accordingly, the Board found the following facts concerning the Partnerships' generation, distribution, and sale of electricity to

determine whether electricity constitutes "tangible personal property."

V. PARTNERSHIPS' GENERATION AND SALE OF ELECTRICITY

A. GENERATION OF ELECTRICITY

Electricity is produced at each Unit using two 80-megawatt natural gas generators and one 90 megawatt steam generator. The generation process begins with the activation of two natural gas turbines, which are similar to aircraft jet engines. The combustion of natural gas causes the rotor in each turbine to rotate at very high speed. The heat exhaust from the gas turbines is used, in conjunction with the burning of additional fuel, to heat water to produce steam. The steam is used as the power source for the steam turbine, causing the rotor in the steam turbine to rotate.

Each generator consists of a "stator" and a "rotor." The stator is a series of stationary coils around the periphery of the generator. Inside the stator is the rotor winding, a coil connected to the turbine that produces a magnetic field. The high-speed rotation of the rotor within the stator causes a changing magnetic field. The changing magnetic field induces a flow of current, or electricity, in the stator.

No new electrons or other "particles" are created by this process. The changing magnetic field caused by the rotation of the rotor causes electrons in the stator coils to move in alternating directions, resulting in "alternating current." In the United States, the standard current used is 60-cycle current, in which there are 60 alternating cycles per second, referred to as "60 hertz" or "60 HZ." In 60 hertz current, electrons change direction 120 times per second.

The rapid oscillation of electrons caused by the rotation of the rotor within the stator results in a flow of energy within the coils of the stator. The electrons themselves do not flow in any one direction; for example, individual electrons do not flow out of the generator, onto the transmission lines and into consumers' homes and businesses. Rather, the oscillation of the electrons within the stator of the generator causes a flow of electrical energy which, as described below, is distributed to electricity consumers.

B. TRANSMISSION AND DISTRIBUTION OF ELECTRICITY

The electrical energy flows out of the stator on wires to a transmission substation where the energy generated at the Units is transferred to the transmission system servicing New England, known as the New England Power Pool

("NEPOOL") transmission grid (the "grid"). The grid is a series of interconnected transmission lines throughout New England carrying power generated by the Partnerships and by other generating facilities to delivery points for distribution to New England consumers. The grid consists of that portion of the distribution system between "transmission substations," located near generating facilities, and "power substations," located near the consumer. NEPOOL is not involved in the delivery of power from generation facilities to the transmission substation or the distribution of the power from the power substation to the consumer.

The substation at which the electricity generated by the Units is transferred to the grid is called the "Sherman Farm Road Extra High Voltage/Pool Transmission Facility" ("EHV/PTF"). The EHV/PTF is also located in Rhode Island, a few hundred feet from the Plants. It is owned by Blackstone Valley Electric Company.

Efficient distribution of electrical energy over wires requires a voltage, which is the measure of the energy's force, of 345 kilovolts ("KV"). The voltage of the power produced by the Units' generators is typically only 13 to 20 KV. Therefore, the power flowing from the generators is put through a series of "transformers" before it is

transferred to the grid at the EHV/PTF. A transformer consists of two coils of wires, called "windings," that are wrapped around a magnetic core. Current flowing through one winding at a given voltage induces a magnetic field in the core, which in turn induces a current at a different voltage in the other winding. There is no physical connection or movement of electrons between the two windings; the only connection is through a magnetic field.

Once its voltage reaches the proper level, the electricity is "impressed" or "injected" onto the grid for distribution throughout New England. Electricity is distributed through an integrated system of transmission and distribution facilities using interconnected transmission lines, transformers, and other equipment to bring the power generated by the Partnerships and other power generators to consumers. Just as the voltage is stepped up at transmission substations such as the EHV/PTF to efficiently travel over wires, it must be stepped down to be usable by customers. Generally, the voltage is first reduced to an intermediate level suitable for bringing the electricity into various distribution areas, then reduced further at power substations to an appropriate distribution voltage level, and then, at or near the customer, the voltage is further reduced to a level suitable for customer

use. The voltage reduction is achieved using transformers, which operate in the same general manner as the transformers used to increase its voltage.

C. CONTRACTS REGARDING THE SUPPLY OF ELECTRICITY

1. NEPOOL

NEPOOL is an organization of electric utilities created by the NEPOOL Agreement. NEPOOL was formed as a result of the unprecedented power blackout that occurred in New York and New England in 1965. The goals of NEPOOL are to maintain the reliability of the bulk power system for the delivery of electricity to consumers and to produce and deliver power at the lowest cost that is consistent with prudent utility practice.

The NEPOOL Agreement is a contractual agreement among electric utilities that is open to all electric utilities operating in New England. During the tax years at issue, the Purchasers were members of NEPOOL, but the Partnerships were not. The NEPOOL Agreement provides the central dispatching and primary pooling arrangement for electric utilities operating in New England.

(a) SCHEDULING OF POWER GENERATION

NEPOOL does not own any generating or transmission facilities. Rather, it or its agents schedule the operation of the generation facilities that contribute to

the NEPOOL grid, including the Partnerships' Units, and account for the purchases and sales of electricity among its members.

Although NEPOOL is not directly involved in the physical operation of the generating plants, it does determine the output levels at which the plants operate. The output levels are based on a projection that takes into account the amount of power withdrawn from the grid by power purchasers and anticipated "line losses," the dissipation of electricity during the transmission process resulting from the inherent resistance of conductors. During most of the periods at issue, decisions concerning the plants' output levels were made by NEPOOL's dispatch agent, the New England Power Exchange, or NEPEX.

(b) SETTLING ACCOUNTS AMONG MEMBERS

During the tax years at issue, the Partnerships sold all of the electricity they produced at the Plants to the Purchasers, who were engaged in the transmission and/or distribution of electricity.

Each of the Purchasers entered into a Unit Power Agreement with each of the Partnerships governing the sale of electricity to that purchaser. Under the Unit Power Agreement, the Partnerships were obligated to sell, and the Purchasers were obligated to purchase, the following

percentages of the Partnership's output: BECO, twenty-three and one-half percent; Montaup, twenty-eight percent; NEP, forty-eight and one-half percent.

NEPOOL accounted for the activity of its members in terms of "resources" and "loads." Resources are the amount of power that a NEPOOL member contributed to the grid and "loads" are the amount of power that a member withdrew from the grid. For example, power generated and transferred to the grid by the Partnerships would be credited as resources to each of the Purchasers in proportion to the percentage of power that the purchaser was entitled and obligated to purchase. Conversely, each of the Purchasers would be charged with loads when its wholesale or retail customer withdrew power from the grid. A deficit in resources in effect represented a purchase by the NEPOOL member from other members, while an excess of resources over loads in effect represented a sale into the pool.

NEPOOL and its administrative agents determined on an hourly basis the net amount of each NEPOOL member's resources and loads. The net purchases and sales were then settled on a monthly basis as a net dollar amount due to or from each member as a result of its activities during the month.

2. PARTNERSHIPS' DELIVERY OBLIGATIONS

In addition to delineating the percentage of the Partnerships' output which each of the Purchasers was entitled, and obligated, to purchase, the Unit Power Agreements also governed the Partnerships' obligations concerning the delivery of power to the Purchasers.

The Unit Power Agreements specified that the delivery point for the electricity was in Rhode Island at the "point of interconnection with the [EHV/PTF] facilities adjacent to" the Plants. The Partnerships' responsibility for delivering the electricity ended at the transmission substation. Further transmission was the responsibility of the Purchasers, including the cost of using the transmission facilities, which are owned by other NEPOOL members, and the line losses resulting from the dissipation of electricity during transmission.

VI. BOARD'S ULTIMATE FINDINGS ON DISPUTED ISSUES

On the basis of the foregoing subsidiary findings, the Board found that electricity is not "tangible personal property" for purposes of G.L. c. 63, § 38. Electricity is not an object that is manufactured; it is a flow of power that is generated by the manipulation of magnetic fields. Electricity has no physical shape, form or geographic

location. It has no height, weight, volume or other dimension by which tangible property is typically measured.

Although electricity may be perceived by the senses, such as feeling a shock, it has no form or substance which can be touched. It is of a nature similar to heat, light and sound, all of which can be sensed and even measured but, given their lack of form or substance, would not be considered "tangible."

Electricity generated and injected into the grid is indistinguishable from electricity in the transmission and distribution network. Individual electrons are not created in Rhode Island and delivered to Massachusetts; rather, the Partnerships generate power in Rhode Island that, once injected into the grid, merges with power in the grid produced by other generators and is instantaneously available to consumers throughout the network. One cannot trace the energy generated in Rhode Island and determine by any meaningful standard the ultimate destination of that energy. Concepts such as title, possession and delivery, which are relevant for determining the allocation of sales of tangible personal property under § 38, make little sense in the context of the generation and sale of electric power.

Even if such concepts were applicable to electricity, the evidence of record supports a finding that title and possession of the electricity passed from the Partnerships to the Purchasers in Rhode Island. Under the Unit Power Agreements, the Partnerships completed their performance by delivering the electricity at the EHV/PTF substation in Rhode Island. As members of NEPOOL, it was the Purchasers, not the Partnerships, which had the right to use the transmission facilities owned by other NEPOOL members. It was the Purchasers, not the Partnerships, which were responsible for further transmission of the electricity beyond the Rhode Island substation, including the cost of using all necessary transmission facilities. Further, the Purchasers absorbed the line losses resulting from the dissipation of electricity during transmission beyond the Rhode Island substation. Accordingly, even applying tangible property rules to the sale of electricity would result in the sale taking place in Rhode Island, where title and possession of the electricity was delivered to the Purchasers.

The Commissioner's various attempts to allocate a portion of the Partnerships' electricity sales based on the "reverse dock sale rule," the location of the ultimate retail consumer, or the headquarters of the Purchasers, are

flawed because they fail to recognize the nature of both electricity itself and the manner of its sale by the Partnerships to the Purchasers. Electricity is not "shipped" by a "common carrier," as required by the reverse dock sale rule. Rather, it is made available on the grid in the amounts the Purchasers were obligated to purchase and withdrawn from the grid by the Purchasers' customers. The sale of electricity is, in effect, determined by accounting adjustments based on a comparison between how much power a purchaser has made available on the grid and the level of consumption by its customers.

The Partnerships could not know the location of the "ultimate consumer" of the electricity they generated because they were not privy to the records of their Purchasers and, even if they were, the consumer location would not be revealed in the Purchasers' records of the many sales to resellers of electricity. Finally, the location of the Purchasers' headquarters is not a relevant consideration, even if electricity were tangible: it is the place where the seller's delivery obligation is completed, not the headquarters of the purchaser, which determines where a sale of tangible personal property takes place.

The Commissioner's difficulty in arriving at a reasonable apportionment approach underscores the fact that

the sale of electricity does not fit the model of a sale of tangible personal property under § 38(f). Rather, because electricity lacks a physical form and a precise geographic location, making concepts such as title, possession, and delivery somewhat illusory in this context, the standard under § 38(f) that governs all sales other than sales of tangible personal property best fits the sale of electricity. That standard attributes a taxpayer's gross receipts from income-producing activity to the state in which the taxpayer incurs the greatest proportion of the costs of performing that activity.

The evidence of record in these appeals clearly establishes that the Partnerships incurred all of their costs of performance in Rhode Island; the Commissioner's own witness concedes this fact and he does not attempt to argue otherwise. Accordingly, all of their receipts from the sale of electricity are properly attributable to Rhode Island and none to Massachusetts. Because all receipts from electricity sales are attributable to Rhode Island, no receipts are includible in the numerator of appellants' Massachusetts sales factors and, therefore, appellants' sales factors are zero.

On the basis of the foregoing, the Board issued a decision for the appellants and granted an abatement in the amount of \$1,346,993.

OPINION

I. APPORTIONMENT OF NET INCOME UNDER § 38

Pursuant to G.L. c. 63, § 38, appellants are subject to a corporate excise on that part of their net income which is derived from business carried on in Massachusetts. Taxable income derived from Massachusetts business is determined by taking appellants' federal net income, applying the deductions enumerated in G.L. c. 63, § 38(a), and multiplying the result by the three-factor apportionment formula under G.L. c. 63, § 38(c). The apportionment formula is based on the ratio of the corporation's property, payroll, and sales in Massachusetts to its total property, payroll, and sales everywhere. The statutory purpose of the three-factor apportionment formula is "to obtain a fair approximation of the corporate income that is 'reasonably related to activities conducted within [Massachusetts].'" *Boston Professional Hockey Association, Inc. v. Commissioner of Revenue*, 443 Mass. 276, 280, n.7 ("Boston Professional Hockey Association") (quoting *Gillette Co. v. Commissioner of Revenue*, 425 Mass. 670, 681

(1997), quoting *Exxon Corp. v. Department of Revenue of Wisc.* 447 U.S. 207, 223 (1980)).

The principal issue raised in these appeals is whether any of the Partnerships' sales of electricity should be treated as Massachusetts sales includible in the numerator of appellants' sales factors under G.L. c. 63, § 38(f) ("§ 38(f)").⁵ Under § 38(f), the sales factor is a "fraction, the numerator of which is the total sales of the corporation in this commonwealth during the taxable year, and the denominator of which is the total sales of the corporation everywhere during the taxable year."

Appellants, whether properly taxable as business corporations or utility corporations, must include in their apportionment factors appellants' pro rata share of the Partnerships' own factors. See 830 C.M.R. 63.38.1(1)(a) and 830 C.M.R. 63.38.1(13) (formerly 830 C.M.R. 63.38.1(11) in 1995 version of the Regulation). Accordingly, resolution of these appeals requires the Board to determine which, if any, of the Partnerships' sales of electricity were "in this commonwealth."

Section 38(f) provides two different rules for determining whether a sale is "in this commonwealth,"

⁵ Given the Board's ruling in favor of appellants on this issue, the issue of whether appellants should be taxed in Massachusetts as utility corporations under G.L. c. 63, § 52A, rather than as business corporations under G.L. c. 63, §§ 32 and 39, is moot.

depending on the nature of what is sold. In the case of tangible personal property, the general rule is that the sale takes place where the property is delivered to the purchaser. A sale of tangible personal property is "in this commonwealth" under § 38(f) if "the property is delivered or shipped to a purchaser within this commonwealth regardless of the f.o.b. point or other conditions of sale."⁶

The determination of whether sales other than sales of tangible personal property are "in this commonwealth" is subject to a different standard. A sale of property other than tangible property is a Massachusetts sale under § 38(f) if: (1) "the income-producing activity is performed in this commonwealth;" or (2) "the income-producing activity is performed both in and outside this commonwealth and a greater proportion of this income-producing activity is performed in this commonwealth than in any other state, based on cost of performance."

Accordingly, resolution of the principal issue of whether any of the Partnerships' sales of electricity

⁶ Pursuant to the so-called "throwback rule" under § 38(f), a sale of tangible personal property is also a Massachusetts sale if the tangible personal property is delivered or shipped to a purchaser outside the commonwealth, but the corporation is not taxable in the state of delivery and the property was not sold by an agent or agencies operating out of premises owned or rented by the corporation outside of Massachusetts. Neither party argued that the throwback rule was applicable to these appeals.

should be treated as Massachusetts sales includible in the numerator of appellants' sales factors depends on three sub-issues: 1) whether sales of electricity are sales of "tangible personal property" or sales "other than sales of tangible personal property" for purposes of § 38(f); 2) if electricity is considered tangible personal property for purposes of § 38(f), whether the electricity was delivered in Massachusetts; and 3) if electricity is not tangible personal property for purposes of § 38(f), whether the greater proportion of the Partnerships' income-producing activity is performed in Massachusetts than in any other state. Because the Board found that all of the Partnerships' income-producing activities were performed in Rhode Island, none of the Partnerships' sales would be Massachusetts sales if electricity is not tangible personal property for purposes of § 38(f). Accordingly, the first sub-issue to be determined is whether electricity is tangible personal property for purposes of § 38(f).

II. ELECTRICITY IS NOT TANGIBLE PERSONAL PROPERTY

A. THE COMMON AND ORDINARY MEANING OF "TANGIBLE PERSONAL PROPERTY" DOES NOT ENCOMPASS ELECTRICITY

Section 38(f) does not provide a definition of "tangible personal property." Further, the regulations construing § 38(f) are silent on the issue of whether

electricity is tangible personal property for purposes of the sales factor and no Massachusetts case has addressed this issue.

Where a "dominant statutory term is undefined, 'the Legislature should be supposed to have adopted the common meaning of the word, as assisted by a consideration of the historical origins of the enactment.'" *Commissioner of Revenue v. Houghton Mifflin Company*, 423 Mass. 42, 45 (1996) ("*Houghton Mifflin*").

In cases dealing with the issue of whether a corporation was engaged in "manufacturing," the Supreme Judicial Court has recognized that electricity is not "tangible" property. In *Westinghouse Broadcasting Company, Inc. v. Commissioner of Revenue*, 382 Mass. 354 (1981) ("*Westinghouse*"), the taxpayer, which owned and operated a television and radio station, claimed that it should be classified as a manufacturing corporation in order to qualify for an investment tax credit under G.L. c. 63, § 31A and a property tax exemption under G.L. c. 59, § 5, cl. Sixteenth (3). The court upheld the Board's denial of manufacturing classification, but noted that:

The Board in the present case did indeed allow a request for a ruling that "Westinghouse may not be denied manufacturing status merely because its end product is intangible." That

proposition conformed to our view that the production of electricity may entail manufacture (see *Boston Gas Co. v. Assessors of Boston*, 334 Mass. 549, 565 (1956); *Boston & Me. R.R. v. Billerica*, 262 Mass. 439, 449 (1928)).

Westinghouse, 382 Mass. at 358.

In this same context of determining whether a corporation was engaged in manufacture, the court again used electricity as an example of an intangible product of manufacturing activity:

If it be argued that the definition [of manufacturing] contemplates corporeal or tangible input or output, the taxpayer can cite cases that may read to the contrary - those which consider the production of electricity to involve manufacture.

Houghton Mifflin, 423 Mass. at 48-9, quoting *First Data Corporation v. State Tax Commission*, 371 Mass. 444, 446 (1976) ("*First Data Corporation*").

Courts in other jurisdictions have also recognized in a number of contexts that electricity does not constitute tangible personal property within the ordinary meaning of that term. See, e.g., *Omaha Pub. Power Dist. v. Nebraska Department of Rev.*, 248 Neb. 518, 524-25 (1995) ("*Omaha Pub. Power Dist.*") ("[E]lectricity is a physical phenomenon; it is energy, not matter, and has no mass. Electricity can hardly be called 'tangible,' which means

'capable of being touched'"); *Farrand Coal Co. v. Halpin*, 10 Ill.2d 507, 512 (1957) (while recognizing electricity as personal property, Illinois Supreme Court "has at no time held electricity to be 'tangible' personal property"); *People v. Menagas*, 367 Ill. 330, 338 (1937) ("While [electricity] is intangible, it is no less personal property and is within the larceny statute"); *Elgin Airport Inn v. Commonwealth Edison Co.*, 88 Ill. App. 3d 477, 480 (noting that strict liability issue arises "[b]ecause electricity is intangible"); *Miller v. City of Los Angeles*, 185 Cal. 440, 443 (1921) ("Electricity is rather an intangible asset and the word 'property' is perhaps not the most apt word by which to describe the supply of electrical energy thus sought to be acquired for the use of the city").

The recognition by Massachusetts and other state courts that electricity is intangible is consistent with common definitions and understanding of the phrase "tangible personal property." For example, Black's Law Dictionary (8th Ed. 2004) ("Black's") defines "tangible personal property" as

Corporeal personal property of any kind; personal property that can be seen, weighed, measured, felt, or touched or is any other way perceptible

to the senses, such as furniture,
cooking utensils, and books.

See also *Houghton Mifflin*, 423 Mass. at 48-9 and *First Data Corporation* 371 Mass. at 446 (equating "corporeal" with "tangible"). In turn, Black's defines "corporeal" to be "[a] term descriptive of such things as have an objective, material existence; perceptible by the senses of sight and touch; possessing a real body." It cannot be reasonably argued that electricity has anything resembling a "body" or that electricity itself is perceptible to the senses of sight and touch, as one might see or touch a piece of furniture, a cooking utensil, or a book.

For example, wind, sunlight, sound, heat, and pain are all perceptible to the senses, but cannot be touched. The effects of electricity can be seen, as in a lightning strike, and felt, as in a shock, but electricity itself cannot be seen or touched because, like wind, sunlight, sound, heat, and pain, it has no physical form or body. See Black's (using "light and electricity" as examples of "movable intangible property," defined as "a physical thing that can be moved but that cannot be touched in the usual sense."); *Omaha Pub. Power Dist.*, 248 Neb. at 531 (Caporale, J. concurring) (electricity "has no such physical substance in the sense those two words are commonly

understood . . . it has no readily discernible physical form in the sense that do items such as axes, books, cloth, desks, elevators, fiddles, gavels, and the like").

Accordingly, electricity is not "tangible" as that word is commonly used and understood and therefore is not "tangible personal property" for purposes of § 38(f).

**B. THE ONE CASE THAT HAS ADDRESSED THIS ISSUE IN THE
CONTEXT OF A STATE APPORTIONMENT FORMULA HELD
THAT ELECTRICITY IS NOT TANGIBLE PROPERTY**

The California State Board of Equalization ("SBE"), in construing statutory provisions substantially identical to § 38(f),⁷ held that sales of electricity constitute the performance of services, not sales of tangible personal property, and that the treatment of such sales for sales

⁷ Regarding sales of tangible personal property, § 25135 of the California Revenue & Tax Code provides that:

Sales of tangible personal property are in this state if:

- (a) The property is delivered or shipped to a purchaser, other than the United States government, within this state regardless of the f.o.b. point or other conditions of the sale.
- (b) The property is shipped from an office, store, warehouse, factory, or other place of storage in this state and (1) the purchaser is the United States government or (2) the taxpayer is not taxable in the state of the purchaser.

For sales of property other than tangible personal property, § 25136 of the California Revenue & Tax Code provides that:

Sales, other than sales of tangible personal property are in this state if:

- (a) The income-producing activity is performed in this state; or
- (b) The income-producing activity is performed both in and outside this state and a greater proportion of the income-producing activity is performed in this state than in any other state, based on costs of performance.

factor purposes is properly determined under the cost-of-performance rule. *In Re Appeal of PacifiCorp*, 2002-SBE-005 (Cal. S.B.E. Sept. 12, 2002) ("*PacifiCorp*").

The taxpayer in *PacifiCorp*, like the Partnerships in these appeals, owned and operated a power plant in a neighboring state. As here, the taxpayer sold electricity under contracts providing for delivery at a substation located in the same state as the generating plant. In rejecting an argument that the taxpayer's sales of electricity should be treated as sales of tangible personal property and that its sales should be taxed on a "destination basis," so that sales to customers located in California would be treated as California sales for apportionment purposes, the SBE held:

Like the court in *Otte [v. Dayton Power & Co.]*, 37 Ohio St. 3d 33 (1988)], we conclude that the sales of electricity here are sales of services that essentially consisted of appellant's setting and keeping in motion, through its generation and transmission facilities, electrically charged particles. Also as in *Otte*, we further conclude that the basic reason the generation and transmission process employed by appellant is appropriately characterized as a service is that the process does not result in either (1) the "creation" in its generation facilities of any such arguably tangible particles or (2) the "injection" of those particles into its transmission facilities.

PacifiCorp, supra.

The *PacifiCorp* analysis and holding are persuasive authority on the issue raised in these appeals. Because electricity lacks physical form and a precise geographic location, concepts such as title, possession, and delivery, which are the lynchpins of apportionment for sales of tangible personal property, are ill-suited to the context of electricity sales. Even the Commissioner, in the context of a sale of electricity for sales tax purposes, recognizes that "as a matter of physics, electricity is not transported in a manner similar to other tangible personal property." See Technical Information Release 98-16. It is only through abstractions, approximations, and assumptions that the Commissioner's auditors could fit the sale of electricity into the tangible personal property model under § 38(f). Given the nature of electricity and the accounting function by which it is considered to be bought and sold, the use of the tangible personal property model does not effectuate the statutory purpose of the § 38(c) apportionment formula of approximating that part of corporate income which is related to Massachusetts activities. See *Boston Professional Hockey Association*, 443 Mass. at 280.

Rather, the standard under § 38(f) that applies to all sales other than sales of tangible personal property is best suited to attributing income from sales of electricity to the state in which appellant performed its income-producing activities. That standard attributes a taxpayer's gross receipts from income-producing activity to the state in which the taxpayer incurs the greatest proportion of the costs of performing that activity. In the present case, the Partnerships incurred all of their costs of performance in Rhode Island. Accordingly, all of their receipts from the sale of electricity are properly attributable to Rhode Island and none to Massachusetts.

C. THE LEGISLATIVE HISTORY OF THE SALES TAX EXEMPTION FOR ELECTRICITY AND CASES IN OTHER CONTEXTS DO NOT ESTABLISH THAT ELECTRICITY IS TANGIBLE PERSONAL PROPERTY

The Commissioner cites legislative and judicial treatment of electricity in contexts other than the corporate excise to support his argument that electricity should be considered tangible personal property for purposes of the sales factor. As described below, these authorities are neither persuasive nor determinative.

1. SALES TAX TREATMENT OF ELECTRICITY

G.L. c. 64H, § 1 provides that "for purposes of this chapter," the phrase "'tangible personal property' shall also include gas, electricity and steam." The Commissioner initially asserted, in his A&R determination letter and abatement denials, that this sales tax definition supported his treatment of electricity as tangible property for purposes of the corporate excise apportionment factor. However, the sales tax definition is of little aid in analyzing the corporate excise apportionment statute at issue here.

First, § 1 explicitly provides that the definition applies "for purposes of this chapter," that is, the sales tax under Chapter 64H. Limited just to the sales tax context, the provision represents nothing more than a legislative determination that retail sales of electricity should be subject to the sales tax.

Further, § 1 also provides that the definition of tangible personal property for sales tax purposes "also" includes electricity. The clear implication of the use of the word "also" is that what follows is not simply a clarification of the general definition, but rather an addition to that definition. The need for such an addition suggests that the Legislature understood that electricity

would not fall within the general definition of tangible personal property.

In his post-trial brief, the Commissioner refined his argument by suggesting that an exemption from sales tax for sales of electricity that was enacted as part of the original sales tax statute in 1966 evidenced a Legislative recognition that electricity would otherwise be considered tangible personal property. The Commissioner essentially argued that the Legislature, by initially providing that electricity should not be treated as tangible personal property under the 1966 version of G.L. c. 64H, § 6(i), revealed that it considered electricity to be tangible personal property.

The fundamental flaw in the Commissioner's initial argument is also present here. The Legislature's 1966 sales tax exemption for electricity under § 6(i), like the current definition of tangible personal property under § 1, is applicable for sales tax purposes. Accordingly, the 1966 exemption, like the current sales tax definition, represents a legislative determination of how sales of electricity should be treated under the sales tax, and sheds no light on whether the Legislature considered electricity to be "tangible personal property" for any other purpose.

Moreover, the Legislature's 1990 amendments to Chapter 64H that eliminated the exemption for sales of electricity belie the notion that the Legislature understood that the meaning of tangible personal property included electricity. If, as the Commissioner argued, electricity was so clearly understood to be tangible personal property, the Legislature could simply have repealed or limited § 6(i), leaving electricity to be taxed as other tangible personal property. Initially, the Legislature did just that, in emergency legislation that was enacted on July 18, 1990. See St. 1990, c. 121, § 47.

The July 18, 1990 amendment to § 6(i) was to take effect on September 1, 1990. St. 1990, c. 121, § 110. However, prior to that effective date, on August 1, 1990, and only weeks after the amendment to § 6(i) was enacted, the Legislature made a further change. Despite the already broad definition of tangible personal property, which included personal property of "any nature" including any "commodities whatsoever," the Legislature amended the definition to specifically include electricity. See St. 1990, c. 150, § 359. The specific inclusion of electricity would be superfluous if, as the Commissioner maintained, the Legislature understood the general meaning of tangible personal property to include electricity. See, e.g. *State*

Tax Commission v. LaTouraine Coffee Co., Inc., 361 Mass. 773, 778 (1972) (recognizing that "[n]one of the words of . . . [the] statute is to be regarded as superfluous" in determining legislative intent).

For the foregoing reasons, the Commissioner's reliance on sales tax definitions is not persuasive on the issue of whether electricity is tangible property for purposes of the corporate excise.

2. PROPERTY TAX TREATMENT OF ELECTRICITY GENERATION

The Commissioner also argued that the generation of electricity has historically been treated as a "manufacturing" operation for purposes of the local property tax exemption under G.L. c. 59, § 5, cl. Sixteenth (3) and the investment tax credit for manufacturing corporations under G.L. c. 63, § 31A. See, e.g., *Assessors of Holyoke v. State Tax Comm'n*, 355 Mass. 223, 227 (1969); *Boston Gas Co. v. Assessors of Boston*, 334 Mass. 549, 565 (1956); *Boston & Maine R.R. v. Billerica*, 262 Mass. 439, 447-49 (1928). The Commissioner therefore asserts that the fact that electricity is manufactured indicates that it is tangible personal property.

That electricity is considered to be manufactured for purposes of a local property exemption and qualification for investment tax credits does not answer the question of

whether it is tangible personal property. The issue addressed in these cases is whether "manufacturing" was taking place. "Manufacturing" has been defined as "the process of transforming raw or finished materials by hand or machinery, and through human skill and knowledge, into something possessing a new nature and name and adapted to a new use." *Commissioner of Corps. & Tax'n v. Assessors of Boston*, 321 Mass. 90, 94 (1947). There is nothing in the definition which supports the notion that only tangible products result from manufacturing.

In fact, as discussed above, Massachusetts courts have recognized that the generation of electricity is an example of a manufacturing process that results in the production of an intangible product. See *Westinghouse*, 382 Mass. at 358 (holding that Board's ruling that manufacturing status cannot be denied because end product is intangible "conformed to [court's] view that the production of electricity may entail manufacturing"); *Houghton Mifflin*, 423 Mass. at 48-9, and *First Data Corporation*, 371 Mass. at 446 (recognizing that cases that consider the production of electricity to involve manufacture counter the argument that the definition of manufacturing "contemplates corporeal or tangible input or output").

Accordingly, Massachusetts manufacturing cases not only fail to advance the Commissioner's position but in fact support the Board's ruling that electricity is commonly understood to be intangible.

3. CASES HOLDING THAT ELECTRICITY IS A "COMMODITY" OR A "PRODUCT" ARE INAPPOSITE

The Commissioner cites a handful of cases in non-tax contexts to support his proposition that the general meaning of "tangible personal property" includes electricity. These cases fail to establish such a proposition and instead serve to underscore the unique nature of electricity as something quite different from tangible property.

G.E. Lothrop Theatres Co. v. Edison Elec. Illuminating Co. of Boston, 290 Mass. 189 (1935) ("*Lothrop Theatres*"), involved a dispute between an electric company and a building owner over the recovery of certain electric charges billed to both the owner and its tenants. The court noted that there "may be" cases where electricity would be considered "a commodity subject to sale and delivery rather than a service furnished by the generating company." *Lothrop Theatres*, 290 Mass. at 193. At a minimum, this observation indicates that the determination of whether electricity is a commodity or a services depends

on the context in which the question is asked; it also can be read to suggest that the court's general understanding of electricity is that it is a service.

The court also said that when electricity is sold, it "may be conceded" that there is "something corresponding to delivery in the sale of a tangible chattel." *Id.* The need for analogy contradicts the Commissioner's claim that electricity is itself tangible personal property. There is nothing in *Lothrop Theatres* that supports the notion that electricity is so commonly understood to be tangible that it must be so characterized generally or for corporate excise purposes.

In *Town of Concord, Mass. v. Boston Edison Co.*, 676 F.Supp. 396 (D.Mass. 1988) ("*Town of Concord*"), the court addressed whether electricity was a "commodity" for purposes of the price restrictions under the Robinson-Patman Act, 15 U.S.C.A. § 13(a). A "commodity" is not necessarily tangible personal property; in fact, it is considerably broader in scope. See *Opinion of the Justices*, 408 Mass. 1201, 1206-11 (1990) (concluding that inclusion of the term "commodities" in Article 4 of the Massachusetts Constitution authorizes taxation of services). In fact, the court in *Town of Concord* pointed out that "electricity is not an obviously tangible" item or

product and acknowledged that "the average consumer of electricity" might well believe that "she is paying for a service rather than purchasing a product." *Id.* at 398.

The court's decision is based on considerations specifically relating to price restrictions under the Robinson-Patman Act, particularly whether electricity, like other items subject to those restrictions, "is a thing bought and sold in the marketplace." *Id.* The fact that the court determined that, except for not being "an obviously tangible item," "electricity is not significantly different from other items deemed commodities subject to the price discrimination prohibitions of antitrust laws" (*Id.*) does not mean that electricity should be treated as tangible personal property for purposes of the corporate excise apportionment formula.

The Commissioner's citation of a case holding that electricity is a "product" within the meaning of the strict liability rule in Restatement (Second), Torts, § 402A (1965) is also not helpful. The Wisconsin court in *Ransome v. Wisconsin Elec. Power Co.*, 87 Wis.2d 605 (1979), while never using the term "tangible personal property," relied on public policy grounds to support its decision in favor of the consumer-plaintiff. The public policy grounds

supporting a ruling of strict liability have no relevance to the issue in the present appeals.

The remaining cases cited by the Commissioner, holding that electricity can be measured, add nothing to the analysis. The fact that electricity can be measured is not contested and does not answer the question of whether it is tangible personal property. If there is anything significant about the subject of measurability, it is that electricity is measured in a manner - the passage or use of current over time - that does not remotely resemble the measurements - height, weight, volume, number of items, etc. - that apply to items of tangible personal property.

II. EVEN IF ELECTRICITY IS PROPERLY CONSIDERED TANGIBLE PERSONAL PROPERTY FOR PURPOSES OF § 38(f), THE PARTNERSHIPS' SALES TOOK PLACE IN RHODE ISLAND, NOT MASSACHUSETTS

The tangible property rule under § 38(f) attributes sales to the state in which the taxpayer completes its delivery to the purchaser. Under the Unit Power Agreements with the Purchasers, the Partnerships effected delivery of the electricity they generated and sold at a specific interconnection point with the NEPOOL grid, the EHV/PTF substation in Rhode Island. At that point, the Purchasers took responsibility for further transmitting the electricity, including the cost of using all NEPOOL

transmission facilities and the line losses from dissipation of power during transmission beyond the Rhode Island substation. Accordingly, the Partnerships completed their delivery obligations, and the Purchasers took possession of the electricity, in Rhode Island.

The Commissioner argues that NEPOOL acted as a "common carrier" that "picked up electricity" from the Partnerships in Rhode Island and delivered it to customers in Massachusetts. If a seller hires a "common carrier" to ship goods to a buyer, the sale occurs at the buyer's location, where the property is delivered to the buyer. See 830 C.M.R. 63.38.1(9)(c)1. However, if a buyer "uses its own truck and driver or hires its own carrier to pick up" the property, the sale occurs at the seller's location, when the buyer or the carrier it hires picks up the property. *Id.*

Apart from the awkwardness of fitting the sale of electricity into a model that uses concepts such as "pick up," "truck," "driver," and "carrier," the common carrier analogy fails on a number of fronts. First, the Purchasers, not the Partnerships, were members of NEPOOL that had both the right to use other NEPOOL members' transmission facilities and the contractual responsibility to transmit the electricity beyond the Rhode Island

substation. To the extent that the NEPOOL grid could be considered a "truck" or "carrier," it was a carrier hired by the Purchasers that delivered the electricity.

Further, neither NEPOOL nor the NEPOOL transmission grid fit the definition of a "common carrier" which, according to Black's, is one who is:

required by law to convey passengers or freight without refusal if the approved fee or charge is paid . . . One who holds himself out to the public as engaged in business of transportation of persons or property from place to place for compensation.

See also *National Private Truck Council, Inc. v. Commissioner of Revenue*, 426 Mass. 324, 325, n. 1 (1997) ("common carrier" is a "for-hire" transporter of goods). There is nothing in the record to suggest that NEPOOL is required by law to make its facilities available to the general public or any non-member, such as the Partnerships, that is willing to pay the cost of transmission. Only members, such as the Purchasers, that have accepted the terms of the NEPOOL Agreement may use the transmission grid. Accordingly, to the extent that NEPOOL can be viewed as a "carrier" that "shipped" the electricity, it was the Purchasers, as members of NEPOOL that were also contractually responsible for transmitting the electricity

beyond the Rhode Island substation, that "hired" the carrier.

Further, the Partnerships cannot be considered as having a responsibility to deliver the electricity to retail customers because, unlike a seller that arranges for the shipment of goods to a purchaser, the Partnerships have no idea of the identity or location of the ultimate purchaser. The ultimate destination of the electricity generated by the Partnerships is the location of the Purchasers' customers, if not the customers of the Purchaser's customers. The identity and location of the Purchasers' wholesale and retail customers is not reasonably ascertainable by the Partnerships. Accordingly, the Partnerships cannot be viewed as having "delivered" the electricity to these entities.

Accordingly, even if, contrary to the Board's finding and ruling, electricity is properly considered "tangible personal property" for purposes of § 38(f), the Partnerships' sales of electricity would still be attributable to Rhode Island, where their delivery obligation to the Purchasers was satisfied.

III. CONCLUSION

On the basis of the foregoing, the Board ruled that electricity is not "tangible personal property" for

purposes of the sales factor of the corporate excise apportionment formula under § 38(f). Accordingly, the Partnerships' sales of electricity are attributed to the state in which the Partnerships incur the greatest proportion of their cost of performing their income-producing activity. Because, on the basis of the record, the Partnerships incurred all of their costs of performance in Rhode Island, their receipts from electricity sales are properly treated as Rhode Island, not Massachusetts, sales. Accordingly, no receipts are includible in the numerator of appellants' Massachusetts sales factors and, therefore, appellants' sales factors are zero. The Board, therefore, issued a decision for appellants in these appeals.

THE APPELLATE TAX BOARD

By:

Frank J. Scharaffa, Commissioner

Donald E. Gorton, III, Commissioner

Nancy T. Egan, Commissioner

James D. Rose, Commissioner

A true copy,

Attest: _____
Assistant Clerk of the Board

DD

EXHIBIT DD

Westlaw

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P

ABNER MILLER, Respondent,

v.

THE CITY OF LOS ANGELES (a Municipal Corporation), et al., Respondents; MARY RIDEOUT, Intervener and Respondent; MARY H. MORGAN, Intervener and Appellant.

Supreme Court of California.
 L. A. No. 6517.
 April 1, 1921.

[1] MUNICIPAL CORPORATIONS — AUTHORITY TO PURCHASE ELECTRICITY FOR RE-SALE — VALIDITY OF CONTRACT — LOS ANGELES CHARTER.

The city of Los Angeles has authority under subdivision 7, section 2, of article I of its charter to enter into a contract with a private corporation by which the city agrees to purchase from the corporation for a period of years all electric energy necessary for distribution to its consumers on the municipal system in excess of that produced by the power-generating plants owned and operated by the city.

[2] ID.—AUTHORITY TO SELL ELECTRICITY—VALIDITY OF CONTRACT— LOS ANGELES CHARTER.

The city of Los Angeles has authority under subdivision 7, section 2, article I of its charter to enter into a contract with a private corporation giving the latter the right for a period of years to purchase from the city all surplus electric power produced at the city's generating plants and not necessary for distribution to the consumers through the city's distributing system or for sale to the city of Pasadena for distribution and use within that city.

[3] ID.—AUTHORITY TO PURCHASE DISTRIBUTING SYSTEM—VALIDITY OF CONTRACT—LOS ANGELES CHARTER.

The city of Los Angeles has authority under paragraphs (d) of subdivision 7 of section 2 of its

charter to enter into a contract for the purchase of the electric distributing system of a private corporation within the corporate limits of the city on a cash basis for a fixed price without submitting it for approval by a majority of the qualified electors of the city.

APPEAL from a judgment of the Superior Court of Los Angeles County. Leslie R. Hewitt, Judge. Affirmed.

The facts are stated in the opinion of the court.

*441 Overton, Lyman & Plumb and Wm. B. Himrod for Intervener and Appellant.

Charles S. Burnell, City Attorney, W. B. Mathews, Ray C. Eberhard and Lewis E. Whitehead for Respondents, City of Los Angeles et al.

SLOANE, J.

This is an appeal from a judgment for defendants in a taxpayers' action against the city of Los Angeles to enjoin the carrying out of a contract of date May 26, 1919, between the Southern California Edison Company, a corporation, on the one part, and the city of Los Angeles, on the other.

The contract is one whereby, first, the California Edison Company agrees to sell to the city of Los Angeles and the city agrees to buy the entire electric distributing system of the company within the corporate limits of the city at a *442 price of eleven million dollars. Secondly, the contract contains a further provision that the city shall purchase from the company during a period of thirty years all electric energy necessary for distribution to its consumers on the municipal system in excess of that produced by the power-generating plants owned and operated by the city, and thirdly, the contract contains a provision that the company shall have the right for a period of fifteen years to purchase from the city all surplus electric power produced at the city's generating plants and not necessary for

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distribution to the consumers on the city's distributing system or for sale to the city of Pasadena for distribution and use within that city.

Other phases of this contract were originally involved in the action, but the three propositions above referred to are all that remain in controversy on this appeal.

The moving parties to the action in the lower court were the plaintiff and two interveners, appearing separately as individual citizens and taxpayers, in opposition to the contract. Judgment was for the defendant as against plaintiff and both interveners. Only the intervener Mary H. Morgan has appealed, and her attack is upon the general provisions of the contract above stated and presents the following three grounds of opposition:

First, that the city has no power to purchase electricity in bulk and resell and distribute the same to its inhabitants; second, that the city has no power to sell electricity to the Southern California Edison Company for resale and distribution by that company to consumers outside of the city of Los Angeles; third, the contract of purchase has never been approved by a majority of voters of the city of Los Angeles.

The provision of the contract against which the first objection is directed is contained in subdivision 7 thereof, as follows:

Seventh: The company shall sell, furnish and deliver to the city, and the city shall purchase and take from the company, ... electric energy as follows, to wit:

(a) All electric energy which the city shall require each year for and during the period of ten years from and after the date of the transfer and delivery to the city of said properties of the company ... in order to supply consumers served by the city for use within the limits of the city, as *443 aforesaid, in excess of the amount which the city shall generate at hydro-electric plants now or hereafter

owned or controlled by it; ...

"(b) All electric energy which the city shall require each year for and during a period of twenty years immediately succeeding the aforesaid ten year period, in order to supply consumers served by it for use within the limits of the city, as aforesaid, in excess of the amount which the city shall generate at electric plants of any kind now or hereafter owned or controlled by it; ..."

Appellant claims that while the city of Los Angeles, under certain provisions of its charter, has authority to acquire by purchase or otherwise the necessary plants, machinery, and equipment for manufacturing and distributing electric light and energy for the use of the municipality and its inhabitants, it is without power to purchase the manufactured article in quantity for such use and distribution.

(1) It is contended by respondent that authority exists for such purchase of electric energy in bulk under subdivision 7, section 2, of article I of the Los Angeles city charter.

That section provides that the city shall have the right and power "to acquire by purchase, condemnation, lease, gift or otherwise, or to construct, extend, maintain and operate, within or without the city limits, any and all plants and property necessary or convenient for furnishing the city and its inhabitants ... with ... light, heat, power, or any other public service."

Stripping this section of the charter of all expressions nonessential to the point in controversy, respondent would have it read thus: The city shall have the right and power "to acquire by purchase ... or otherwise ... any and all property necessary or convenient to furnish the city and its inhabitants ... with ... light, heat, power." In a broad analysis of the term it can hardly be disputed that electrical energy as manufactured and supplied for public and private use is property. Electricity is rather an intangible asset, and the word "property" is perhaps

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not the most apt word by which to describe the supply of electrical energy thus sought to be acquired for the use of the city. However, if it was a water supply to be delivered from without to the mains of the city's distributing system it *444 might appropriately be so described, and an electric current to be delivered at the main conduit of the city's electrical distributing system is not essentially different.

Conceding the limitations of the powers of a municipality to such as are expressly granted or necessarily implied from powers expressly given, and that language purporting to define the powers of a municipality is to be strictly construed (*Oro Elec. Corp. v. Railroad Com.*, 169 Cal. 466, [147 Pac. 118]; *Hyatt v. Williams*, 148 Cal. 585, [84 Pac. 41]; *Wichmann v. City of Placerville*, 147 Cal. 162, [81 Pac. 537]; 1 Dillon on Municipal Corporations, 5th ed., par. 237), we have here an express authority granted under the city charter to acquire and distribute such property as is necessary or convenient for supplying the city and its inhabitants with light, heat, power, or any other public service, and this general purpose being express and definite, the means for carrying it into effect is within the reasonable discretion of the city authorities.

Counsel for appellant contend that this authority is not general but special and limited; that it is confined by the use of the terms "plants and property" to an equipment for manufacturing its own supply of electrical energy, and they call attention to the more general provision as it existed under an earlier expression of this same section of the charter where the city was in terms given power "to provide for supplying the city and its inhabitants with water, gas, and electricity, or any thereof." Under the amendment of 1913 this general clause was eliminated and the section re-enacted as hereinbefore quoted, thereby, as appellant claims, restricting the general power of the city. There are other sections of the charter, however, that seem to supply this general authority or at least to justify the broader interpretation of subdivision 7 of section 2 of article I, claimed by the respondent. Subdivision

(g) of section 192, article XVIII, after authorizing the board of public service commissioners to construct, operate, maintain, and extend electric plants, systems, and equipments, declares that said board shall have power "to acquire and take by purchase, lease, condemnation, or otherwise, and in its own name to hold as special trustee for the city any and all property situated within or without the limits of the city that may be necessary or convenient for such construction, operation, maintenance*445 or extension." Subdivision (50) of section 2 of the charter contains this general rider, apparently intended to cover all contingencies in the way of acquiring and operating municipal utilities:

"The city of Los Angeles shall have and it is hereby given and it hereby reserves unto itself, and the people of the city hereby reserve unto it, and the people of the state of California hereby grant unto it, and said city may hereafter exercise each and every of the powers which a municipal corporation might or could exercise under the Constitution of the state of California; and said city may hereafter acquire, own, hold, sell, deal in, manage, operate or control any office, department, business, enterprise, utility, or property which might or could be acquired, owned, held, sold, dealt in, managed, operated or controlled by any person, firm or corporation whatsoever; provided, that under the authorization of this subdivision the city of Los Angeles shall not engage in any purely commercial or industrial enterprise not now engaged in by the city, except on the approval of a majority of the electors voting thereon at an election. By the insertion in this Charter of the sentence next preceding the present sentence, the city of Los Angeles and the people thereof intend, and the people of the state of California, acting by and through the Legislature thereof in ratifying this Charter, intend that the said sentence shall be, and is hereby declared to be, an express grant of the powers referred to therein, without a more specific enumeration or designation."

The power here sought to be exercised is to

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purchase from sources without the city such amount of electrical energy to be supplied for distribution through its own distributing system as may be required to supplement the product of the city's own generating plants. We are of the opinion that such a contract as is here involved constitutes under the terms of the charter a purchase of property necessary or convenient for furnishing the city and its inhabitants with an authorized public service.

The convenience and economy of public service which is thus secured by a contract providing against any deficiency in the supply of electricity for public use would seem to be further served by an arrangement for the sale to a public service corporation outside the city of any surplus electrical *446 energy the city may from time to time have on hand after supplying all its municipal demands and private or municipal customers.

Such is the purpose of the provision of the contract between the city of Los Angeles and the Southern California Edison Company, against which appellant's second objection is directed.

(2) It is declared by section 9 of the contract that if at any time within fifteen years after the contract goes into effect the city shall generate a surplus of electric energy in excess of the amount required to supply the city of Los Angeles and its consumers in such city and in the city of Pasadena, it may sell, during such period, such surplus to the Southern California Edison Company on terms to be fixed by the proper authorities.

It is further provided by the contract that the agreement shall not become effective until the same is approved by the Railroad Commission of California and until the provisions for sale of such surplus shall have been assented to by two-thirds of the qualified voters of said city voting on the proposition at a general or special election.

The contention of appellant is that the city of Los Angeles under its charter has no authority to dispose of its surplus electrical power for resale or

distribution excepting to other municipal corporations.

Subdivision 7 of section 2, article I, of the charter, however, provides generally that the city shall have power "to sell the products or service" of any utilities described in that subdivision. Subdivision 17 of section 2 grants power "to sell gas, electric current and all products of any public utility operated by the city." Subdivision (50) of section 2, hereinbefore quoted, declares that said "city may hereafter acquire, hold, sell ... any business enterprise, utility or property," and further sets forth that such provision "is an express grant of the powers referred to therein without a more specific enumeration or designation."

In the light of this general grant of power to sell we are of the opinion that the other charter provisions relied upon by appellant as a negation of such power are only a limitation to the extent that they impose certain conditions upon certain sales.

*447 Subdivision (41) of section 2 declares that "no electric power now or hereafter owned or controlled by the city shall ever be sold, transferred, leased or disposed of to any person or corporation for resale, rental, disposal or distribution to consumers or other persons without the assent of two-thirds of the qualified voters of said city."

It is then provided by this section of the charter that the provision just quoted shall not apply to the ordinary sale of electric power to consumers in or out of the city for their own use, "or to other municipal corporations for municipal use or for resale and disposal by such municipal corporations to consumers within such municipality."

The reference, in the first sentence quoted, to disposal of electric power to "corporations for resale, rental, disposal or distribution to consumers" cannot be construed to refer to municipal corporations, but is obviously a limitation of a general power to sell to private corporations, by requiring such sale to be first approved by a two-thirds vote

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of the people. Read in connection with the general power to sell utilities, products, or service, heretofore cited, we think this provision of subdivision (4) establishes authority under the charter to make the sale here contracted for, it appearing by the record that such proposition was submitted at an election held for that purpose and approved by two-thirds of the voters.

The validity of this election was upheld in a contest in the superior court of Los Angeles County, which judgment is now affirmed by the decision of this court (*Rideout v. City of Los Angeles*, ante, p. 426, [197 Pac. 74]).

(3) The third contention of appellant is that the contract for the purchase of the distributing system of the Edison Company within the city of Los Angeles is void because it has never been submitted to or approved by a majority of the qualified electors of the city.

Respondents deny that such a submission and approval is required by the charter. The decision on this point depends entirely upon the construction of paragraph (d) of subdivision (7) of section 2 of the charter. By this provision the city is empowered, "To enter into a contract with the owner of any public utility held or operated under franchise rights acquired prior to the adoption of this charter by the terms of which contract the city may ... agree to purchase all or *448 any part of the property of such utility upon paying therefor a price to be paid in accordance with the terms of the contract."

Thus far this power of contract stands unrestricted. Immediately following the sentence just quoted, however, it is further declared: "Such contract may provide that the city may acquire the utility subject to all or any portion of the outstanding indebtedness against the same, within the limitations above prescribed, but no such contract shall be valid until it is approved by a majority of the qualified electors of the city voting thereon at an election." The question in dispute is as to whether

this requirement, for submission to a vote of the electors, applies alone to "such contract" providing that the city shall purchase the utility "subject to its outstanding indebtedness," or whether it also governs the general power contained in the first sentence of paragraph (d) to contract and purchase at a fixed price.

Considering the fact that the requirement for an election is part of the same sentence with the authorization to enter into a contract of purchase subject to outstanding indebtedness, the logical and grammatical interpretation would be to apply the election requirement solely to this form of purchase. This construction is also supported by the fact that further modifying provisions of paragraph (d), which obviously relate to either form of contract, are set out in separate sentences, and contain words of inclusion showing their general application. These remaining provisions of paragraph (d) are as follows: "The financial obligation assumed by the city under any such contract shall not be subject to the debt limitation [of the city] until the purchase is actually consummated and then may be exempted by ordinance approved by a majority of the electors voting at an election, from such limitation, if the state railroad commission shall determine that the utility is self-sustaining." "The provisions of the contract in this paragraph (d) mentioned need not include any, and the sale contract shall not be subject, as to the price to be paid thereunder, to any limitation prescribed in section 2 of this charter of which section this paragraph (d) is a part." "Nothing in any such contract contained shall operate to extend the term of any franchise of any utility therein mentioned."

*449 The reason for subjecting a contract which assumes an outstanding indebtedness to the approval of the voters is the fact that it might otherwise come in conflict with the provisions of section 6, article XI, of the constitution forbidding without such approval the incurring of an indebtedness exceeding the yearly income of the municipality.

In the second sentence of this paragraph above

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quoted the words "within the limitations above prescribed" refer back to a preceding paragraph, (a), which limits the indebtedness of a utility that the city may take over to an amount not exceeding the purchase price to be paid by the city, and the subsequent reference to exemption from limitation of indebtedness by approval of the voters upon determination of the Railroad Commission relates back to paragraph (c) of the section which provides for such action whenever the public utility purchased shall be determined by the Railroad Commission to be self-sustaining and the exemption is approved by a majority vote of the electors.

The whole paragraph is sufficiently ambiguous and confusing, but it does not appeal to us as a reasonable construction that these words requiring ratification by an election should have been coupled with and limited to a separate sentence with an entirely separate and distinct form of contract of purchase, if it was intended thereby to govern the entire subject matter of the subdivision.

Another circumstance is that the city of Los Angeles, under the powers enumerated in section 2 of the charter, is authorized to purchase lands, rights, and properties, to purchase, lease, condemn, or otherwise construct, own, maintain, and equip telephone systems, telegraph systems, street railways, steamboats, and other means of conveyance, improve, maintain, and control its waterfronts and harbors, build wharves, acquire and operate warehouses, bunkers, wharves, and dry-docks, and engage in numerous other enterprises which would involve great expenditures, without submitting the question of such expenditure to a vote of the electors.

There is no reason in the nature of the transaction covered by this subsection of the charter why the requirement for approval by the electors which, under the ordinary grammatical construction of the language used, would seem to be limited to such contracts as involve an assumption of outstanding indebtedness of the utility purchased, should be *450 by implication to an ordinary purchase of a

public utility on a cash basis and within the means of the city, more than to the numerous other contracts and purchases authorized without such restrictions.

The judgment is affirmed.

Lennon, J., Shaw, J., Olney, J., Wilbur, J., Lawlor, J., and Angellotti, C. J., concurred.

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P

Supreme Court of Louisiana,
 STATE
 v.
 NEW ORLEANS RY. & LIGHT CO.

No. 15,953.
 Feb. 12, 1906.

Appeal from Civil District Court, Parish of Orleans; John St. Paul, Judge.

Rule by the tax collector against the New Orleans Railway & Light Company to show cause why it should not pay a license. Rule made absolute, and from judgment in favor of the state, defendant appeals. Affirmed.

West Headnotes

Taxation 371 2300**371 Taxation****371III Property Taxes****371III(F) Exemptions****371III(F)1 In General****371k2298 Construction and Operation of Exemptions in General****371k2300 k. General Rules of Construction. Most Cited Cases (Formerly 371k204(2))**

A statute which exempts persons or property from taxation is to be strictly construed.

Licenses 238 19(4)**238 Licenses****238I For Occupations and Privileges****238k19 Exemptions****238k19(4) k. Manufacturers. Most Cited Cases**

An electric light company is not a manufacturer in the sense of exemption clause of Const. art. 229, authorizing the Legislature to impose license taxes.

Licenses 238 5**238 Licenses****238I For Occupations and Privileges****238k2 Power to License or Tax****238k5 k. States. Most Cited Cases****(Formerly 92k20)**

Where, under the identical provisions in two state Constitutions exempting manufacturers from license taxation, the Legislature has for more than 20 years imposed license taxes on the business of gas, electric, waterworks, telegraph, and telephone companies, the construction is entitled to great weight.

Syllabus by the Court

An electric light company is not a 'manufacturer' in the sense of the exemption clause of article 229 of the Constitution of 1898 authorizing the Legislature to impose license taxes.

Where, under identical provisions in two state Constitutions exempting 'manufacturers' from license taxation, the Legislature has for more than 20 years imposed license taxes on the business of gas, electric, waterworks, telegraph, and telephone companies, such a construction is entitled to great weight.

Exemptions from taxation are strictly construed, and doubt is fatal in such cases.
 Denr

Edward Rightor, for appellee state tax collector.

LAND, J.

Defendant company was ruled by the tax collector to show cause why it should not be condemned to pay a license tax of \$1,875, with 2 per cent. per month interest from March 1, 1905, and 10 per cent. attorney's fees, for conducting the business of electric light in the city of New Orleans.

Defendant pleaded for answer that it is exempt

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from the payment of any license tax as being a 'manufacturer' under article 229 of the state Constitution of 1898.

The rule was tried on an agreed statement of facts, and was made absolute as prayed for. Defendant has appealed from the judgment in favor of the state.

It is admitted that, if defendant company is liable at all for the payment of a license tax, the amount sued for is correct.

It is further admitted that defendant employed directly in its electric light plants 90 men, exclusive of solicitors, inspectors, metermen, linemen, bill collectors, office force, storekeepers, etc., and consumes upward*146 of 33,000 tons of coal annually in operating its said plant.

Most of the statement of facts consists of a description by a prominent expert in electricity and electric science of the manner in which the electric light business is conducted. This expert tells us that the burning of coal in a furnace under a boiler produces steam, which through the medium of the engine and other machinery produces the 'motion power,' used to rotate the armature in a certain relation with the magnetic field; that this rotation of the armature produces currents in the wires which compose the armature; and that these currents are carried along wires to lamps, and there, acting on and through carbon rods, finally produce the well-known electric light.

This expert further says:

'The electricity which furnishes the lights does not exist until the armature revolves. The revolution of the armature brings into being something that did not exist before; that is, this electric energy, or energy in this electric form.'

This expert explains in detail the modus by which the light 'in the arc' is produced, and says that the operation of a dynamo machine is analogous to that of a pump forcing water through a series

of pipes. The expert, in concluding his statement, says that 'the energy which becomes light has its origin in the burning of coal under the boiler of the engine,' or, in other words, that the electricity which produces the flame in the arc is created by using the latent energy of the coal.

The only question in the case is whether defendant company is a 'manufacturer,' in the sense of article 229 of the Constitution of 1898, which reads in part as follows:

'Art. 229. The General Assembly may levy a license tax, and in such case shall graduate the amount of such tax to be collected from the persons pursuing the several trades, professions, vocations and callings. All persons, associations of persons and corporations pursuing any trade, profession, business or calling may be rendered liable to such tax, except *147 clerks, laborers, clergymen, school teachers, those engaged in mechanical, agricultural, horticultural, and mining pursuits, and manufacturers other than those of distilled, alcoholic or malt liquors, tobacco, cigars, and cotton seed oil.'

Article 230 of the same Constitution exempted from parochial and municipal taxation for 10 years from the 1st day of January, 1900, the capital, machinery, and other property employed in mining operations and in the manufacture of a large number of enumerated articles. Electric light plants are not included in the list, and therefore are subject to state and municipal property taxation.

The first Legislature which convened after the adoption of the Constitution of 1898 passed a general license tax law, which is still in force. See Act No. 171, p. 387, of 1898. Section 3 of said act imposed a graduated license tax on manufacturers subject to license under article 229 of the Constitution, and section 11 (page 408) for carrying on each business of gaslight, electric light, waterworks, etc. It is to be presumed **598 that section 11 of said act has been enforced from 1898 to the present time and that licenses have been paid in accordance with its provisions.

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Article 206 of the Constitution of 1879 and article 229 of the Constitution of 1898 exempt in the same language the same classes of persons from the payment of license taxes. Yet section 4, p. 144, of Act No. 119 of 1880, imposed a license tax 'on each business of gaslight, waterworks, telegraphing,' etc., 'and all other manufacturing and work done with fixed machinery or steam power and not exempted by the Constitution.'

In 1884 a new license statute was enacted and a license tax imposed 'on each business of gaslight, electric light, waterworks, telegraphing, including local and district telegraphs, telephone exchange,' etc.

Hence for more than 20 years the uniform legislative construction of the same provisions*148 in two state Constitutions has been that the business of gas and electric lighting is not exempt from license taxation.

In 1905, for the first time, this construction was challenged in a court of justice by the claim of exemption set up in defendant's answer in this suit.

In *Cooper Manufacturing Company v. Ferguson*, 113 of U. S. 733, 5 Sup. Ct. 741, 28 L. Ed. 1137, the court said:

'The act was passed by the first Legislature that assembled after the adoption of the Constitution, and has been allowed to remain on the statute book to the present time. It must therefore be considered as a contemporary interpretation, entitled to much weight. *Stuart v. Laird*, 1 Cranch, 299, 2 L. Ed. 115; *Martin v. Hunter*, 1 Wheat. 304, 4 L. Ed. 97; *Cohens v. Virginia*, 6 Wheat. 264, 5 L. Ed. 257; *Adams v. Storey*, 1 Paine, 79, 90, Feb. Cas. No. 66.'

Of course, this doctrine is limited to ambiguous provisions; but, where ambiguity exists, a contemporaneous legislative exposition 'is entitled to great deference, as it may well be supposed to result from the same views of policy and modes of reasoning

which prevailed among the framers of the instrument expounded.' 6 Am. & Eng. Ency. Law (2d Ed.) p. 931.

In *City v. Robira*, 42 La. Ann. 1098, 8 South. 402, 11 L. R. A. 141, which was a license tax case in which defendant claimed exemption as a 'photographer' under article 206 of the Constitution of 1879, the court said:

'It is to be observed that the act of the Legislature taxes 'photographers' expressly. It must therefore be inferred that the General Assembly did not consider them as coming within the constitutional exemption.

'The acts of a Legislature are to be treated with the greatest respect, as they emanate from a co-ordinate and powerful branch of government. They must be presumed to be constitutional, unless they be shown manifestly to have transgressed or violated the organic law.'

The court further said:

'It may be added that it is universally settled that exemption laws, being in derogation of a general rule, must be strictly construed; that whoever claims shelter under them must prove himself clearly entitled to the immunity; and that a such cases doubt is fatal. Plausible hesitation warrants an adverse finding.'

*149 It was the obvious purpose of the framers of the Constitutions of 1879 and of 1898 to encourage, by exemption from direct taxation, mining operations and the manufacture of certain articles specifically designated. It is significant that no gas or electric plant or work of public utility of any kind is included in the list. In the articles of the two Constitutions relative to license taxation there is exempted 'mining pursuits and manufacturers other than those of distilled, alcoholic or malt liquors, tobacco, cigars and cotton seed oil.' The articles thus excepted, as well as those specified in article 230, suggest material things in commerce, susceptible of

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being given new shapes, new qualities, or new combinations by some process of manufacture. Every decision of this court cited by counsel for defendant relates to articles of commerce either in their raw state or after they had gone through some artificial process, and the question decided has been whether the additional work done on such articles can be classified as a manufacturing industry. This question has proved difficult of satisfactory solution and has led to conflicting decisions.

In the ordinary popular meaning of the word, a corporation which operates gas or electric works is not a 'manufacturer,' and is not so styled, though, scientifically speaking, gas or electricity may be a product of manufacture.

In the instant case the popular meaning of the term 'manufacturer' is reinforced by long legislative action and by long acquiescence therein by the persons and corporations affected.

Counsel for defendant company, in their very able and ingenious brief, say:

'A number of cases have passed upon the question of whether an electric light company was or was not a manufacturer. Some decisions have been adverse, but the greater number have been in our favor.'

*150 In other words it is a debatable question whether an electric light company is a manufacturer. Conceding, for the sake of the argument, that defendant company does manufacture electricity and light, the next question for solution is whether a producer of that kind of energy is a 'manufacturer' in the sense of article 229 of the Constitution. In the legislative history of Louisiana the term 'manufacturer' has never been applied to a gas, water, or electric corporation. Section 683 of the Revised Statutes of 1870 speaks of 'manufactures' of cotton, woolen, linen, silk, hempen cloth, and cordage, and of the 'manufacture' of iron and other metals and things. It authorized the formation of corporations for the purpose of manufacture and for

many other purpose, including the construction and operation of works to supply cities and towns with gas or water. As **599 amended and re-enacted by Act No. 154, p. 288, of 1902, the word 'manufacture' is used in the same restricted sense, and is not applied to works of public utility to supply cities and towns with water, electricity, gas, or fuel oil. There is no reason of public policy for exempting light companies from taxation and at the same time denying exemption to other corporations exercising similar franchises in the interest of the public.

In *Commonwealth of Pennsylvania v. Northern Electric Light & Power Company*, 22 Atl. 839, 14 L. R. A. 107, the Supreme Court of the state held that, while the defendant company might technically be considered a manufacturer of electricity and light, it was not a 'manufacturing corporation' in the sense of a statute exempting the stock of such corporations from taxation.

Defendant's claim of exemption is at least doubtful, and therefore cannot be allowed.

Judgment affirmed.

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C

Supreme Court of New Hampshire.
WILLIAMS et al.

v.

PARK et al.

Nov. 3, 1903.

Transferred from Superior Court; Young, Judge.

Petition by one Williams and another for mandamus requiring the selectmen of Warren to assess a tax upon the property of William R. Park for the year 1901. Case transferred from superior court by Young, J., on agreed facts. Case discharged.

West Headnotes

Municipal Corporations 268 ¶967(5)

268 Municipal Corporations

268XIII Fiscal Matters

268XIII(D) Taxes and Other Revenue, and Application Thereof

268k967 Exemptions from Taxation

268k967(5) k. Property of Water and Electric Companies. Most Cited Cases

Statutes 361 ¶64(8)

361 Statutes

361I Enactment, Requisites, and Validity in General

361k64 Effect of Partial Invalidity

361k64(8) k. Taxation, License Fees, and Public Funds. Most Cited Cases

Pub.St.1901, c. 55, § 11, provides that towns may, by vote, exempt from taxation for a term not exceeding 10 years any manufacturing establishment proposed to be erected or put in operation therein. Held, that furnishing electric light and power, and distributing the same, was not manufacturing, within such statute, and such business not being separable from a vote exempting an establishment for manufacturing

lumber, and furnishing steam and electric power, and distributing the same, from taxation, the entire exemption was void.

*463 At a meeting duly warned, held October 9, 1899, the town, under sufficient articles in the warrant, voted as follows: "The establishment that said establishment shall include a sawmill and dressing mill for manufacturing lumber and wood, and furnishing steam and electric power and light and distributing the same, proposed to be erected and put in operation in the village of Warren by William R. Park, and the capital to be used by him in operating the same, not exceeding thirty thousand dollars, shall be exempted from taxation for the period of ten years. Provided, that said Park shall invest and expend not less than three thousand dollars upon and in his said proposed establishment in the village of Warren; and provided, further, that said Park shall give in to the town of Warren all personal property not hereby exempted, on the first day of each April, for the purpose of taxation in said Warren." Park, relying upon the vote, erected in the village of Warren, at an expense of more than \$3,000, an establishment consisting of a sawmill and dressing mill for manufacturing lumber and wood, and sufficient room, power, and shafting for generating and furnishing steam and electric power and light, and for distributing the same, but installed no dynamo or other appliances for collecting and distributing currents. The sawmill and dressing mill have been put in operation, and Park offers to show that he has always been ready and willing to install the electric plant, but has not done so because the town or its officers have not requested him to do it; and the selectmen have requested him not to do it until it was ascertained what power and light were required. Park was a resident of Warren April 1, 1901, and had in the town this mill plant, worth not less than \$10,000, logs to be manufactured into lumber at the mill worth not less than \$21,000, and other taxable property of the value of \$16,034. He also owned several horses, which then were, and for several months prior to that date had been, employed in his lumbering business in the town of Benton, and logs then in Benton and other New Hampshire towns where they were cut. He gave in to the selectmen of Warren, for taxation, all his personal property taxable in that town, except the logs therein, and the horses and logs which were in other towns.

The selectmen taxed him upon \$16,034 worth of property, and, though requested by the plaintiffs, did not tax him for the mill and the logs in Warren, because of the vote of the town, nor for the horses and logs in other towns because of their liability to taxation in the towns where they were located. Batchellor & Mitchell and Smith & Smith, for plaintiffs.

Burleigh & Adams, for defendants.

CHASE, J.

The statute under which the town acted in making the exemption to Park reads as follows: "Towns may by vote exempt from taxation for a term not exceeding ten years any manufacturing establishment proposed to be erected or put in operation therein, and the capital to be used in operating the same, unless such establishment has been previously exempted from taxation by some town." Pub.St.1901, c. 55, § 11. The establishment contemplated by the town's vote was to be equipped for furnishing steam and electric power and light, and distributing the same, as well as for manufacturing lumber and wood. It was a single establishment, designed for two independent purposes. While it is possible that a boundary line might be discovered separating the portions of the building and machinery used for one purpose from the portions used for the other, and that the capital might be appropriated in definite shares to the several purposes, it is not possible to ascertain whether the vote would have been adopted if it had not provided that both kinds of business should be carried on at the establishment. Some of the voters may have been induced to favor the scheme by the promise of an electric light and power plant, and would *464 have voted against it in the absence of such promise. Others may have voted for it because they were more particularly interested in having a lumber mill established in the town, and were willing to subsidize an electric plant, in addition to the mill, to secure their wish. See Cox Needle Co. v. Gifford, 62 N.H. 503. The provision for having a light and power plant is a material part of the vote, and cannot be separated from the other provisions and treated as void, leaving the latter in force. The action of the town covered both subjects indiscriminately, and must stand or fall as a whole. It therefore is a fundamental question in the case whether an establishment designed for furnishing and distributing such power and lights is a "manufacturing establishment," within the meaning of the statute. In

attempting to answer the question, it must be borne in mind that the policy of the state requires the taxation of property, as a general rule. "Every member of the community has a right to be protected by it in the enjoyment of his life, liberty, and property. He is, therefore, bound to contribute his share in the expense of such protection, and to yield his personal service when necessary, or an equivalent." Bill of Rights, art. 12; Const. art. 5. "It will never be assumed that the government intended to release any part of the property entitled to its protection from the burden incident to such protection and it is the duty of those who assert that claim to show it by language which can admit of no other conclusion; and, where doubt arises as to the meaning of the language used which it is claimed confers the exemption, it will be construed most strongly against those who maintain the exemption." Phillips Exeter Academy v. Exeter, 58 N.H. 306, 307, 42 Am.Rep. 589; Boody v. Watson, 63 N.H. 320, 321; Kimball Carriage Co. v. Manchester, 67 N.H. 483, 484, 39 Atl. 334; Alton Bay Camp Meeting Ass'n v. Alton, 69 N.H. 311, 312, 45 Atl. 95. The burden is upon Park to clearly show that the Legislature intended by the statute to authorize the exemption from taxation of an establishment like his. "Any manufacturing establishment" is a phrase that may have a broad meaning, but was it used in the statute in its broadest sense? The earliest statutes specified the manufactures that were to have the benefit of exemption. Mills, etc., used for the manufacture of linseed oil (Laws, Ed.1797, p. 341), for slitting, rolling, or plating iron (Id. p. 343), for the manufacture of sail cloth or duck (Id. p. 347), and for the manufacture of malt and malt liquors (Laws, Ed. 1792, p. 400), were exempted in the first decade after the adoption of the present Constitution. By the act of June 18, 1819, the buildings, machinery, and capital of the Souhegan Nail, Cotton & Woolen Factory, not exceeding in value \$30,000, were exempted for a term of 10 years. Souhegan Nail, Cotton & Woolen Factory v. McConihe, 7 N.H. 310. The preamble of the first act states the reason of its adoption as follows: "Whereas the manufacturing of oil from flaxseed, within this state, will furnish employment for poor persons, have a happy influence on the balance of trade, and greatly contribute to the wealth of the good subjects of this state: Therefore, to encourage the same, Be it enacted," etc. The prevention of a drain of money from the state to foreign countries is given as the reason for the enactment of other statutes. The object of them all was to promote the increase, industry, and prosperity of the inhabitants of the state. A careful examination has not

brought to notice any statute upon the subject passed between 1819 and 1860. In the latter year an act was passed "to encourage manufactures," by which the machinery and capital used for the manufacture of "fabrics of cotton or wool, or of both cotton and wool," might, with the assent of the town, be exempted from taxation for the term of 10 years after the passage of the act; the town's assent to have "the force of a contract, and be binding for the full term above specified." Laws 1860, p. 2262, c. 2361, § 1. By the General Statutes enacted in 1867, the term of the exemption was made a period not exceeding 10 years, to be fixed by the town granting the exemption. In other respects the statute continued the same in substance, although its form was changed. Gen.St. 1867, c. 49, § 9. It seems that prior to 1871 exemption was sought for other industries, aside from cotton and woolen manufactures. In 1869 Littleton was specially authorized to exempt an establishment for the manufacture of hoes, forks, shovels, or scythes. Laws 1869, p. 370, c. 124, § 1. Authority for the exemption of establishments generally engaged in such manufactures and the manufacture of fabrics from other materials was granted by the act of July 7, 1871. The subjects of exemption were described in the act as establishments for the manufacture of "fabrics of cotton, wool, wood, iron, or any other material." Laws 1871, p. 529, c. 25, § 1. Upon the compilation and revision of the statutes in 1891, the phrase "any manufacturing establishment" was substituted for "any establishment *** for the manufacture of fabrics of cotton, wool, wood, iron, or any other material," but without an intention of changing the law. Com'rs' Rep.Pub.St. c. 55, § 11. "Manufacturing," then, in the present statute, is used in the sense of working materials into a fabric or structure for use-as, for example, cotton into cloth, iron into tools, wood into carriages, etc. This is the ordinary meaning of the word, and, independently of the light thrown upon it by the history of the statute, would be regarded as the meaning which the Legislature attached to it. The question then resolves itself into this: Whether the collection and distribution of electricity for purposes of power and light are manufacturing, within this sense of the word? Machinery and manual labor are required in the process, but this fact alone does not bring it within the meaning of the word. The product of the machinery and labor must be a *465 fabric or structure made from materials of some kind. It has not yet been discovered what electricity is. Sir Oliver Lodge, an eminent English scientist, said in a lecture delivered in 1880: "We cannot assert that it is a form of matter, neither can we deny it.

On the other hand, we certainly cannot assert that it is a form of energy, and I should be disposed to deny it. It may be that electricity is an entity per se, just as matter is an entity per se." In a lecture delivered the present year, he seems to give assent to the theory that it is matter in a fourth state, consisting of something very much smaller than atoms—"ultra-atomic corpuscles"—which revolve about each other within atoms at tremendous speed. The knowledge of electricity thus far acquired certainly does not warrant one to speak of it as a manufacture. In common speech, an electric light and power plant is not spoken of as a manufacturing establishment. In enumerating the manufacturing industries of a town, the electric plant would not ordinarily be included. It is true that the collection of electricity is sometimes spoken of as manufacturing it; but in such cases other words are usually added, as generating, producing, supplying—showing a consciousness that "manufacturing" does not correctly express the idea. Laws 1881, pp. 605, 606, 610, cc. 235, 237, 241; Laws 1887, pp. 595, 601, 605, cc. 237, 243, 247, 287, 292. The charter of the Franklin Gas & Electric Light Company probably describes the process more nearly correctly by the words "produce, collect, and store." Laws 1887, p. 619, c. 261, § 3. There is direct evidence that the Legislature did not intend by this statute to authorize the exemption from taxation of electric light plants. By an act approved March 25, 1897, a vote of the town of Franconia, "exempting from taxation an electric light plant, to be established in said town," was made legal and valid. Laws 1897, p. 207, c. 208. Of course, this vote would have been unnecessary if it had been understood that the general statute authorized the town to grant the exemption. If it be said that doubts existed whether the general statute authorized the vote, and the special statute was passed to remove them, the evidence, in that view, is scarcely less effective in establishing the proposition that the general statute does not authorize such exemption, for, by the well-established principle of law above mentioned, the doubts should be construed most strongly against the exemption.

A similar question has arisen in other jurisdictions, but the decisions are conflicting. In a recent Maryland case it was held that an electric light company does not carry on a "manufacturing industry," within the meaning of a city ordinance exempting from municipal taxation "the machinery and manufacturing apparatus of all manufacturing industries" located in the city. Frederick, etc., Co. v. Frederick, 84 Md. 599, 36 Atl. 362, 36 L.R.A. 130. In New York

it was held that such a company was a "manufacturing corporation," within the meaning of a statute exempting manufacturing corporations from taxation. People v. Wemple, 129 N.Y. 543, 29 N.E. 808, 14 L.R.A. 708. See, also, Commonwealth v. Power Co., 145 Pa. 105, 22 Atl. 839, 14 L.R.A. 107; Commonwealth v. Power Co., 170 Pa. 231, 32 Atl. 419; Commonwealth v. Power Co., 193 Pa. 245, 44 Atl. 326.

The real question is, what was the intention expressed by the language of the Legislature in this case? In view of the ordinary meaning of the terms used in the statute, the policy of the state, and the evidence furnished by the history of the legislation on the subject, and the action of the Legislature in the Franconia Case, it does not clearly appear, to say the least, that the Legislature intended to authorize the exemption of property of this kind. As the exemption of the electric plant is so connected with the exemption of the other property mentioned in the vote that it cannot be separated and treated independently, the entire vote must fail, and be regarded as unauthorized and void. This conclusion renders it unnecessary to consider the question of the constitutional power of the Legislature to authorize towns to exempt property from taxation, and the other questions argued in the briefs. The petition should be granted so far as it relates to property situated in Warren. Boody v. Watson, 64 N.H. 162, 9 Atl. 794.

Case discharged.

PARSONS, C.J., did not sit. The others concurred.

N.H. 1903.
Williams v. Park
64 L.R.A. 33, 72 N.H. 305, 56 A. 463

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GG

EXHIBIT GG

C

Supreme Court of Pennsylvania.
 COMMONWEALTH
 v.
 NORTHERN ELECTRIC LIGHT & POWER CO.

Oct. 5, 1891.

Appeal from court of common pleas, Dauphin county.

Proceedings by the commonwealth for the taxation of the capital stock of defendant company. From a judgment for the commonwealth defendant company appeals.

West Headnotes

Taxation 371 ⚡ 2332

371 Taxation

371III Property Taxes
 371III(F) Exemptions
 371III(F)1 In General
 371k2331 Manufacturing Companies
 371k2332 k. In General. Most Cited

Cases

(Formerly 371k236)

A corporation engaged in the production of electricity and in selling it to customers for the generation of light, heat and power.

Taxation 371 ⚡ 2332

371 Taxation

371III Property Taxes
 371III(F) Exemptions
 371III(F)1 In General
 371k2331 Manufacturing Companies
 371k2332 k. In General. Most Cited

Cases

(Formerly 371k236)

A corporation chartered for the purpose of sup-

plying gas to the public and disposing of the various products of coal and other materials used in its works and actually engaged in the manufacture of illuminating gas by the distillation of bituminous coal and by the decomposition of steam enriched by hydrocarbon vapors is within the meaning of this proviso and is exempt from the payment of tax upon so much of its capital stock as is invested in its manufacturing business.

Taxation 371 ⚡ 2332

371 Taxation

371III Property Taxes
 371III(F) Exemptions
 371III(F)1 In General
 371k2331 Manufacturing Companies
 371k2332 k. In General. Most Cited

Cases

(Formerly 371k236)

A company generating electricity and selling it to customers for power, illuminating, or heating purposes, is not a manufacturing company, within Act Pa. 1885, exempting the capital stock of manufacturing companies from taxation.

Taxation 371 ⚡ 2332

371 Taxation

371III Property Taxes
 371III(F) Exemptions
 371III(F)1 In General
 371k2331 Manufacturing Companies
 371k2332 k. In General. Most Cited

Cases

(Formerly 371k236)

Beginning with the Act of June 16, 1836, P.L. 799, 15 P.S. § 1511, followed by the Act of April 7, 1849, P.L. 563, 15 P.S. § 1591, and others, provision was made for the incorporation of manufacturing companies as a class of corporations. When the constitution of 1873 was adopted and the general Corporation Act of April 29, 1874, P.L. 73, 15 P.S. § 1 et seq., was passed, in obedience to its requirements the incorporation of manufacturing corporations as a class

was provided for under the head of companies formed for "carrying on any mechanical, mining, quarrying or manufacturing business, including all the purposes covered by the provisions of the act of general assembly entitled 'An act to encourage manufacturing operations in this commonwealth, approved April 7, 1849,' and its several supplements."

Taxation 371 2332

371 Taxation

371III Property Taxes

371III(F) Exemptions

371III(F)1 In General

371k2331 Manufacturing Companies

371k2332 k. In General. Most Cited

Cases

(Formerly 371k236)

No corporation engaged in the service of its customers in a quasi public capacity is a member of the statutory class built up under the Act of 1849 and its supplements. Such companies have never been included in any of the legislation provided for the encouragement and protection of manufacturing corporations and have no right to share in the benefits of such legislation. They really form a class by themselves.

Taxation 371 2332

371 Taxation

371III Property Taxes

371III(F) Exemptions

371III(F)1 In General

371k2331 Manufacturing Companies

371k2332 k. In General. Most Cited

Cases

(Formerly 371k236)

The exemption of manufacturing companies applies only to the statutory class of manufacturing corporations created by the said Act of April 7, 1849, P.L. 563, 15 P.S. § 1591, and subsequent acts. It does not cover all corporations whose business comes within the meaning of the word "manufacture" as it is given by the lexicographers.

*113 *M. E. Olmsted and Morgan & Lewis*, for appellant.

*115 *W. U. Hensel*, Atty. Gen., and *Jas. A. Stranahan*, Deputy Atty. Gen., for the Commonwealth.

***116 WILLIAMS, J.**

This case presents a new and an interesting question, viz.: Is a company that produces electricity, and sells it to customers for the generation of light, heat, or power, a manufacturing company, within the meaning of the act of 1885, exempting the capital stock of manufacturing companies from taxation? This case was tried without a jury, and the facts upon which the judgment was based appear in the findings of the court below. One of these, which was based upon the opinion, and largely expressed in the words of an expert electrician; who was called as a witness, asserts that the electricity sold by the company was created by the process adopted by the company. The learned judge says: 'The electricity which furnishes the light does not exist until the armature revolves. The revolution of the armature brings into being something that did not exist before, that is, this electric energy, or energy in this electric form.' In the same finding he describes the process by which this product is evolved or created as follows: 'Coal is burned under the boilers, producing heat. The heat generates steam in the boilers, which moves the engine. The engine supplies the power by which the armature is made to revolve. The revolution of the armature produces electric currents where they did not exist before. The electricity thus generated is carried over wires provided by the company, and delivered to its customers, where it is used to produce light. The process by which electricity is made to furnish light is found to consist of the movement of an electric current from one carbon point to another, which are made part of its circuit. In leaping from one point to another great heat is developed by the energy of the current. This heat liberates or evolves from the carbon a gas, which it burns. The light is thus found to *117 be due partly to the passage of the electric current between the carbon points, and partly to **840 the combustion of the gas furnished by the heated carbons.' Notwithstanding these findings, which showed a creation, or 'bringing into being where it did not exist before,' of the electricity sold by the company, the learned judge held as matter of law that the process was not one of manufacture, because the product was not a material substance. Conceding that the thing sold was 'brought into being,' made, 'manufactured,' in the common use of that word, he denied that such making was in a

legal sense a manufacture, because it did not appear affirmatively of what the my sterious product was made, and that it was material, as matter is now defined. This conclusion appears to have been drawn from the derivation and definition of the word 'manufacture,' and is forcibly presented in a learned opinion, in which lexicons and books of reference are largely drawn upon. It is very clear that the word originally meant 'handmade.' It is equally clear, in the light of the definitions collated by the learned judge, that its meaning has expanded with the advance of the arts and sciences, until it has come to mean, as a verb, the making of anything by human art or skill, (Burrill, Law Dict.,) and as a noun, anything made by art or skill, (Rap. & L. Law Dict.) The mere appropriation of an article which is furnished by nature is not a manufacture. Thus the liberation of natural gas or oil from the earth, and its transportation to consumers, is not a manufacture; but the production of illuminating gas is. Gas-Light Co. v. Brooklyn, 89 N. Y. 409; also, Emerson v. Com., 108 Pa. St. 111. The collection, storage, preparation for market, and transportation of ice is not a manufacture, but the production of ice by artificial means is. People v. Ice Co., 99 N. Y. 181, 1 N. E. Rep. 669. A telegraph company produces electricity by artificial means, but it uses it in its own business as a carrier of messages for the public; so does a telephone company. Both receive messages for carriage, and deliver them at the point of destination. They transport for their customers. This company whose character we are considering sells the electricity it makes, or 'brings into being,' as a commodity. It provides the lamps or appliances for the use of its customers, by means of which the light is produced. It sells them the *118 electricity, measures it as it is delivered, and is paid according to the quantity furnished. Whatever electricity may be, it seems to be absolutely within the power and under the control of the company that brings it into being. It is compelled by the process employed to come into being. It is secured, stored, poured out, or liberated at will. Its manifestations are both seen and felt. It moves with incredible velocity and power. It carries the tones and inflections of the human voice, or moves loaded cars, depending on the volume of the current and the manner of its application. It may be, in the hands of the physician, a soothing remedial agent, and, in the hands of the law, an instrument of execution swifter and surer than the headsman's axe. It may be too early to say just what it is. The scientists whose views the learned judge adopted may be right or wrong. We have no need to decide that question. Laws are written

ordinarily in the language of the people, and not in that of science; and, if this case depended on the question on which it turned in the court below, we should be led by the findings of fact to a different conclusion of law from that which was there reached, and which held that this company was a manufacturing company.

But we think the controlling question in this case is that of the sense in which the words 'manufacturing companies' are used in the statute under consideration. It provides that the taxes laid on corporations by the revenue laws of the commonwealth are repealed or abolished as to manufacturing corporations. Now, if there were a class of corporations existing at that date known by the name of 'manufacturing companies or corporations,' we must assume that the legislature intended that class when it used the name by which the class had been known in previous legislation; and we need go no further than the statute-book to determine the legislative intent in the act of 1885. The act of 1879 imposed a capital-stock tax on all corporations alike, so that we get no help from it. Looking back to the laws under which corporations have been created, we find that in 1835 an act was passed providing for the organization of corporations for the manufacture of iron from the ores with *119 coke or mineral coal, which was subsequently extended so as to include companies using charcoal. This was followed in 1849 by a law which provided for the organization of 'manufacturing companies' as a class of corporations. It included the manufacture of woolen, cotton, flax, or silk goods, of iron, paper, lumber, or salt. In 1850 it was extended so as to include the manufacture of glass. In 1851 printing and publishing were taken into the class. In 1852 the making of mineral paints and artificial slate was included. In 1853, quarrying and mining. In 1859 the manufacture of leather and leather goods. Mineral and carbon oils were included by a series of acts passed in 1856, 1859, and 1860. It will thus be seen that the words 'manufacturing corporations' had been employed as the name of a definite class of corporations for many years, and that the kinds of manufacture embraced within the class were not left to be settled by coniecture, or by reasoning built upon definitions, but had been settled by actual enumeration in the statutes referred to and some others. When the constitution of 1873 was adopted, and when the general corporation act of 1874 was passed in obedience to its requirements, manufacturing corporations as a class were provided for, and the kinds of manufacture included made certain by a long series of statutes. The act of 1874 provided a uniform mode for

the incorporation of companies formed for profit, describing them as corporations of the second class, while corporations not for profit composed the first class. In the second class were included, among others, **841 companies formed for 'carrying on any mechanical, mining, quarrying, or manufacturing business, including all the purposes covered by the provisions of the act of general assembly entitled 'An act to encourage manufacturing operations in this commonwealth, approved April 7, 1849,' and its several supplements. Thereafter any company formed for the prosecution of the objects enumerated in the act of 1849 and its supplements entered the class of manufacturing corporations through the gate opened by the act of 1874, instead of through previous legislation. But, whether they came in the one way or the other, if they were within the class as the *120 legislature had made it, the act of 1885 relieved them from the tax imposed by the act of 1879. A company supplying illuminating gas is, in the general sense of the word, a manufacturing company, (*Gas-Light Co. v. Brooklyn*, *supra*,) but it is not a member of the statutory class built up under the act of 1849, nor is any corporation engaged in the service of its customers in a *quasi* public capacity. A municipality may furnish water and light to its citizens. A company performing this service may be said to perform a *quasi* public or municipal function, which the municipality may disturb at its pleasure, or supersede altogether. Such companies have never been included in any of the legislation provided for the encouragement and protection of manufacturing corporations, and have no right to share in the benefits of such legislation. They really form a class by themselves. When the act of 1885 was passed laws had been made in adjoining states which gave encouragement to the establishment of factories by exempting them from certain forms of taxation. The mischief to be remedied was the danger that such legislation might lead to the removal of capital and labor from this state to others, to the detriment of the business and prosperity of our own. The remedy provided was the removal of the tax imposed by the act of 1879, so as to remove the inducement to leave the state. It was as broad as the mischief which it was intended to meet, and made applicable to the class which since 1836 it had been the policy of the state to encourage, viz., 'manufacturing corporations.' It did not reach financial corporations like banks and insurance companies, nor transportation companies, nor companies performing functions partaking of a municipal character, but that class of productive industries which the legislature had sought to encourage as

a means of bringing and keeping within our borders capital and labor, to be employed in the development of our mineral wealth, and in the production of the staples of commerce. We think the learned judge reached a correct conclusion in this case. The appellant is not within the exemption or immunity provided by the act of 1885, but we prefer to rest our judgment on the definition of 'manufacturing corporations' which the legislature has adopted and adhered to for more than *121 half a century, rather than upon the meaning of the word 'manufacture' as it is given by lexicographers. The judgment is affirmed.

Pa. 1891
Commonwealth v. Northern Electric Light & Power Co.
145 Pa. 105, 22 A. 839

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HH

EXHIBIT HH

1 Can you explain to me the origin of
2 that view?

3 A. Well, the origin of that view comes
4 from my understanding of what energy is. Energy is
5 the ability to do work. And it cannot be created;
6 it cannot be destroyed. And on that basis, we
7 provide electric energy. We do not create
8 anything, we just change one form of energy into
9 another that is useful to the end user.

10 You know, a good example that I have,
11 that I -- you know, the image that I have in my
12 mind it's a -- you know, a conversion of energy is
13 a -- a farmer plowing his field chooses to use an
14 ox to pull a plow. That -- I don't think anybody
15 would argue that that ox is providing a service
16 rather than providing a product. Would you agree?
17 I would assume everyone would agree that this is a
18 -- a service.

19 Q. I'm going to let you answer the
20 questions today.

21 A. Sure. So what happens with the ox is
22 one form of energy is transformed into a different
23 form of energy. Each -- it eats the -- the food,
24 which is energy, one form of energy, it converts,
25 internally, that form of energy into mechanical

1 energy that can get work done.

2 That is as close as to the service that
3 we provide. We take a form of energy that is
4 potentially imbedded in oil, gas, coal or nuclear,
5 wind or sun and we convert it into a form of energy
6 that can perform work. And we charge you on the
7 basis of your enjoyment of that, just like a farmer
8 would charge on the basis of how much was plowed.
9 So that's where the time element comes in. It's a
10 service on the basis of the amount of time that you
11 enjoyed it.

12 Q. Okay. Was -- was the concept of
13 producing electricity as manufacturing, was that
14 ever a topic or a service? Was that ever a topic
15 of discussion at any of your classes in school?

16 A. No, I don't think so.

17 Q. Not that you recall?

18 A. Not that I recall.

19 Q. How do you talk about electricity on a
20 day-to-day basis, when you're talking to
21 subcontractors or contractors or employees, how do
22 you refer to electricity?

23 MR. TRESH: Objection as to form.

24 THE WITNESS: I refer to it as energy.

25 BY MR. GREEN:

EXHIBIT II

Duke Power Company
Legal Department
422 South Church Street
Charlotte, NC 28242-0001



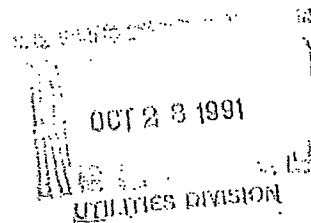
DUKE POWER

704/382-8127

October 25, 1991

(704) 382-8137 Fax

STEVE C. GRIFFITH, JR.
LEWIS F. CAMP, JR.
RAYMOND A. JOLLY, JR.
W. EDWARD POE, JR.
ELLEN T. RUFF
WILLIAM LARRY PORTER
JOHN E. LANSCH
ALBERT V. CARR, JR.
WILLIAM J. BOWMAN, JR.
ROBERT M. BISANAR
EDWARD M. MARSH, JR.
RONALD V. SHEARIN
W. WALLACE GREGORY, JR.
JEFFERSON D. GRIFFITH, III
JEFFREY M. TREPEL
PAUL R. NENTON
GARRY S. RICE
LISA A. FINGER
KAROL P. MACK
CHRISTIN J. BRAMLETT
OF COUNSEL
WILLIAM I. WARD, JR.
GEORGE W. FERGUSON, JR.



Mr. Charles W. Ballentine
Executive Director
The Public Service Commission
of South Carolina
P. O. Drawer 11649
Columbia, South Carolina 29211

Re: SCPSC Docket No. 91-216-E

Dear Mr. Ballentine:

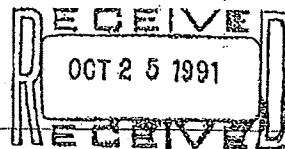
Please find enclosed for filing in the above-captioned matter the original and 10 copies of the Proposed Order of Duke Power Company. Attached is a Certificate of Service for the parties of record.

Sincerely yours,

Ellen T. Ruff
Deputy General Counsel

ETR/sch
Enclosures
cc: Parties of Record
Mr. William F. Austin

S.C. PUBLIC SERVICE COMMISSION



CERTIFICATE OF SERVICE

I hereby certify that I have this day mailed a copy of the Proposed Order of Duke Power Company (SCPSC Docket No. 91-216-E) to the following:

Ms. Marsha A. Ward, General Counsel
The Public Service Commission
of South Carolina
P. O. Drawer 11649
Columbia, South Carolina 29211

Mr. Steven W. Hamm, Consumer Advocate.
Ms. Nancy J. Vaughn, Staff Attorney
Department of Consumer Affairs
P. O. Box 5757
Columbia, South Carolina 29250-5757

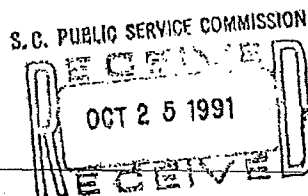
Mr. Arthur G. Fusco
Sherrill and Rogers, PC
P. O. Box 100200
Columbia, South Carolina 29202-3200

Mr. William E. Booth, III
Mays, Foster, Booth & Gunter
2512 Devine Street
Columbia, South Carolina 29205

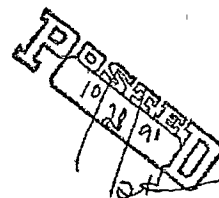
Mr. Jasper P. Rogers
Route 1, Box 346
Ridgeway, South Carolina 29130

This the 25th day of October, 1991.

ELF. P. J.



BEFORE THE
PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA
DOCKET NO. 91-216-E



In the Matter of
Application by Duke Power Company
for Authority to Adjust and Increase
Its Electric Rates and Charges

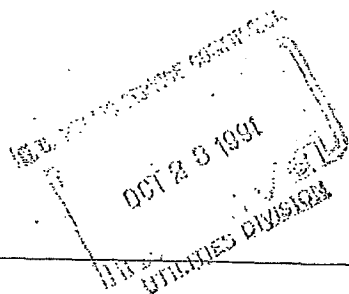
PROPOSED ORDER
OF
DUKE POWER COMPANY

Steve C. Griffith, Jr.
Executive Vice President and General Counsel

Ellen T. Ruff
Deputy General Counsel

Karol P. Mack,
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Attorneys for Duke Power Company

October 25, 1991

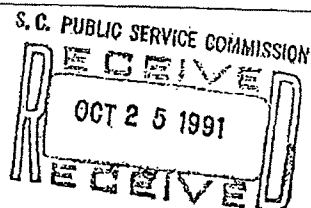


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On May 17, 1991, Duke Power Company (Duke or the Company) filed an Application with the Public Service Commission of South Carolina (the Commission) to adjust and increase its retail electric rates and charges, effective for service in accordance with the terms and conditions of §58-27-870, Code of Laws of South Carolina (1976), as amended.^{1/} The rates proposed by the Company in its Application were designed to increase annual gross revenues from South Carolina retail operations by \$72,542,000 or 7.29% based on the test year, i.e., the twelve (12) months ended December 31, 1990.

The proposed revenue increase is distributed among classes of customers by increasing residential revenues by 9.08%, general service revenues by 7.96%, industrial revenues by 5.96%, and outdoor lighting revenues by 6.18%. Different percentage increases for customer classes are proposed because of the existing disparity in rates of return between customer classes.

The principal reason for the requested increase set forth in the Application is the commercial operation of the Bad Creek Hydroelectric Station, a 1,065 MW facility located in the mountains of western South Carolina. Units 1 and 2 began commercial operation on May 15, 1991. Units 3 and 4 began commercial operation on September 3 and September 13, 1991, respectively.

Petitions to intervene were received from the Consumer Advocate, South Carolina Department of Consumer Affairs, the South Carolina Energy Users Committee (SCEUC), the Clifton Power Corporation, and Jasper P. Rogers. These petitions to intervene were allowed by the Commission.

By letter of May 30, 1991, the Executive Director of the Commission required the Company to file with the Commission on or before June 24, 1991, and serve on all parties of record, the testimony and exhibits of the witnesses which the Company intended to offer at the hearing in this matter.

^{1/} Pursuant to the provisions of that section, the Company gave the Commission the statutory 30-day notice of its intention to file an increase in its rates.

By letter of June 11, 1991, the Executive Director of the Commission scheduled a public hearing on September 23, 1991, and required the Company to provide notice of the public hearing by newspaper notices and bill inserts. The Company furnished proof of publication of the required notice on July 19, 1991.

On June 24, 1991, the Company filed with the Commission its prepared direct testimony and exhibits for the following witnesses: William S. Lee, Chairman of the Board and President, Duke Power Company; Roger G. Ibbotson, President of Ibbotson Associates, Inc.; Richard J. Osborne, Vice President, Finance, Duke Power Company; Donald H. Denton, Jr., Senior Vice President, Planning and Operating, Duke Power Company; W. R. Stimart, Vice President, Rates and Regulatory Affairs, Duke Power Company; Ronald E. White, Senior Vice President, Foster Associates, Inc.; and Thomas S. LaGuardia, President, TLG Engineering, Inc. On September 3, 1991, Duke filed Supplemental Testimony and Supplemental Exhibit 1 of W. R. Stimart. Duke filed Supplemental Exhibit 2 on September 20, 1991. During the hearing, Duke filed Supplemental Exhibit 3.

By letter of August 8, 1991, the Executive Director of the Commission required the Commission Staff and all other parties of record to file their testimony on or before September 9, 1991. The following testimony was filed: for the Consumer Advocate: Paul Chernick, Resource Insight, Inc.; Peter J. Lanzalotta, Whitfield Russell Associates; Phillip E. Miller, Riverbend Consulting, Inc.; John B. Legler, Professor of Banking and Finance in the College of Business Administration, University of Georgia; for the Commission Staff: I. Curtis Price, III, A. R. Watts, and James E. Spearman; for the South Carolina Energy Users Committee: Nicholas Phillips, Jr.^{2/} The Commission also

^{2/} Pursuant to their respective requests, the Consumer Advocate and SCEUC were granted an extension of time to September 13 to file their testimony.

received a written statement from Jasper P. Rogers on or about September 21, 1991.

On September 16, 1991, Duke filed updated and revised testimony of Roger G. Ibbotson, and the Consumer Advocate filed a revised exhibit of Peter J. Lanzaotta.

On September 11, 1991, in Order No. 91-775, the Commission scheduled a prehearing conference for September 18, 1991, at 10:00 a.m. The prehearing conference was held as scheduled.

The public hearing before the Commission commenced as scheduled on September 23, 1991. William F. Austin, Esquire, Steve C. Griffith, Jr., Esquire, Ellen T. Ruff, Esquire, and Karol P. Mack, Esquire, represented the Company; Marsha A. Ward, Esquire, represented the Commission Staff; Steven W. Hamm, Esquire, Raymon E. Lark, Jr., Esquire, Nancy J. Vaughn, Esquire, and Richard Elam, Esquire, represented the Consumer Advocate; Arthur G. Fusco, Esquire, represented SCEUC; William E. Booth, III, Esquire, represented Clifton Power Corporation; and Jasper P. Rogers appeared on his own behalf. The public hearing was completed on September 26, 1991.

On September 25, 1991, the Company filed the rebuttal testimony of Donald H. Denton, Jr. and William F. Reinke. Subsequent to the hearing, the Consumer Advocate filed the surrebuttal testimony of Philip E. Miller and Paul Chernick on October 2, 1991.

~~A night hearing was held in Greenville, South Carolina on October 7, 1991.~~

The Commission heard testimony from the following witnesses: Tom Blank, Jim Schumer, Earl Mills, Joe Jelks, Jim McKittrick, Ron Vankirk, John E. Newman, Robert Keenan, and Kris Risley.

Clifton Power Corporation was granted an extension of time to September 17 to file its testimony, but did not file any testimony.

Based upon the verified Application, the testimony, and exhibits received into evidence at the hearing and the entire record of these proceedings, the Commission now makes the following findings of fact:

FINDINGS OF FACT

General Procedural Issues

1. Duke is engaged in the generation, transmission, distribution, and sale of electric energy in the central portion of North Carolina and the western portion of South Carolina, comprising the area in both states known as the Piedmont Carolinas.

2. Duke is an electric utility operating in the State of South Carolina where it is engaged in the generation, transmission, distribution, and sale of electricity to the public for compensation. The Company's retail operations in South Carolina are subject to the jurisdiction of this Commission pursuant to S.C. Code Ann. §§58-27-10 et seq. (1976), as amended. The Company's wholesale operations in South Carolina are subject to the jurisdiction of the Federal Energy Regulatory Commission (hereinafter "FERC").

Test Period

3. The test period for purposes of this proceeding is the 12-month period ended December 31, 1990, adjusted for certain known and measurable changes.

Requested Increase

4. Duke, by its Application, sought an increase in its basic rates and charges to its South Carolina retail customers of \$72,542,000. Subsequent to the filing of the Application, the Company lowered its request to \$68,384,000.

Cost Allocation

5. The summer coincident peak (summer CP) demand allocation methodology is the most appropriate method for making jurisdictional allocation of production costs and for making fully distributed cost allocations among customer classes in this proceeding. Consequently, each Finding of Fact

appearing in this Order which deals with the overall level of rate base, revenues, and expenses for South Carolina retail service has been determined based upon the summer CP allocation method.

Test Period Revenue

6. The appropriate operating revenues for Duke for the test year under present rates and after accounting and pro forma adjustments are \$994,450,000 for service to the South Carolina retail jurisdiction.

Bad Creek Hydroelectric Station

7. The Commission finds that the costs of the Bad Creek Hydroelectric Station were prudently incurred. In so doing, the Commission specifically finds that all four units were in commercial operation prior to the commencement of the hearing; that the station was completed under Duke's budget; that considering Duke Power's system generation needs, the choice of pumped storage was prudent compared to other types of generation such as combustion turbines; that Bad Creek is needed to enable Duke to meet the load on its system and to maintain a minimum level of reserve requirements; and that the Bad Creek Station is used and useful. The costs of the Bad Creek Station should be included in Duke's rate base.

Carolina Power & Light Co. Contract (Schedule J)

8. No adjustment to the test period for billings to Carolina Power & Light Company under Schedule J is appropriate.

Test Year and Post-Test Year Cost Increases

9. It is appropriate to increase operation and maintenance expenses by \$4,832,000 to reflect increases in wage rates and related fringe benefit costs that occurred during the test year. This adjustment also results in a corresponding increase in payroll taxes of \$419,000.

10. It is appropriate to increase operation and maintenance expenses by \$4,287,000 to reflect increases in wage rates and related fringe benefits and payroll taxes which occurred after the end of the test year.

Implementation of SFAS 106

11. It is appropriate to increase operation and maintenance expenses by \$3,830,000 to reflect the implementation of accrual accounting for other post-retirement benefits expense in accordance with Statement of Financial Accounting Standards No. 106.

Demand-Side Management Programs

12. The Commission Staff, the Consumer Advocate, and the Company entered a Stipulation relating to Demand-Side Management (DSM) cost deferral. The Stipulation is reasonable and is approved by the Commission.

13. It is appropriate to increase operation and maintenance expenses by \$3,911,000 to reflect known increases in costs associated with the Company's load control and interruptible service demand-side management programs.

Depreciation and Decommissioning Expenses

14. The appropriate depreciation rates for purposes of setting depreciation expense are as follows:

<u>Function</u>	<u>Rate</u>
Production	
Steam	2.57%
Nuclear	
Decommissioning	1.61%
Investment	3.09%
Total Nuclear	4.70%
Hydraulic	1.98%
Other	0.74%
Transmission	2.57%
Distribution	3.59%
General (Summary Only)	3.59%

15. In determining decommissioning expense to be included in cost of service, it is appropriate to assume zero real return for qualified nuclear decommissioning trust investments and 1% for nonqualified investments.

16. The appropriate components of decommissioning expense to be included in cost of service are as follows:

<u>(Dollars in Thousands)</u>		<u>Annual Cost</u>	
<u>Unit</u>	<u>Total Cost</u>	<u>System</u>	<u>S. C. Retail</u>
Oconee 1	\$164,792	\$10,491	\$ 2,722
Oconee 2	158,311	10,101	2,621
Oconee 3	202,855	12,218	3,171
Oconee ISFSI	21,750	1,325	344
McGuire 1	171,246	8,950	2,323
McGuire 2	186,265	9,294	2,412
Catawba 1	23,476	1,199	311
Catawba 2	26,163	1,271	330
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TOTAL	\$954,858	\$54,849	\$14,234
	=====	=====	=====

Other Operating Expenses

17. The reasonable level of test year operating revenue deductions for the Company after pro forma adjustments is \$837,757,000.

Capital Structure and Rate of Return

18. The appropriate capital structure for the Company for use in this proceeding is as follows:

<u>Item</u>	<u>Percent</u>
Long-Term Debt	40.50%
Preferred Stock	9.68%
Common Equity	49.82%

Total	100.00%
	=====

19. The proper embedded cost rates for long-term debt and preferred stock are 8.78% and 7.74%, respectively.

20. The reasonable rate of return on common equity that Duke should be allowed an opportunity to earn is 13.17%, which the Commission adopts for this proceeding. Combined with the debt and preferred cost rates and the capital

structure set forth in the table below, which the Commission finds reasonable, the overall rate of return is 10.87%.

<u>Item</u>	<u>Percent</u>	<u>Cost</u>	<u>Weighted Rate</u>
Long-Term Debt	40.50%	8.78%	3.56%
Preferred Stock	9.68%	7.74%	.75%
Common Equity	49.82%	13.17%	6.56%
	-----		-----
TOTAL	100.00%		10.87%

Material and Supplies

21. The reasonable allowance for materials and supplies investment is \$73,668,000.

Plant Held for Future Use

22. The reasonable allowance for plant held for future use is \$4,402,000.

Working Capital

23. The reasonable allowance for working capital is \$57,832,000.

Rate Base

24. Duke's reasonable original cost rate base used and useful in providing service to the public within the State of South Carolina is \$1,834,972,000, consisting of electric plant in service of \$2,868,210,000; net nuclear fuel of \$88,747,000; plant held for future use of \$4,402,000; materials and supplies of \$73,668,000; and allowance for working capital of \$57,832,000, reduced by accumulated depreciation and amortization of \$924,185,000, accumulated deferred income taxes of \$315,569,000, operating reserves of \$14,180,000, and customer deposits of \$3,953,000.

Revenue Requirement

25. Based upon the foregoing, Duke should increase its annual level of gross revenues under present rates by \$68,384,000. The annual revenue requirement approved herein is \$1,062,834,000 which will allow Duke a reasonable

opportunity to earn the rate of return on its rate base which the Commission has found just and reasonable.

Rate Design

26. The rate designs, rate schedules, miscellaneous charges, and terms and conditions proposed by the Company are appropriate and should be adopted, except as specifically modified herein.

27. The rate of return for the Industrial class is outside of the "band of reasonableness", a band or range of plus or minus 10% of the average retail rate of return. Consequently, the revenue increase approved herein should be distributed in order to move the Industrial class rate of return to the band of reasonableness.

28. The modifications to the penalty provisions of Interruptible Rider IS proposed by the Company should be adopted. The credit should not be increased in view of the substantial participation by customers at the current level of credit.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 1 AND 2

The evidence supporting these findings concerning the Company's business and legal status is contained in the Company's verified Application and in prior Commission Orders in this Docket of which the Commission takes notice. These Findings of Fact are essentially informational, procedural, and jurisdictional in nature; and the matters which they involve are essentially uncontested.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 3 AND 4

The evidence for these findings concerning the test period and the amount of the revenue increase requested by the Company is contained in the verified Application of the Company and the testimony and exhibits of Duke witnesses Lee and Stimart.

On May 17, 1991, the Company filed an Application requesting approval of rate schedules designed to produce an increase in gross revenues of \$72,542,000.

Subsequent to the filing of the Application, the Company decreased its request to \$68,384,000. The Company's filing was based on a test period consisting of the 12 months ending December 30, 1990. The Commission finds that this test period is appropriate and should be approved.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 5

The evidence for this finding concerning the proper production allocation method consists primarily of the testimony and exhibits of Company witness Denton, Commission Staff witness Watts, and SCEUC witness Phillips.

Duke provides retail service in two states as well as wholesale service to certain municipalities and electric membership cooperatives; therefore, it is necessary to allocate the cost of service among jurisdictions and among customer classes within each jurisdiction. The Company based its Application on the use of the summer coincident peak allocation methodology (summer CP), which was found appropriate by the Commission in its order in the Company's last rate case, Docket No. 86-188-E. As Company witness Denton testified, Duke has utilized and the Commission has approved the summer CP method in its cost studies since 1970. Denton also testified that by all forecasts, Duke will continue to be a summer peaking company. (Tr. Vol. 2, p. 91)

Commission Staff witness Watts and SCEUC witness Phillips supported the continued use of the summer CP method. SCEUC witness Phillips presented testimony and exhibits demonstrating the dominance of the summer peak demand on the Duke system. Phillips further testified that other methods of cost allocation would not adequately account for the dominant summer coincident peak and would therefore fail to reflect the actual load characteristics of the Duke system. (Tr. Vol. 4, p. 112) No witness challenged the appropriateness of the summer CP allocation methodology for Duke.

The Commission finds, based on the evidence submitted by the Company, Staff, and SCEUC, that the summer coincident peak allocation methodology utilized by

Duke is most appropriate for Duke and therefore adopts the summer CP for cost allocation in this proceeding.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 6

The evidence for this finding concerning the adjusted level of operating revenues is found in the testimony and exhibits of Company witness Stimart, Commission witnesses Watts and Price, and Consumer Advocate witness Miller.

Company witness Stimart's exhibits reflected adjusted operating revenues under current rates of \$994,450,000 for South Carolina retail operations. (Hearing Exhibit 4, Stimart Exhibit 1, page 1, Stimart Supplemental Exhibit 3, page 1) Commission Staff witness Watts agreed with the Company's (\$1,004,000) adjustment to annualize revenues to the level of rates reflected in the currently approved South Carolina Retail tariffs. Watts also recommended that the Company's adjustment be modified by \$110,510 to reflect the additional revenue associated with the requested increase in the Company's Reconnect Fee from \$5.00 to \$15.00. (Tr. Vol. 5, p. 229) The Commission finds that it is inappropriate to adjust test year revenues to reflect the proposed increased reconnect fee. The additional revenues to be derived from this proposal are ~~part of the Company's requested increase of \$68,384,000 and should be reflected~~ as such.

Company witness Stimart adjusted test year revenue by \$6,517,000 to reflect the expected annual level of KWh sales resulting from growth in the number of customers during the test period. (Hearing Exhibit 4, Stimart Exhibit 1, ~~page 3) Mr. Stimart further testified that the end of period level of~~ residential and general service customers was compared to the average number of customers during the test period. The increases in number of customers were then multiplied by the applicable average KWh consumption per customer to derive the annualized change in KWh consumption based on the number of customers at the end of the test period. (Tr. Vol: 2, pp. 145-146)

Commission Staff witness Price suggested that the standard Commission method of accounting for customer growth be utilized. (Tr. Vol. 5, p. 79) Consumer Advocate witness Miller also recommended using the procedure employed by the Commission in the Company's past cases. (Tr. Vol. 5, pp. 33-34)

The Commission notes that although the Staff and Consumer Advocate contend that they are using the standard approach to customer growth, they determined growth of .87% and .6927% respectively. (Hearing Exhibit 37, Accounting Exhibit A-2 and Hearing Exhibit 36, Schedule PEM5)

The Commission concludes that the Company's adjustment which is based on growth in specific customer classes and which utilizes average consumption by class is a more precise calculation than that proposed by either the Staff or the Consumer Advocate and is therefore appropriate for use in this proceeding.

The Commission finds that the Company's adjustment to annualize revenues to reflect the currently approved South Carolina retail tariffs is appropriate and should be adopted. The Commission also finds that Duke's recommendation for the customer growth adjustment should be adopted.

Based on the above findings, the appropriate level of operating revenues ~~for the Company under present rates after accounting and pro forma adjustments~~ is \$994,450,000.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 7

The evidence for this Finding of Fact is contained in the testimony of Company witnesses Lee, Stimart and Reinke, and Consumer Advocate witness Lanzalotta. Mr. Lee testified that the Bad Creek Hydroelectric Station, a four-unit, 1,065 MW facility, was completed ahead of schedule and under budget. In his prefiled testimony, Mr. Lee testified that Bad Creek would be completed under budget at an approximate cost of \$1.1 billion. (Tr. Vol. 1, p. 59) Mr. Lee testified that pumped storage offers special dynamic advantages to the Duke system that no other type of capacity can offer. Without Bad Creek, the

projected reserve margin in 1991 would have been well below the minimum reserve margin of 20%. (Tr. Vol. 1, p. 60)

In his summary and update of his testimony given on the stand, Mr. Lee stated that Bad Creek Units 1 and 2 went into commercial operation on May 15, 1991 and were in operation at the time of the record summer peak. If these two units had not been on-line, Duke's summer reserve margin would only have been 15%. Unit 3 began commercial operation on September 3, 1991 and Unit 4 on September 13, 1991. Mr. Lee testified that Bad Creek had been completed ahead of schedule and over \$100 million under budget. He stated that the completed cost of Bad Creek compares favorably to other projects completed in the same timeframe. In addition, he testified that the capacity from Bad Creek is necessary to meet the growing demand for reliable electricity in the Duke service area and to maintain adequate reserve margins (Tr. Vol. 1, pp. 66-67)

Mr. Stimart, in the summary of his direct testimony, testified that the final plant cost of Bad Creek was approximately \$1,008,000,000. (Tr. Vol. 2, p. 165)

Company witness Reinke also testified that Bad Creek Units 1 and 2 were ~~needed to meet the summer 1991 peak and Units 3 and 4 are needed to keep reserves~~ at the minimum levels in 1992. Duke's reserves are projected to be 20.7% in 1992 and 18.3% in 1993. (Tr. Vol. 6, p. 94)

Planning for Bad Creek began in the late 1960's when the Company foresaw the need for pumped-storage capacity to complement the nuclear and base load ~~plants that were being planned and built by the Company.~~ Mr. Reinke testified that pumped-storage projects such as Bad Creek offer benefits over and above the value of the capacity alone. Pumped storage is a benefit to the Duke system because its load shape can accommodate the technology and there is sufficient nuclear and fossil generation to provide low-cost pumping energy for Bad Creek. (Tr. Vol. 6, pp. 90-91) With the addition of Bad Creek, the Duke system will

be able to operate more reliably and economically because of the complimentary fit of the pumped-storage generation with the rest of Duke's generation. At a final cost of \$1,008,000,000, Bad Creek compares favorably with other units of its type completed in the same timeframe. Exhibit (WFR-1), Hearing Exhibit 44, to Mr. Reinke's testimony, which assumes commercial operation in 1992, reflects this favorable comparison which is further enhanced by the fact that all four Bad Creek units were brought into operation ahead of schedule.

Consumer Advocate witness Lanzalotta was the only witness who raised any issues concerning the prudence of Bad Creek. Mr. Lanzalotta testified that there are indications that Duke has adequate pumped storage without the addition of Bad Creek. He testified further that his belief was based on his Exhibit (PJL-5), Hearing Exhibit 38, which showed that the generation from Duke's other pumped-storage generating unit, Jocassee, dropped by about 50% in 1992 and 1993, the first years of Bad Creek's operation. (Tr. Vol. 5, p. 119)

Company witness Reinke testified in response to this point and stated that the projected reduced output from Jocassee in 1992 and 1993 is the result of two of the Jocassee units being scheduled to be out of service for approximately ~~six months in each year for major maintenance work.~~ Mr. Reinke testified further that the addition of Bad Creek would enhance the opportunity to conduct the maintenance at Jocassee in the most economical way. (Tr. Vol. 6, pp. 92-93)

Witness Reinke testified that both the Jocassee and Bad Creek units operated above their projected levels of output in 1991. In addition he testified that ~~the pumped-storage generation for the first 19 days of September, 1991, exceeded~~ the total generation for Jocassee in September, 1990. (Tr. Vol. 6, p. 93) The Commission finds the evidence presented on this point by the Company to be convincing and rejects the position advanced by witness Lanzalotta.

Consumer Advocate witness Lanzalotta also testified that Units 3 and 4 of Bad Creek are not needed to maintain reliable reserves over the three-year

period during which Duke expects the rates from this proceeding to be in effect. Mr. Lanzalotta testified that with the addition of Bad Creek Units 3 and 4, Duke's reserves would range from 27.9% to 23.3% during 1991-1993. (Tr. Vol. 5, p. 125) This testimony was addressed by Company witness Reinke who showed that Mr. Lanzalotta had erred in the method he used to calculate Duke's reserves. The apparent discrepancy is in how demand-side programming should be treated in calculating reserve margins. Mr. Reinke testified that the proper method to calculate reserves is to determine the combustion turbine equivalent of demand-side management programs rather than as load, which is how Mr. Lanzalotta made his calculation. Mr. Reinke's testimony sets forth in some detail that where generating capacity is to be deferred or replaced by demand-side programs, it is appropriate to use a generation equivalent model to calculate reserves. Mr. Reinke testified that using this method, Duke's reserves would be 20.7% in 1992 and 18.3% in 1993 after the addition of Units 3 and 4 of Bad Creek. (Tr. Vol. 6, pp. 94-96)

The Commission is convinced by Duke's evidence and finds that Bad Creek Units 3 and 4 are required to maintain reliable reserves. In addition, the ~~Commission specifically finds that Duke's methodology for calculating reserves~~ as presented in its testimony is the proper method to use.

Company witness Reinke discussed the proper Minimum Planning Reserve margin in response to Mr. Lanzalotta's testimony concerning reserve margins. Mr. Reinke testified that the consideration of new demand-side programs and the ~~long lead times required to construct major generating projects~~ have made the matching of growth and the need for generating capacity even more imprecise. Because of these factors, it may well be prudent to increase the minimum planning reserve margin above 20%. (Tr. Vol. 6, pp. 96-97)

The Commission believes this approach has merit and finds that the Company will need to give special consideration to the impact of demand-side programs

in establishing its minimum reserve in accordance with its testimony in this case.

Consumer Advocate witness Lanzaletta offered testimony to show that 1,237 MW of combustion turbines would cost less in 1992 than Bad Creek. Mr. Lanzaletta used a bus bar analysis to show that 1,237 MW of CTs would be able to supply the same amount of capacity and energy expected from Bad Creek in 1992 at a total annual cost which is about \$43,000,000 less than Bad Creek is expected to cost. Mr. Lanzaletta's analysis used a 5.8% capacity factor. (Tr. Vol. 5, p. 128)

Company witness Reinke testified in rebuttal to this point. Mr. Reinke testified that a bus bar analysis, which is simply the annual costs, including capital costs, of the plant divided by its annual output, is inappropriate as a means of comparing generating options with different characteristics. Such an analysis does not take into account the system benefits associated with pumped-storage such as the reduction in spinning reserve requirement and its load following capability. Mr. Reinke testified further that pumped storage is beneficial to the Duke system because its load shape is such that the pumped-storage generation can be utilized during the day to meet system load, and there are sufficient resources in the form of nuclear and efficient fossil generation to provide low-cost pumping at night and on the weekends. (Tr. Vol. 6, pp. 97-98)

Mr. Reinke testified further that Mr. Lanzaletta's use of a 5.8% capacity factor, which does not reflect the impact of the other system benefits of pumped storage in his bus bar analysis, was incorrect. In fact, Bad Creek has operated as high as 33.3% in 1991, and had numerous weeks when the capacity factor has been greater than 15%. Jocassee, Duke's other pumped storage hydroelectric generating station, has operated well in excess of 15% during 1991. A bus bar analysis using a 15% capacity factor rather than a 5.8% capacity factor, would

cost \$10 million less annually than combustion turbines. (Tr. Vol. 6, p. 98) Similarly, a 27% capacity factor for Bad Creek produces a \$79 million benefit annually over combustion turbines.

The Commission finds that, based on the evidence presented by the Company, Bad Creek provides greater savings to the consumer than an equivalent amount of combustion turbines.

Consumer Advocate witness Lanzalotta testified that the cost of Bad Creek was higher than the rates paid to co-generators. (Tr. Vol. 5, p. 127) Company witness Reinke testified in response to this point. Mr. Reinke stated that Mr. Lanzalotta's comparison was incorrect because it attempted to compare resources which have different operating characteristics. Mr. Reinke testified that co-generators and other QF's typically operate around the clock and fluctuate to meet the owner's requirements rather than Duke's system requirements. (Tr. Vol. 6, pp. 98-99) Mr. Lanzalotta acknowledged on cross-examination that one of the advantages of Bad Creek is that it will operate when the Company needs it. (Tr. Vol. 5, p. 171) The Commission finds that based on the evidence, a cost comparison of Bad Creek with co-generation is inappropriate.

After carefully reviewing all of the evidence presented by the parties, the Commission finds that the construction of Bad Creek was prudent and that it is needed to meet the demand in Duke's service area. The Commission finds further that the costs of constructing the station were prudently incurred and that the ~~selection of hydroelectric pumped-storage generation is prudent compared to~~ other generating alternatives. In addition, the Commission finds that Duke's reserve margins with the Bad Creek units in service will be at levels that are reasonable and necessary for reliable service.

The Consumer Advocate has criticized certain other aspects of Bad Creek. The Commission has reviewed this testimony and exhibits carefully. The

remaining criticisms, while not specifically addressed, must be rejected by the Commission as not being supported by the facts in evidence.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 8

In Mr. Stimart's supplemental testimony, he recommended an adjustment to test period revenues to reflect the anticipated billings to be received under FERC Rate Schedule J between Duke Power Company and Carolina Power & Light Company. (Tr. Vol. 2, pp. 159-160) This adjustment would have decreased test period costs by \$11,487,906. (Hearing Exhibit 4, Stimart Supplemental Exhibit 1, page 2) Mr. Lee testified on the stand, however, that Duke had received notice from Carolina Power & Light Company that it did not intend to comply with the provisions of Schedule J. He also testified that litigation could well result. (Tr. Vol. 1, p. 73) Based upon these events, Mr. Lee and Mr. Stimart recommended that no adjustment be made to the test period as a result of Schedule J due to the uncertainties involved in that contract. (Tr. Vol. 1, p. 74) (Tr. Vol. 2, p. 160) Mr. Stimart proposed that any collections received pursuant to Schedule J be placed in a deferred account and that when the uncertainty surrounding the contract is resolved, the Company submit a proposal to adjust rates to reflect the collections in the deferred account and to reflect future collections under Schedule J in rates. (Tr. Vol. 2, p. 160)

The Commission concludes that it would be inappropriate to include any amounts from Schedule J in rates adopted in this proceeding. The Commission orders the Company to place any collections received pursuant to Schedule J in a deferred account.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 9

The Company and Consumer Advocate differed on the Company's adjustment to annualize the increases in wage rates and related fringe benefit costs during the test period. The Company proposed an adjustment of \$4,832,000. Witness Price agreed with this adjustment. While witness Miller agreed with the

"concept of recognizing wage increases which have occurred during the test year", he opposed the Company's adjustment because of Duke Power's plans to reduce its workforce by three percent through attrition by the end of 1991. (Tr. Vol. 5, pp. 26-28)

Mr. Lee testified the three percent workforce reduction is the Company's expectation in an effort to identify all potential cost savings. He also testified that these efforts will not serve to reduce our cost of service but will serve to lower the level of increases. (Tr. Vol. 1, p. 53)

The Commission finds that witness Miller's proposed adjustment is inappropriate and inconsistent with the principles applied by this Commission. The effect of Duke Power's workforce plan on year-end wage expense and other expense levels is neither known nor measurable. The amount of wage increases granted during the test year is known and measurable and should be included in cost of service.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 10

The Company also made provision for the impact of cost increases on the Company's expenses occurring after December 31, 1990, which would be known and measurable at the time of the hearings in this proceeding.

At the hearing, Mr. Stimart identified actual wage increases of \$4,287,000 and an actual increase in NRC fees of \$1,048,000 that the Company had experienced since the end of the test year, December 31, 1990. Mr. Stimart testified that these cost increases are now known and measurable and should be considered by this Commission in determining the cost of service.

(Tr. Vol. 2, pp. 166-167)

Staff witness Price recommended in his Supplemental Testimony the inclusion in cost of service of the additional NRC fees. Staff based its recommendation on its examination of the actual bills from the NRC which were furnished to the Staff and Consumer Advocate by the Company. (Tr. Vol. 4, p. 71) (Tr. Vol. 5,

p. 88) Consumer Advocate witness Miller did not address the additional NRC fees. Witness Miller did not take exception to the Company's adjustment to NRC fees as originally filed. In his direct testimony addressing attrition, witness Miller states that the Commission's current ratemaking philosophies mitigate against attrition by permitting "the annualization of various expenses to reflect changes which have occurred beyond the end of the test year, as long as the costs being used are known and measurable and reflective of normal, ongoing operations." (Tr. Vol. 5, p. 24) The Commission concludes that the additional NRC fees of \$1,048,000 are an appropriate component of cost of service which has been audited by the Commission Staff and are a known and measurable ongoing expense.

In his Supplemental Testimony, Staff witness Price did not recommend the inclusion in cost of service of \$4,287,000 for increased wages resulting from actual wage rate increases granted to employees during the period December 31 to July 31, 1991, because he did not have the opportunity to audit those wage increases. Witness Stimart explained on cross-examination that the workpapers were supplied to the Commission Staff and that the wage increase was calculated ~~in the same manner as the adjustment for wage increases occurring within the~~ test year which the Commission Staff accepted. (Tr. Vol. 4, pp. 71-72) The Consumer Advocate did not address this update in wage increases occurring after the test year.

The Commission concludes that the wage increases granted by the Company ~~through July 31, 1991, meet the Commission's test of known and measurable.~~ The Commission is mindful of the continuing effects of inflation on the Company's costs. Wage increases will continue to be granted in the months subsequent to July, 1991, and during the time the rates set in this proceeding are in effect. By including these known wage increases through July, 1991, in cost of service, the Commission is following its policies as outlined earlier by Consumer

Advocate witness Miller in order to give the Company a reasonable opportunity to earn the return this Commission allows.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 11

Consumer Advocate witness Miller recommended that Duke defer the costs associated with Statement of Financial Accounting Standards No. 106 (SFAS 106) because its effective date is not until 1993. (Tr. Vol. 5, p. 48) Company witness Stimart explained that SFAS 106 requires the Company to accrue, during the years that employees render the necessary service, the expected cost of providing those benefits to employees unlike the pay-as-you-go treatment afforded these benefits in the past. Witness Stimart testified that this Statement was effective in 1990 giving Companies some time to obtain the necessary records to adopt this statement as early as possible before the mandatory 1993 date. (Tr. Vol. 4, p. 62) The amount of the Company's adjustment is based on the cost determinations reflected in the Company's recently completed actuarial study undertaken to establish compliance with current accounting requirements. Commission Staff witness Price agreed with the Company's recommendation to recognize SFAS 106 costs in this proceeding particularly in light of the Company's recent major changes in retirement benefits. Price noted that the Company and Commission Staff have known for years that this expense was coming. (Tr. Vol. 5, pp. 92-94) This Commission approved the adoption of SFAS 106 in the GTE South Telephone case in Docket No. 90-698-C. (Tr. Vol. 5., p. 93)

The Commission finds that the Company's adjustment to reflect the implementation of SFAS 106 meets the known and measurable standard and is appropriately included in operating expense.

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NOS. 12 AND 13

The evidence relating to Demand Side Management (DSM) costs and the DSM Stipulation is contained in the testimony of Company witnesses Lee, Denton,

Reinke, and Stimart; Consumer Advocate witnesses Chernick, Miller, and LanzaIotta; Commission Staff witness Watts; and SCEUC witness Phillips.

Pursuant to Docket No. 87-223-E, the Company, as well as other parties including the Consumer Advocate and Commission Staff, have agreed to comprehensive integrated resource planning procedures, including the requirement for utilities to submit by April 30, 1992, Integrated Resource Plans (IRPS) in accordance with the procedures agreed to and approved by the Commission therein.

Company witness Denton testified that the Company has been engaged in least cost planning since 1974 when the Company recognized the need for an alternative to building generation. (Tr. Vol. 6, p. 124) This planning process became more formalized in recent years and the least cost planning analysis produced a Least Cost Integrated Resource Plan in 1989 followed by two Short Term Action Plans which were submitted to the North Carolina Utilities Commission in 1990 and 1991. Duke will file the results of its current least cost planning cycle with this Commission in April, 1992. (Tr. Vol. 6, p. 125) Mr. Denton testified at length in his prefiled testimony and in his rebuttal testimony as to the comprehensive methodology used by Duke to assess the value of demand-side options as part of the least cost planning process. He testified that the purpose of the process is to select the most appropriate least cost alternative to meet future resource requirements. This is done by subjecting demand-side programs to a complex analysis, the results of which will be to create a blend of available options that will dependably and reliably meet customers' needs at the lowest reasonable cost. (Tr. Vol. 2, pp. 92-93) Witness Denton testified that all of the programs implemented by Duke for which Duke is seeking recovery have been stringently tested to ensure that they are cost effective. (Tr. Vol. 6, p. 127)

Company witness Reinke offered testimony to show how demand-side programs are evaluated as part of Duke's Short Term Action Plan to offset the need for generating capacity. (Tr. Vol. 6, p. 89)

Company witnesses Lee and Denton testified that the Company has accelerated its demand-side expenditures. These increased expenditures are included in cost of service in this case. (Tr. Vol. 1, p. 54; Vol. 2, p. 94) Mr. Stimart testified that test year expenses were adjusted to reflect incremental operating expenses for expansion of DSM programs. (Tr. Vol. 2, p. 151) Mr. Denton testified that the Company is seeking to recover incremental DSM costs of \$6,475,000 in this case. (Tr. Vol. 2, p. 95) Commission Staff witness Watts reflected a similar adjustment in his analysis. Mr. Watts testified that the Staff had reviewed the demand-side programs, analyzed cost data from programs in effect in 1990, and concurs with Mr. Stimart's adjustment. These programs include many currently ongoing programs such as Residential Air Conditioning Load Control, Water Heater Load Control, Interruptible Service, Standby Generator, and Residential Off-Peak Water Heater Sales as well as an end-use research project. (Tr. Vol. 5, pp. 230-231)

Consumer Advocate witness Chernick testified that since the Company has not submitted its integrated resource plan for regulatory review, it has failed to establish that the plan is truly least cost. Mr. Chernick contends that the Company has provided no basis to evaluate the prudence of its demand-side program expenditures. Therefore, Mr. Chernick recommended that the \$6,475,000 should not be recovered in rates in this proceeding until the Company could show the prudence of these costs. If the Company can demonstrate in this proceeding that certain of these expenditures can be prudently committed, then those costs may be approved for recovery through expensing, rate basing, and/or deferrals. For DSM costs that cannot be supported in this case, Mr. Chernick proposed that Duke file for Commission review at a later time. In addition, Mr. Chernick

testified that there were a number of features of the Company's DSM programs that were inconsistent with least-cost principles including: (1) the cost effectiveness of certain programs referred to as "load building", (2) the "lost opportunities" due to the way Duke structured its programs, (3) the possibility of cream skimming, and (4) rate design that encourages customers to "take back" their energy savings through increased consumption. (Tr. Vol. 5, pp. 182-186)

Following the submission of prefiled direct testimony, the Commission Staff, the Company, and the Consumer Advocate reached agreement on a Stipulation for recovery in this proceeding of DSM expenditures related to the Company's least cost plan. (Hearing Exhibit No. 45, Attachment B)

The Stipulation provides first, that the test year (1990) expenditures including advertising expense may be recovered as proposed by the Company in this proceeding. Second, \$6.475 million of DSM costs for programs listed on page 15 of Mr. Denton's prefiled testimony actually incurred by the Company above the test year level may be booked by the Company into a deferred account. Advertising expenditures for these programs that are reasonable and designed to achieve the goals of the respective programs may also be booked into the deferred account. Further, the Company will credit the deferred account for found revenues to the extent lost revenues resulting from lost KWh sales due to DSM conservation programs are included in the deferred account. A return on the deferred balance will be computed monthly and added to the balance. The rate of return will equal the net of tax rate of return approved by the Commission in Docket No. 91-216-E or subsequent rate cases. The Stipulation provides further that if it is determined that the expenditures were prudent and for used and useful DSM programs, the balance in the deferred account will be reflected in the Company's next rate case or appropriate IRP docket by amortizing the then existing balance over a period of five years, except that

the Commission can order a different period if the amount in the deferred account would have a significant impact on rates.

Paragraph 8 of the Stipulation provides that the Commission may consider for inclusion in rates in this proceeding additional DSM costs that are actual and prudently incurred by the Company in 1991 attributable to the Company's Interruptible Service Program, Stand-by Generator Program, Water Heater and Air Conditioner Load Control Programs and associated advertising costs. These programs are listed on Appendix 2 to the Stipulation and amount to \$3,910,814.

Finally, the Stipulation provides that although the parties have entered into the Stipulation, all relevant prefiled testimony, rebuttal and surrebuttal testimony, will be entered into the record as if given orally, and the parties will not cross-examine the witnesses on the testimony. Accordingly, rebuttal testimony was offered by Company witness Denton in response to points raised by Consumer Advocate witness Chernick and surrebuttal testimony was offered by Consumer Advocate witnesses Chernick and Miller.

In rebuttal testimony, Company witness Denton addressed each of the points raised by Mr. Chernick in his direct testimony. Mr. Denton testified that the load building programs referred to by Mr. Chernick and implemented by the Company have been stringently tested to ensure that they are cost effective. Mr. Denton testified further that these programs are cost effective because the marginal revenues exceed the marginal costs and therefore reduce rates for all customers. In particular, Mr. Denton testified that the Company's residential MAX program is not load building but rather is a program that combines high efficiency home insulation techniques with high efficiency heating and cooling equipment. Further, Mr. Denton explained that the dual fuel heat pump program utilizes a high efficiency unit to replace an existing cooling unit which will have a significant demand and energy reduction in the summer months. (Tr. Vol. 6, pp. 127-128)

With regard to the second point raised by Mr. Chernick -- "lost opportunities" --, Mr. Denton testified that the Company agrees with the principle of "lost opportunity" resources and includes this concept in its demand-side program design. In response to Mr. Chernick's concerns regarding the residential MAX program and high efficiency refrigerator and freezer programs, Mr. Denton testified that by specifying a total energy efficiency structure prior to construction, lost opportunities are eliminated. The high efficiency refrigerator and freezer program also makes use of opportunity resources by providing incentives at the time of purchase or replacement of existing units. Finally, Mr. Denton testified that the High Efficiency Heat Pump and Air Conditioning Incentive Program supports opportunity resources by providing a sliding scale rebate that directly provides the economic incentive to purchase the most energy efficient heating and cooling. (Tr. Vol. 6, p. 129)

Mr. Denton also offered testimony rebutting Mr. Chernick's concerns about "cream-skimming". Mr. Denton testified that DSM programs considered by Duke are evaluated for cost effectiveness through the least cost planning process. He pointed out that these programs are designed to maximize total KW and KWh reductions by taking into consideration anticipated customer participation. Mr. Denton concluded that Mr. Chernick was incorrect in his assertions concerning "cream skimming". (Tr. Vol. 6, p. 130)

Mr. Chernick's fourth area of concern dealt with what he called inappropriate conservation rate designs. He stated that Duke's pricing "fits poorly" with least cost planning. (Tr. Vol. 5, p. 211) Company witness Denton testified in rebuttal that Duke uses an established cost of service methodology for rate design which reflects the costs associated with serving customers in particular rate categories. (Tr. Vol. 6, p. 130)

Mr. Denton offered extensive testimony on the Company's least cost planning process. He stated that all DSM programs are stringently tested to ensure their

cost effectiveness. He testified further that all DSM dollars have been prudently spent according to the Company's Short Term Action Plan. (Tr. Vol. 6, pp. 131-132)

Consumer Advocate witness Chernick recommended disallowance of the costs associated with the Company's DSM pilot programs. (Tr. Vol. 5, p. 213) The Company disagreed with this position. Witness Denton testified that the seven pilot programs in place in 1991 are an expansion of these types of programs following the recommendations of certain DSM experts advising the NCUC Public Staff. Mr. Denton stated that these programs will provide important information that will reduce the costs of full scale implementation. Similar testimony was offered by Mr. Denton with regard to funds for evaluation procedures. Mr. Denton testified that such evaluation procedures were needed to ensure accomplishment of objectives for ongoing programs and to verify least cost planning accomplishments. (Tr. Vol. 6, pp. 133-134)

With regard to the Stipulation, witness Denton recommended that the Commission approve the deferred accounting provided for in the Stipulation so that the Company will not be penalized for prudent DSM expenditures. In addition, Mr. Denton testified that 1991 costs referred to in Appendix 1 of the Stipulation were actual costs incurred by the Company with regard to the interruptible service and load control payments that were in excess of the 1990 test year costs. Mr. Denton offered evidence to show that an additional \$3,668,342 was incurred by the Company in 1991 with regard to the Interruptible Service and an additional \$242,472 was incurred with regard to load control payments. Mr. Denton testified that these costs were actual and prudent and should be included in rates in this proceeding. He testified further that Standby Generator payments and advertising were at the same level as 1990 costs. (Tr. Vol. 6, pp. 134-137)

Mr. Denton testified that the Interruptible Service Program has 59 South Carolina industrial customers participating with monthly contract payments of \$1,829 per MW. This program allows the interruption of 243 MW. In addition, 48,112 residential customers are participating in the load control program which allows the Company to interrupt 132 MW when there is a capacity shortage in the service area. The average monthly payment is \$2,214. Mr. Denton testified that the Company compensates customers served by both the interruptible and load control programs under rate schedules approved by the Commission. Under the Standby Generator Program, 24 customers have contracted to provide 7.8 MW of generation during emergencies at an average monthly cost of \$1,549. The Company pays these customers a rate approved by this Commission for actual generation. Finally, Mr. Denton testified that advertising is an essential element of these programs in order to communicate their availability. The costs of advertising are included in the cost benefit analysis of the program. With regard to all of these DSM costs, Mr. Denton testified that when customer payments in these programs are combined with other program costs, the program cost is less than the \$5,100 per MW cost of a combustion turbine, the lowest cost source of equivalent supply side capacity. (Tr. Vol. 6, pp. 136-137) Company witness Reinke's testimony confirmed that these programs have been evaluated as part of the Company's Short Term Action Plan and offset generating capacity that would otherwise be needed. (Tr. Vol. 6, p. 89) Company witness Stimart reflected an adjustment of \$3,911,000 as the amount to appropriately be included in rates based on Mr. Denton's testimony. (Hearing Exhibit 4, Stimart Supplemental Exhibit 3, page 3b)

Surrebuttal testimony was presented by Consumer Advocate witnesses Chernick and Miller addressing certain points in Mr. Denton's rebuttal testimony and certain issues raised by the Stipulation. Witness Chernick recommends that the Commission deny recovery of the 1991 actual incremental DSM expenditures in this

case and defer the costs until Duke documents its expenditures and demonstrates the prudence and cost effectiveness of the DSM programs. As a basis for this recommendation, Mr. Chernick states that Duke has failed to provide adequate evidence of the prudence of the 1991 expenditures. (Tr. Vol. 6, p. 151)

With regard to the load control programs, which include interruptible contracts, residential load control and standby generators, Mr. Chernick states that the Company has failed to adequately demonstrate that the costs of these programs are less than the cost of combustion turbine (CT) capacity. In addition, he states that the Company has failed to consider the effects of load control on the transmission and distribution system. Mr. Chernick also states that the fact that the load control programs are operated under Commission-approved tariffs does not mean that such expenditures are prudent. Finally, Mr. Chernick takes issue with what he states is the Company's failure to demonstrate the prudence of the evaluation and pilot programs and advertising. Witness Chernick recommends that all recovery of incremental DSM expenditures associated with these programs be deferred until the Company documents its expenditures and programs and demonstrates their prudence and cost effectiveness. (Tr. Vol. 6, pp. 146-151)

Consumer Advocate witness Miller testified that the \$3,911,000 of 1991 DSM incremental costs should not be included in rates because the Company has provided no support for these costs even though the Consumer Advocate requested supporting workpapers. Therefore, Mr. Miller states that these costs are not known and measurable. (Tr. Vol. 6, p. 153) In a letter to the Executive Director of the Commission dated October 18, 1991, the Company stated there was no specific request for DSM workpapers. The Company further stated that the \$3,911,000 was set forth in the Stipulation to which the Consumer Advocate agreed.

Duke, the Commission Staff, and the Consumer Advocate have submitted their Stipulation to the Commission for approval in this proceeding. No party has objected to approval of the Stipulation. The Commission has carefully reviewed the Stipulation and the testimony of the parties concerning the recovery of DSM costs. The Commission concludes that the Stipulation is reasonable and it is hereby approved. The Commission authorizes deferral accounting as requested in the Stipulation. The Company shall utilize Account No. 188, miscellaneous deferred debits, for the net deferral.

Although the Company, the Commission Staff, and the Consumer Advocate entered into a Stipulation, certain matters were left open for the Commission to decide. Paragraph 5 of the Stipulation provides for deferred accounting of up to \$6,475,000 of incremental DSM expenses incurred above the 1990 test year level of expenses. This \$6,475,000 was the amount included in the Company's original request for incremental DSM expenses. Paragraph 8 of the Stipulation provides that the Commission may include in rates additional DSM costs that are presented in Appendix 1 to the Stipulation and that it finds are actually and prudently incurred or prudently committed costs. Appendix 1 to the Stipulation identifies these costs as \$3,668,342 for Interruptible Service credits and \$242,472 for load control costs as discussed previously. Company witness Denton and Consumer Advocate witnesses Chernick and Miller have offered testimony on the prudence of the \$3,911,000 expenditures. Commission Staff witness Watts recommended allowance of the \$6,475,000 originally requested as an expense item and did not update the adjustment after the parties entered into the Stipulation.

The Commission has carefully considered the testimony and exhibits of each party. Based on the totality of evidence presented, the Commission finds that the \$3,911,000 of 1991 DSM costs have been actually and prudently incurred and should be included in rates in this proceeding. Mr. Denton also testified that

these 1991 costs are ongoing and will continue to escalate. The more costs deferred now will only result in higher rates for future customers and a disincentive for DSM expenditures. Although Mr. Chernick and Mr. Miller contend that these costs were unsupported, Mr. Denton's testimony clearly showed that these 1991 costs were actually incurred by the Company in 1991. Therefore, they are known and measurable. These amounts were agreed to by the parties to the Stipulation, and no party reserved the right to cross-examine the Company with regard to these costs. Although Consumer Advocate witness Miller stated that the Company did not provide support for the DSM costs, this claim is not supported by the facts. Having reviewed the evidence of all of the parties, the Commission finds without merit the Consumer Advocate's arguments that the \$3,911,000 were not known and measurable costs incurred by the Company.

With regard to prudence, the Commission finds that Mr. Denton's testimony with regard to the least-cost planning process and the fact that these DSM programs allow Duke to avoid capacity additions at a cost less than Duke could have built supply-side capacity is compelling on the question of prudence.

Mr. Denton's extensive experience in the area of least-cost planning and DSM programs gives additional weight to his testimony on these matters. In addition, SCEUC witness Phillips testified specifically that the interruptible service credits included in these costs were too low. The Commission notes that the interruptible service credits and the load control credits, which comprise the \$3,911,000 amount, are included in the tariffs of the Company previously approved by this Commission. Therefore, the Commission finds that based on the evidence presented by the Company and Mr. Phillips, the \$3,911,000 incremental DSM costs are prudent and should be reflected in the cost of service in this proceeding.

The Consumer Advocate has challenged other features of Duke's DSM programs. The Commission has carefully reviewed this testimony and exhibits. The remaining objections and proposals, while not specifically addressed, must be rejected by the Commission. The Commission finds that the cost of DSM programs included in the test year and the incremental 1991 DSM costs are prudent and in the best interests of the customers.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NOS. 14, 15 AND 16

The evidence for these findings concerning the appropriate level of depreciation and decommissioning expense is contained in the testimony of Company witnesses Stimart, White, and LaGuardia, Commission Staff witness Watts, and Consumer Advocate witness LanzaIotta.

Duke adjusted depreciation expense to reflect its proposed depreciation rates and nuclear decommissioning expense. The Company based its proposed depreciation rates on a study prepared by Foster Associates, Inc. which is discussed in the testimony of Company witness Ronald White.

The following table sets forth the Company's current and proposed depreciation rates:

<u>Function</u>	<u>Present</u>	<u>Proposed</u>	<u>Difference</u>
- Production			
Steam	3.57%	2.57%	(1.00%)
Nuclear			
Decommissioning	0.67%	1.61%	0.94%
Investment	3.33%	3.09%	(0.24%)
Total Nuclear	4.00%	4.70%	0.70%
Hydraulic	1.50%	1.98%	0.48%
Other	0.00%	0.74%	0.74%
Transmission	3.00%	2.57%	(0.43%)
Distribution	3.40%	3.59%	0.19%
General	5.48%	3.59%	(1.89%)
Total Utility	3.68%	3.69%	0.01%

This study also included the annual funding requirements of the nuclear decommissioning amounts based on the site specific decommissioning costs

studies included in Mr. LaGuardia's testimony. Commission Staff witness Watts testified that both the depreciation and decommissioning studies were reviewed by the Commission Staff and were just and reasonable and in line with the studies previously approved by this Commission. (Tr. Vol. 5, pp. 249-250)

Consumer Advocate witness LanzaLotta also reviewed the decommissioning study performed by Mr. LaGuardia. Mr. LanzaLotta testified that he did not propose any changes to the decommissioning costs developed by Mr. LaGuardia and noted that Mr. LaGuardia's costs were very much in line with the results of the Battelle decommissioning study funded by the Federal Government. (Tr. Vol. 5, p. 158)

The Company proposed in this proceeding to change its decommissioning expense for its nuclear reactors. Mr. Stimart testified that in the past a .67% rate for decommissioning was included in the Company's 4% nuclear depreciation rate. The Company proposed to change the decommissioning expense reflected in rates based upon current studies of the expected cost of nuclear decommissioning expense. The amounts in the study are based on the prompt dismantlement method of decommissioning because the Nuclear Regulatory Commission requires total funding of the contaminated components as of the date of termination of the operating license of each unit. In order to minimize costs, Duke decided to utilize a combination of internal and external funds to fund decommissioning. The Nuclear Regulatory Commission requires external funding for decommissioning the contaminated portion of each unit. The external fund amount is based on estimates contained in the site specific studies conducted by TLG Engineering, Inc. in 1989 and 1990 for each Duke nuclear unit. The external fund will be tax qualified to the extent possible under IRS rules and guidelines. The cost of decommissioning the rest of the plant will be funded internally and accrued based on a sinking fund methodology. (Tr. Vol. 2, pp. 147-148)

The study supporting the annual decommissioning expense is discussed in the testimony of Thomas LaGuardia. The following table sets forth the components of decommissioning expense included in cost of service in this proceeding:

(Dollars in Thousands)		<u>Annual Cost</u>	
<u>Unit</u>	<u>Total Cost*</u>	<u>System</u>	<u>S.C. Retail</u>
Oconee 1	\$164,792	\$10,491	\$ 2,722
Oconee 2	158,311	10,101	2,621
Oconee 3	202,855	12,218	3,171
Oconee ISFSI	21,750	1,325	344
McGuire 1	171,246	8,950	2,323
McGuire 2	186,265	9,294	2,412
Catawba 1	23,476	1,199	311
Catawba 2	26,163	1,271	330
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Total	\$954,858	\$54,849	\$14,234
	=====	=====	=====

*1990 Dollars

All parties agreed with the Company's adjustment to use 1% real return for nonqualified nuclear decommissioning trust investments. The only area of difference between the Company and the Consumer Advocate relates to the appropriate real after tax return on funds invested in qualified nuclear decommissioning trusts. Consumer Advocate witness Lanzalotta proposed that Duke assume a 1.5% real after tax return on these funds instead of a zero real return assumption. Lanzalotta based his recommendation on a study of selected bond yields during the past ten years. (Tr. Vol. 5, pp. 134-140) On cross-examination of Lanzalotta, Duke presented evidence that, based on data from 1960 to 1988, no class of assets allowable for investment by qualified decommissioning trusts earned a real return as reported in a 1991 volume of The Energy Journal. Another study in the same volume reports that a zero real return assumption is "the only realistic alternative" for qualified fund securities. Returns on nonqualified funds should not be expected to be

significantly higher unless the utility accepts an amount of risk which is not appropriate for such funds. (Tr. Vol. 5, pp. 174-175) (Hearing Exhibit No. 42)

Mr. Stimart also testified that the Company will reassess its decommissioning provision every four years in order to consider changes in the estimate of the cost of decommissioning (including the effect of any life extensions granted to the Company by the NRC) and how well the decommissioning fund has performed. (Tr. Vol. 4, pp. 74-76)

Based on all the evidence, the Commission finds the Company's depreciation rates reasonable and approves the rates. The Commission also finds that it is appropriate to adopt the Company's annual decommissioning provision to include in cost of service. The Commission further finds that the Company's assumption of a zero real return on funds invested in qualified nuclear decommissioning trusts is reasonable and well supported by the evidence.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 17

The evidence for this finding concerning the reasonable level of test-year electric operating expenses is found in the testimony and exhibits of Company witnesses Stimart, White and LaGuardia, Commission Staff witnesses Price and Watts, and Consumer Advocate witnesses Miller and Lanzalotta. The Company proposed total electric operating expense of \$837,757,000. ^{3/}

The differences between the Company, the Commission Staff, and Consumer Advocate are summarized below:

^{3/} Unless otherwise specified, all numbers throughout the remainder of this Order are allocated as South Carolina retail.

Electric Operating Expenses

	<u>Company</u>	<u>Commission Staff</u>	<u>Consumer Advocate</u>
O&M Expenses:			
Fuel Used in Electric Generation	\$197,625	\$196,592	\$196,592
Purchased Power and Net Interchange	141,680	141,680	130,192
Wages, Benefits, Materials, etc.	274,563	267,974	251,058
Depreciation and Amortization	121,499	116,895	119,855
General Taxes	48,755	42,122	46,091
Interest on Customer Deposits	468	474	468
Income Taxes	57,562	61,465	69,709
Amortization of ITC	(4,395)	(4,395)	(4,395)
	-----	-----	-----
Total Electric Operating Expenses	\$837,757 =====	\$822,807 =====	\$809,570 =====

O&M Expenses

The three categories of O&M expenses are fuel, purchased power and net interchange, and other O&M expenses, i.e., wages, benefits and materials. The Commission will discuss each area separately. The only difference between the ~~Company, the Commission Staff, and Consumer Advocate~~ with respect to fuel used in electric generation is related to the fuel expense derived from the Company's customer growth adjustment. This adjustment has been considered by the Commission previously. Having accepted the Company's proposed adjustment for customer growth, the Commission concludes that \$197,625,000 is the appropriate level of fuel expense for use in this proceeding.

The difference between the Company and the Consumer Advocate with respect to purchased power expense is the 400 MW Schedule J sale to Carolina Power & Light Company. The Commission's findings concerning this item were previously discussed under Finding of Fact No. 8 and will not be repeated here.

Other O&M Expenses (Wages, Benefits, Materials, etc.)

The difference between the Company, Commission Staff, and Consumer Advocate with respect to other O&M expenses is summarized below:

(000's)

	<u>Company</u>	<u>Commission Staff</u>	<u>Consumer Advocate</u>
Wages, Benefits, Materials, etc.	\$274,563	\$267,974	\$251,058
Difference		\$(6,589)	\$(23,505)

Analysis of Differences

1. Disallowance of Test Year Growth and Inflation	\$(3,796)	\$(3,796)
2. Post-Test Year Cost Increases:		
NRC Fees		(1,048)
Wage Increases	(4,287)	(4,287)
3. Reclassification of Expenses as Nonelectric	(274)	
4. Increase for Wage Rate Changes During the Test Year	--	(4,832)
5. Removal of LES amortization	(616)	(574)
6. Disallowance of Portion of Officers' Salaries	(180)	(15)
7. Demand Side Management Costs	2,564	(3,911)
8. Industry Association Dues	--	(469)
9. Employee Moving Expense	--	(455)
10. Advertising Expense	--	(110)
11. Storm Damage Costs	--	(121)
12. Lobbying Expense	--	(57)
13. Implementation of SFAS 106	--	(3,830)
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TOTAL DIFFERENCE	\$(6,589)	\$(23,505)

Item 1. Test Year Growth and Inflation

Company witness Stimart proposed adjustments for growth and inflation during the test year. The Company made an adjustment of \$859,000 to annualize O&M expenses other than fuel, purchased power, wages and benefits based on growth in customers during the test period. The Company also adjusted test period operating expenses, primarily operating materials and supplies, by \$2,937,000 to reflect the continual rise in unit costs which occurred during the test period. This adjustment annualizes the effect of inflation which took

place throughout the test period. (Tr. Vol. 2, p. 150) Both Commission Staff witness Price and Consumer Advocate witness Miller proposed to disallow adjustments for test year inflation as not being known and measurable. (Tr. Vol. 5, pp. 25, 79-80)

Witness Stimart testified that this type of adjustment is necessary to make test period O&M expenses representative of the expenses which will be incurred while the proposed rates are in effect. (Tr. Vol. 2, p. 150) However, neither the Commission Staff nor the Consumer Advocate witness disputed the fact that inflation occurred both before and during the test period, and is likely to continue for years to come.

The Commission finds that the Company's adjustments for test year inflation and growth are appropriate. The objective of the test period is to be representative of the conditions expected to exist during the period of time the rates determined in this proceeding will be in effect. Various adjustments to the historical test year are made to accomplish this objective. The Commission acknowledges that inflation is and has been a "fact of life" in the modern economic environment. The level of inflation can be reasonably measured, and the Company's calculation of these adjustments is reasonable. The Commission believes it is necessary to reflect cost escalation in cost of service in order to present a representative picture of the conditions expected to exist during the time the rates approved in this Order will be in effect.

Item 2. Post-Test Year Cost Increases

The Commission's findings concerning this issue have already been discussed under Finding of Fact No. 10 and will not be repeated here.

Item 3. Reclassification of Expense as Nonelectric

Commission Staff witness Price eliminated certain actual cost of service items and reclassified them as costs to be borne by the Company's stockholders.

Those costs include:

(000's)

Payments to EEI for Media	
Communications	\$ 64
Dues and Subscriptions	99
General Advertising	40
Recreation Expense	71

TOTAL	\$274
	=====

As explanation for the adjustment, witness Price testified that the Commission has traditionally held that these types of expenses should not be ratepayer supported since they are not necessary to provide electric service. (Tr. Vol. 5, p. 80)

The Commission has adopted the Uniform System of Accounts which provides for costs of this nature to be supported by ratepayers as an electric expense. The Commission therefore rejects witness Price's adjustment. These costs are a necessary part of doing business and they are recorded in the proper accounts according to the Uniform System of Accounts. (Tr. Vol. 4, p. 87)

Item 4. Increase in Wage Rate and Fringe Benefits

The Commission's findings concerning this issue have already been discussed in Finding of Fact No. 9 and will not be repeated here.

Item 5. Louisiana Energy Services

The Company has included in its total Company per book figures \$2,209,000 for the amortization of the Company's investment in Louisiana Energy Services (LES). The Company seeks recovery from South Carolina ratepayers of \$616,000 in this case, which is South Carolina's portion of the amortization. Duke has

classified LES expenditures as research and development (R&D). (Tr. Vol. 1, p. 63)

LES is a partnership between a Duke subsidiary and four other entities. LES is exploring the construction and licensing of a uranium enrichment services technology that has not previously been utilized or licensed in this country. Presently the only provider of uranium enrichment services in the United States is the Department of Energy (DOE). (Tr. Vol. 1, pp. 63-65)

Mr. Lee testified that participation in LES was necessary in order for the project to be viable. The project would supply needed competition to the uranium enrichment services market which will lower the price of uranium enrichment services. Mr. Lee testified that the Department of Energy price is high compared to the costs of uranium enrichment services utilizing centrifuge technology such as LES would employ. In addition, Mr. Lee testified that Duke would receive a favorable uranium enrichment services contract if the LES project was successful. Finally, Mr. Lee testified that as a result of the potential competition provided by LES the Department of Energy had already lowered its uranium enrichment services prices. These lower prices more than offset Duke's total expenditures in connection with LES. (Tr. Vol. 1, pp. 63-65)

Commission witness Price recommended that LES costs be removed from the cost of service for South Carolina ratepayers for several reasons including the almost complete amortization of the LES costs as of the date of this hearing,

the fact that the construction and operating licenses were not docketed by the NRC until May 15, 1991, the likelihood of no response from the NRC until late 1991, the uncertainty of the decision to proceed with the project unless reasonable financing is obtained, the possibility of reduced prices from the DOE with competitive pressure, Duke's lack of experience with this technology,

and the reduction in investment if Duke sells its interest in LES.
(Tr. Vol. 5, pp. 85-86)

Consumer Advocate witness Miller recommended that LES costs be removed from test year operating expenses and set up in a deferred account because of the contingencies surrounding licensing, the decision to proceed to construction, and Duke's plans to sell or redeem its investment at the end of the venture period. (Tr. Vol. 5, p. 16)

The Commission finds that it is appropriate in this proceeding to amortize LES expenditures as proposed by the Company. No party has contested that these expenditures have been reasonably and prudently incurred and are for the benefit of Duke's customers. Furthermore, no party has challenged the research and development nature of these expenditures. There is no reason to treat LES expenditures any differently than any other research and development costs. The points outlined by Mr. Price further indicate the R&D nature of these expenditures as an attempt by the Company to seek innovative ways to supply electricity at least cost. Indeed, the evidence in this case indicates that Duke's present customers already are receiving benefits from LES expenditures because of the reduction of Department of Energy prices. The Commission continues to encourage R&D expenditures especially when there exists a strong potential to benefit electric customers.

Item 6. Officers' Salaries

Both Commission Staff witness Price and Consumer Advocate witness Miller proposed to eliminate the increases in officers' salaries for the test year in accordance with established Commission policy. Mr. Stimart testified that officers' salaries are already allocated to nonelectric operations. First, salaries are allocated to the extent officers can identify time spent on nonelectric business. Second, salaries are allocated to nonelectric through the application of the Massachusetts formula. (Tr. Vol. 4, p. 40)

Based on this evidence, the Commission determines a further allocation of officers' salaries is not required as proposed by Mr. Price and Mr. Miller.

Item 7. Demand-Side Management Stipulation

The Evidence and Conclusions for this item have previously been discussed under Findings of Fact Nos. 12 and 13. The Commission will not repeat that discussion here.

Item 8. Industry Association Dues

Duke included in cost of service dues for Edison Electric Institute (EEI) and the United States Council for Energy Awareness (USCEA). Consumer Advocate witness Miller proposed the elimination of these dues from test year operation and maintenance expenses based on his belief that these two associations' activities do not provide a direct and primary benefit to ratepayers. (Tr. Vol. 5, pp. 38, 44)

The Commission notes that EEI is recognized as a central source of authoritative information on electric energy and provides factual information to congressional committees and regulatory agencies. EEI's efforts have saved electric companies and their ratepayers millions of dollars thus directly benefitting South Carolina retail customers. Mr. Stimart testified that a portion of the EEI dues have already been recorded as a nonelectric expense. Each year EEI tells each of its member companies the portion of EEI dues not related to electric operations. The amount indicated in this letter is the result of audits and negotiations between the NARUC management and EEI. (Tr. Vol. 4, p. 59) As a result, EEI expenses for lobbying and certain media activities are not accounted for in electric utility operations.

The USCEA's activities are primarily related to nuclear energy. Its activities include the examination of generic issues related to nuclear power and the collection and publication of statistical and other information related to nuclear power. Duke and its customers rely heavily on nuclear power for the

reliable delivery of electricity. It clearly benefits the Company's customers to have a reliable source of information in the constantly changing nuclear environment. Based on the foregoing discussion, the Commission finds that witness Miller's adjustments for EEI and USCEA dues are inappropriate.

Item 9. Employee Moving Expense

Witness Miller proposed to adjust the test year costs associated with employee moves and relocations to reflect the average employee moving expense incurred over the 5-year period from 1986-1990 because of fluctuations in moving expense from year to year. Witness Miller explained "it is important that any abnormally low or high expenditure be normalized for rate making purposes in order that the test year expenditure will be as representative as possible of the expenses that are anticipated to be incurred during the time the rates will be in effect." (Tr. Vol. 5, p. 32) Witness Stimart testified on cross-examination that with the ongoing aggressive assessment of costs, the movement of the Company's workforce experienced in 1990 should continue at an even higher rate. He concludes that 1990 costs for employee moving expense are representative of the upcoming years. (Tr. Vol. 4, pp. 81 & 82) The Commission finds that witness Miller's proposed adjustment is not supported by any evidence indicating that the 1990 expense level is unrepresentatively high.

Item 10. Advertising Expense

Witness Miller proposed to exclude advertising expense associated with ads which he alleged were of a goodwill or image building nature, ads which are purportedly contributions to various organizations, and a single billing error in the month of December for which the Company received a credit for \$135,857 in January, 1991. Mr. Miller contended that these advertising expenses do not provide a direct and primary benefit to the ratepayers. (Tr. Vol. 5, pp. 39-41) Mr. Stimart testified that these costs are a necessary part of doing business

and have been recorded in the proper electric operating expense account.
(Tr. Vol. 4, p. 87)

This Commission has adopted the FERC Uniform System of Accounts for recording utility transactions. These advertising costs were recorded as an electric operating expense as prescribed by this accounting system and as such are an appropriate expense for cost of service.

Item 11. Storm Damage Costs

The Commission approved deferred accounting of storm damage costs incurred in 1989 with a five-year amortization. In 1989, Duke experienced two of the most devastating storms in its history, the largest being Hurricane Hugo.

Consumer Advocate witness Miller proposed to adjust the annual amortization of deferred storm damage costs by removing 10.2% of the amortization because the deferred costs include certain labor and associated benefits that Mr. Miller alleges were already included in base rates. (Tr. Vol. 5, pp. 50-51)

The Commission notes that witness Miller incorrectly calculated his adjustment to remove a certain amount of labor by using a jurisdictional allocation factor. The Company's cost of service for South Carolina retail ~~includes storm damage amortization expense on a direct charge basis.~~ Witness Miller acknowledged on cross-examination by the Company that use of a jurisdictional allocation factor is inappropriate when expenses have been directly assigned. (Tr. Vol. 5, p. 64)

Based on the evidence, the Commission finds that the Company's treatment ~~of storm damage expense is appropriate.~~

Item 12. Lobbying

Witness Miller recommended that 50% of all Public Affairs Department expenses be excluded from test year operating expenses and charged below the line as lobbying. Miller contended that the portion of the expense charged below the line by the Company is not representative of the lobbying-related

efforts conducted by employees in the Company's Public Affairs Department.

(Tr. Vol. 5, pp. 42-43)

Mr. Stimart testified that the Company charges employee wages and expenses to nonelectric while they perform their job with respect to lobbying. (Tr. Vol. 4, p. 53) This is in accordance with the Uniform System of Accounts. He further testified that the amount charged to nonelectric is greater than it should be because the Company assumes the employee is lobbying 100% of the time while the employee is in the state capital during legislative session. (Tr. Vol. 4, p. 54)

The Commission disagrees with the Consumer Advocate's lobbying adjustment. Legislation can materially affect utility costs. The Clean Air Act is an example. The Consumer Advocate would eliminate all costs incurred in the Company's attempt to "influence the passage, defeat or amendment of legislation of interest to the Company." The Company has already allocated costs to nonelectric operations for lobbying.

Item 13. Implementation of SFAS 106

The Commission's findings concerning this issue have been discussed under Finding of Fact No. 11 and will not be repeated here.

Depreciation and Amortization

The Company proposes depreciation and amortization expense of \$121,499,000. The differences between the Company, Commission Staff, and Consumer Advocate are summarized below:

	(000's)		
	<u>Company</u>	<u>Commission Staff</u>	<u>Consumer Advocate</u>
Depreciation and Amortization	\$121,499	\$116,895	\$119,855
Difference		\$(4,604)	\$(1,644)

Analysis of Differences

1. Bad Creek Depreciation	\$ (109)	\$ 270
2. Bad Creek Deferred Cost	(4,915)	955
3. Decommissioning Expense	--	(2,869)
4. Amortization of Coley Creek Costs	--	*
5. Amortization of Catawba Costs	420	--
	-----	-----
Total Difference	\$(4,604)	\$ (1,644)
	=====	=====

* Adjustment recommended but not reflected

Item 1. Bad Creek Depreciation

The first area of difference relates to the amount of Bad Creek dollars included in electric plant in service. The Company included all four units; however, Commission witness Price recommended that only the Bad Creek balance through August 31, 1991, be included in gross plant because the Commission Staff had not audited the Company's updated numbers. Because of the difference in plant balance, the Commission Staff and the Company recommended different amounts for depreciation expenses.

Consumer Advocate witness Lanzalotta recommended disallowance of operating costs related to Units 3 and 4 as excess capacity but did not reflect this reduction in any of his exhibits or those of Consumer Advocate witness Miller.

The difference between the Company and the Consumer Advocate results from witness Miller not adjusting his exhibits to consider the Company's update of Bad Creek Costs.

Based on the evidence, the Commission finds that it is appropriate to include \$5,182,000 of depreciation related to Bad Creek in cost of service as proposed by the Company.

Item 2. Bad Creek Deferred Cost

(000's)	
<u>Company</u>	<u>Commission Staff</u>
\$6,649	\$1,734
Difference	\$(4,915)

This difference results from the Commission Staff's recommendation of a ten-year amortization of the deferred cost related to the commercial operation of Bad Creek. The Company included in cost of service a three-year amortization of these costs together with the carrying cost on the unamortized cost during this three-year period. (Tr. Vol. 2, p. 151) The Commission Staff recommends the unamortized balance be included in rate base in order to allow the Company to recover the carrying cost of the unamortized balance during their recommended ten-year amortization period.

Witness Miller made no adjustment to the Company's proposed adjustment (Tr. Vol. 5, p. 62) nor did witness Miller update his exhibits to reflect the lower deferred costs as updated by the Company.

The Commission takes notice of its approval of deferral accounting for the start-up costs of Bad Creek from the commercial operation dates to the effective date of new rates resulting from this proceeding. In order to reduce the carrying cost South Carolina customers pay, the Commission finds the Company's adjustment appropriate.

Item 3. Decommissioning Expense

The Commission's findings concerning this issue have already been discussed under Finding of Fact Nos. 14, 15, and 16 and will not be repeated.

Item 4. Amortization of Coley Creek Costs

Duke proposed amortization over five years of the abandoned Coley Creek costs. The Commission approved the Company's accounting treatment of Coley Creek costs in a letter to Company witness Stimart dated October 29, 1990, reserving further review in this proceeding. Consumer Advocate witness Miller recommended amortization of these costs over a ten-year period. The Commission Staff accepted the Company's five-year write off. (Tr. Vol. 5, p. 92) Mr. Stimart testified that this Commission has tended to amortize items of this nature over varying periods of time depending on the magnitude of the dollars to be amortized. (Tr. Vol. 4, p. 44)

The Commission finds that the Company's accounting treatment of Coley Creek costs is appropriate and approves a five-year amortization period.

Item 5. Amortization of Catawba Costs

The Commission Staff included in cost of service the annual amortization of the Catawba deferred costs. This results from prior Commission decisions to amortize the reasonable and prudently incurred Catawba deferred costs over a ten-year period. No other evidence was submitted by the parties.

Based on the evidence, the Commission finds that the appropriate level of expense for depreciation and amortization is \$121,499,000.

General Taxes

The Company proposed \$48,755,000 as the appropriate level of general taxes. The differences between the Company, Commission Staff, and Consumer Advocate are summarized below:

	(000's)		
	<u>Company</u>	<u>Commission Staff</u>	<u>Consumer Advocate</u>
General Taxes	\$48,755	\$42,122	\$46,091
Difference		\$(6,633)	\$(2,664)

Analysis of Differences

1. Bad Creek Property Tax	(38)	94
2. Customer Growth Adjustment	(26)	(26)
3. Reconnect Fee	1	--
4. Payroll Tax	--	(419)
5. Franchise Fee	(6,570)	--
6. Property Tax	--	(2,313)
TOTAL DIFFERENCE	\$(6,633)	\$(2,664)

Items 1-4. Bad Creek Property Tax, Customer Growth Adjustment, Reconnect Fee
and Payroll Tax

Based on the Commission's previous determinations as to the appropriate adjustments for Bad Creek investment, customer growth, the Company's proposed increase in reconnect fees and increased wage rates, the Commission finds that the general tax adjustments related to these items proposed by the Commission Staff and Consumer Advocate are not appropriate.

Item 5. Franchise Fees

Commission Staff witness Watts recommended removal of franchise fees/municipal license fees as part of the Cost of Service Study, listed in General Taxes as Revenue Related Taxes. (Tr. Vol. 5, p. 235) Mr. Watts cited the Commission's decision in City of Spartanburg v. Public Service Commission of South Carolina, 281 S.C. 223, 314 S.E.2d 599 (1984) as support for his recommendation. These fees, imposed by certain municipalities, would only be charged to those customers living within the corporate limits of that municipality, therefore not affecting all ratepayers.

For purposes of the rates adopted in this Order, the Commission finds that the franchise fees/municipal license fees are to be included in base rates.

The Company shall remove these fees beginning in January, 1992. The Commission requires the Company to give notice to all customers concerning the removal of these fees from the cost of service. After this notice period, the Commission finds it appropriate to reduce base rates for removal of franchise fees/municipal license fees and include these fees as a separate line component on affected customers' bills effective with the first billing cycle in January, 1992.

Item 6. Property Taxes

The Company annualized test period property taxes on plant in service at December 31, 1990. Witness Stimart testified that property taxes for calendar year 1990 were assessed based upon property balances at the end of 1989. Likewise, property taxes for calendar year 1991 will be assessed based upon property balances at the end of 1990. This adjustment increases property tax expense in the test period to the year-end level of investment. The Company's calculation was based upon actual historically experienced changes in rates. (Tr. Vol. 2, pp. 151-152) Witness Price supported the Company's adjustment. Witness Miller supported the concept of annualizing property taxes to reflect the taxes related to property in service at the end of the test year. However, Miller alleged that the Company's proposed adjustment was not known and measurable because it was an estimate. (Tr. Vol. 5, p. 45)

The Commission determines that the Company's adjustment to annualize property taxes is appropriate and because it is based on end of year actual plant balances, it is based on known and measurable standards.

The Commission finds that the appropriate level of expense for general taxes is \$48,755,000.

Interest on Customer Deposits

The Company proposed that the actual test year level of interest on customer deposits of \$468,000 be reflected in the cost of service. Commission Staff

witness Price proposed to annualize interest on customer deposits. (Tr. Vol. 5, p. 86) The Commission is not persuaded by the evidence that it is necessary to make any adjustment to the actual test year level of interest on customer deposits. Therefore, the Commission finds that \$468,000 is the appropriate level of interest on customer deposits to include in the cost of service.

Income Taxes

The positions of the Company, Commission Staff, and Consumer Advocate regarding income taxes are summarized below:

(000's)

	<u>Company</u>	<u>Commission Staff</u>	<u>Consumer Advocate</u>
Income Taxes	\$57,562	\$61,465	\$69,709
Difference		\$ 3,903	\$12,147

The differences in the parties' positions regarding the appropriate level of income taxes are due to the different levels of operating revenues and operating expenses proposed by each party as well as the rate bases proposed by each party. Based on the Commission's previous decisions regarding each of these items, the Commission finds that the appropriate level of expense for income taxes is \$57,562,000.

Amortization of ITC

All parties agreed on the Company's proposed level of (\$4,395,000) for amortization of ITC, which the Commission determines is the appropriate level of expense.

Based on the entire record in this proceeding, the Commission concludes that the appropriate level of operating revenue deductions for use in this proceeding is \$837,757,000, calculated as follows:

Operating Revenue Deductions
(000's)

O&M Expenses:

Fuel	\$ 197,625
Purchased Power and Net Interchange	141,680
Wages, Benefits & Materials	274,563
Depreciation and Amortization	121,499
General Taxes	48,755
Interest on Customer Deposits	468
Income Taxes	57,562
Amortization of ITC	(4,395)

Total Operating Revenue Deductions	\$ 837,757
	=====

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 18

The evidence concerning the appropriate capital structure is presented in the testimony and exhibits of Company witnesses Lee, Osborne and Ibbotson, Commission Staff witness Spearman and Consumer Advocate witness Legler. In its Application, the Company utilized its actual per book capital structure as of December 31, 1990, consisting of 49.82% common equity, 9.68% preferred stock and 40.50% long-term debt.

Both Mr. Lee and Mr. Osborne testified that maintaining the Company's AA bond rating is a major financial goal of the Company and a key to the retention of the Company's credit worthiness and financial strength so that the Company can obtain new financing when necessary, in both good and bad capital markets. They testified that one of the most important determinants of the Company's bond rating is its coverage of fixed charges, and they pointed out that Duke's SEC interest coverage ratio is currently lower than it has been at any time since 1983. (Tr. Vol. 1, p. 56) (Tr. Vol. 2, p. 48) Mr. Osborne testified that maintaining the capital structure of the Company at approximately its present levels of common equity and long-term debt is necessary in order to enable the Company to maintain a fixed charges coverage ratio at a level necessary to retain its AA bond rating. He testified that the importance of maintaining

Duke's credit quality is shown by what occurred in the mid-1970's when Duke was unable to finance at all in difficult capital markets after its bond rating had dropped to a single A. This resulted in Duke having to stop work at certain construction projects which resulted in increased costs of those projects. He also pointed out that certain rating agencies have expressed concern about the negative trend in Duke's fixed charges coverage and have emphasized the importance of the outcome of this rate case on Duke's credit since Duke is approaching the lower limits of the AA rating. (Tr. Vol. 2, pp. 46-53)

Dr. Ibbotson also testified that, in his opinion, the capital structure of Duke as proposed in this proceeding reflects appropriate financial management and should be maintained. Dr. Ibbotson also stated that an increase in the amount of debt in Duke's capital structure would leave the overall weighted cost of capital unchanged in the long run because while the debt weight would increase, both debt and equity costs of capital would also increase. He pointed out that today's market is understandably very wary of companies with high leverage. (Tr. Vol. 3, pp. 27-29)

~~Consumer Advocate witness Legler noted that although the Company's equity~~
ratio may appear to be high on the surface, the equity ratio closely approximates the average equity ratio for AA rated electric utilities as reported by Value Line. Legler also noted that the 1990 equity ratio reflects a slight decline from the equity ratio in 1988 and 1989. (Tr. Vol. 6, p. 10)

~~Having carefully considered all of the evidence, it is our judgment that~~
Duke's actual capital structure, which it is proposing, is within reasonable bounds under all of the circumstances. The Commission finds and concludes that the appropriate capital structure for Duke for use in this proceeding is as follows:

Long-Term Debt	40.50%
Preferred Stock	9.68%
Common Equity	49.82%

	100.00%
	=====

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 19

The evidence concerning the proper embedded cost rates for long-term debt and preferred stock is presented in the testimony and exhibits of Company witnesses Lee, Osborne, and Ibbotson, Commission Staff witness Spearman and Consumer Advocate witness Legler.

The positions of the Company, the Commission Staff and the Consumer Advocate with respect to the embedded cost rates for long-term debt and preferred stock are as follows:

	<u>Company</u>	<u>Commission Staff</u>	<u>Consumer Advocate</u>
Long-Term Debt	8.78%	8.67%	8.78%
Preferred Stock	7.74%	7.53%	7.74%

The embedded cost rates proposed by the Commission Staff reflect an updating to June 30, 1991 (Hearing Exhibit 37, Accounting Exhibit A-5)

Upon review of the evidence, the Commission finds and concludes that the embedded cost rates as of December 31, 1990, as proposed by the Company and agreed to by the Consumer Advocate which are synchronized with the capital structure as of December 31, 1990, are appropriate for use herein. Accordingly, the Commission finds that the appropriate embedded cost rates for use in this proceeding are as follows:

	<u>Embedded Cost Rate</u>
Long-Term Debt	8.78%
Preferred Stock	7.74%

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 20

The evidence for this finding concerning the appropriate return on common equity is found in the testimony and exhibits of Company witness Ibbotson, Commission Staff witness Spearman, and Consumer Advocate witness Legler. A principal issue in any ratemaking determination involves the proper earnings to be allowed on the common equity investment of the regulated utility. In this proceeding, the Commission heard the expert testimony of three witnesses relating to the fair and reasonable rate of return on common equity for the Company.

This Commission has frequently stated that it adheres to no particular theory or methodology for the determination of a fair rate of return on common equity. (See, e.g., Order No. 85-841, at p. 56) Rather, we perceive our function as that of engaging in a careful and reasoned analysis of the evidence in a practical context. The record of the instant proceeding illustrates the use of several fundamental methods for the determination of the cost of equity capital by the expert witnesses for the Company, the Consumer Advocate, and the Commission Staff. Those methods include the discounted cash flow ("DCF") method, the capital asset pricing model ("CAPM"), the risk premium method, and the comparable earnings approach.

The evidence presented by the witnesses demonstrated an approach to their respective investigations within the parameters of the language of the United States Supreme Court in its decision in Federal Power Commission v. Hope Natural

Gas Co., 320 U.S. 591 (1944), at 603:

[T]he return to the equity owner should be commensurate with the return on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.

While the independent studies of each witness, either implicitly or explicitly, commenced with those standards, the respective methods employed produced quite different results, presenting the Commission with recommendations ranging from 11.5% to 13.17%. The Commission must weigh the opinions of the expert financial witnesses as to the expectations of investors or the opportunity costs of equity capital in conjunction with the tangible facts of the entire record of the proceeding, including the observable financial condition of the Company. Southern Bell Telephone & Telegraph Co. v. Public Service Commission of South Carolina, 270 S.C. 590, 244 S.E.2d 278 at 282 (1978). In the final analysis, we must determine the credibility and probative value of the testimony of the expert financial witnesses and use our judgment to evaluate this evidence in regard to the cost of common equity.

Furthermore, the Commission cannot determine the fair and reasonable return on common equity for the Company in isolation. Rather, the Commission must carefully consider a variety of relevant factors, including identifiable trends in the market relating to the costs of labor, materials, capital, interest rates and inflation rates; comparisons of past earnings with present earnings and prospective earnings; the prices for which the Company's service must be rendered; the returns of other enterprises and the reasonable opportunities for investment therein; the financial policy and capital structure of the Company and its ability to attract capital; the demonstrable competency and efficiency of the Company's management; the inherent protection against destructive competition afforded the Company through the operation of the regulatory process and the competitive forces that are coming into being that have never been experienced before; general economic conditions; and the public demand for growth and expansion which is required to evaluate the construction program for the foreseeable future. The Commission must strike the balance among these complex and interrelated factors in the context of the record herein.

In its determination of a fair and reasonable rate of return, the Commission maintains the ultimate responsibility of setting the rates to be charged for the utility services provided by the Company. The exercise of that responsibility involves the balancing of the interests of the consumer and the investor. The Commission must gravely balance the interests of the consumer in regard to the price of utility service with the interests of the same consumer in regard to the reliability and adequacy of the supply of energy. The Commission has maintained these interests paramount throughout this proceeding. The Commission's determinations of the Company's revenue requirements and of the proper allocation of those revenues within the approved rate structure embodied in this Order reflect fairly and equitably the interests of those consumers expressed in the record before us.

Duke presented Dr. Roger G. Ibbotson, the Consumer Advocate presented Dr. John B. Legler, and the Commission Staff presented Dr. James E. Spearman to testify on the rate of return to be applied to Duke's common equity. These witnesses updated their prefiled testimony to reflect changes in the capital ~~markets which had occurred after preparation of their testimony.~~ Dr. Ibbotson's testimony was filed on June 24, 1991, and was prepared in February of 1991 and used data current at that time. Dr. Ibbotson updated his prefiled testimony in September 1991 and used data current at that time. Dr. Spearman's testimony was filed on September 23, 1991, and was based on data current as of that date. ~~Dr. Legler's testimony was filed on September 9, 1991, and used data current~~ as of that date. Dr. Legler updated his testimony on September 25, 1991, and used current data as of that date.

A summary of the respective recommended returns on common equity, as updated, is as follows:

<u>PARTY</u>	<u>WITNESS</u>	<u>METHOD</u>	<u>RETURN ON COMMON EQUITY</u>
Company	Dr. Ibbotson	CAPM	13.17%
Staff	Dr. Spearman	CAPM/DCF	12.0% to 12.5%
Consumer Advocate	Dr. Legler	DCF/CAPM	11.5% to 12.5%

The Company's witness, Dr. Ibbotson, recommended in his prefiled testimony a return on common equity of 13.75%. Prior to the hearing, Dr. Ibbotson updated his recommended return on common equity to 13.17% because of changes in market conditions occurring between the time he prepared his testimony and the time of the hearing. (Tr. Vol. 3, p. 35)

Dr. Roger W. Ibbotson is Professor of Finance at Yale University and President of Ibbotson Associates, a Chicago-based financial consulting firm. Dr. Ibbotson estimated Duke's cost of equity using the Capital Asset Pricing Model (CAPM) which defines the cost of equity to be equal to the sum of the rate of return on a riskless security plus an equity risk premium, which is an additional return for the risk of holding the particular security (in this case Duke Power's common stock). The risk premium is estimated by multiplying the beta (a measure of risk) of Duke's common stock by the additional return which an investor expects to realize by investing in a diversified market portfolio rather than in the riskless security. (Tr. Vol. 3, p. 12) For the riskless security Dr. Ibbotson used an average of recent yields on 20-year U. S. Treasury bonds, selected mainly because that maturity matches more nearly the horizon over which equity capital is committed to Duke Power Company. For his estimate of the expected equity risk premium of the market as a whole, Dr. Ibbotson used 7.1%, which was developed in Ibbotson Associates' Stocks, Bonds, Bills and Inflation 1991 Yearbook, and is the arithmetic average of the differences, or spreads, between the annual total returns on the stock market (represented by the S&P 500), and the average annual income returns on 20-year treasury bonds, over the period 1926 through 1990. (Tr. Vol. 3, p. 25) Dr. Ibbotson explained

that this period was used because it is the longest period for which there is good quality data, and that the use of the longest available period yields the best estimate of the risk premium because the risk premium is a random variable and therefore the accuracy of the estimate increases with the period over which it is measured. (Tr. Vol. 3, pp. 15-18) Using a risk-free rate of 8.55%, a beta for Duke of 0.65 and a market risk premium of 7.1%, Dr. Ibbotson concluded that the current required rate of return on equity for Duke Power Company is 13.17%, which includes no allowance for down markets or flotation costs. (Tr. Vol. 3, pp. 26, 31 & 32)

The Commission Staff's witness, Dr. Spearman, used two independent methods -- the Capital Asset Pricing Model (CAPM) and the Discounted Cash Flow Method (DCF) -- in arriving at his estimates of the cost of capital. Based upon these two methods, he recommended a rate of return on common equity in the range of 12.0% to 12.5%. (Tr. Vol. 5, p. 295) In his DCF analysis, Dr. Spearman utilized a dividend rate of \$1.72 per share and a stock price of \$29.25 to derive a yield of 4.9% and a growth rate of 5% to 6%. Dr. Spearman's DCF analysis which included several variations resulted in an expected cost of common equity of 10.34% to 12.01%. (Tr. Vol. 5, pp. 275)

Dr. Spearman's prefiled testimony indicated a rate of return in the range of 10.59% to 12.50% based on his analysis of the CAPM method. (Tr. Vol. 5, p. 293) Dr. Spearman qualified his rate of return testimony as being perhaps on the low side. He stated that a cost of equity approaching the high end of the range requires that the market returns maintain their long-term average and that the betas "may be understated". (Tr. Vol. 5, pp. 294-295)

The Consumer Advocate's witness, Dr. Legler, primarily used the DCF methodology. Based on a stock price calculated by averaging the prices of Duke stock for June - August, 1991, of \$28.88 per share, dividends of \$1.72 per share, and a growth rate of 5.0% to 6.0%, Dr. Legler arrived at a range of cost

of equity capital for Duke Power Company using the DCF method of 11.0% to 12.0%. Dr. Legler's risk premium method produced a rate of return range of 11.2% to 11.5%. His CAPM method indicated a range of 10.3% to 12.5%. In his prefiled testimony, Dr. Legler's recommended rate of return produced a range of 11.7% to 12.8%. From this he suggested a return on common equity of 12.25%. In his updated testimony his range was 11.5% to 12.5% with a midpoint of 12%, his final recommended rate of return on equity capital. (Tr. Vol. 6, pp. 48-49, 53)

The Commission has been presented with differing testimony and evidence with respect to the cost of common equity. As that is the case, it is therefore our responsibility to weigh and evaluate such evidence and reach a decision after applying our expertise and reasoned judgment. The Commission observes that there are a number of valid approaches to the cost of equity determination, but that, in the final analysis, the results of all these approaches are influenced by the judgments and assumptions of the witnesses. In this case, judgment plays a critical role, for the disparity between the recommendations of the witnesses in their use of the DCF method is not attributable to any fundamental difference in methodology, but rather to legitimate differences of opinion as to what data provides the best evidence of the cost of equity. This Commission must ultimately use its own judgment in evaluating the evidence presented by the witnesses.

It therefore becomes the Commission's responsibility to set a fair and reasonable rate of return on common equity from which can be derived the lawful rates for the Company for its retail electric operations. This responsibility must be discharged in accordance with statutory and judicial standards, and based upon the numerous factors identified herein, and applied in accordance with the informed judgment of the Commission.

In light of all the relevant evidence in the record of this proceeding, the Commission is of the opinion, and so finds, that a fair and proper range of

return on common equity is from 12.5% to 13.17%. The Commission further finds that a fair and proper return on common equity of 13.17% provides the opportunity to produce additional annual revenues of \$68,384,000 for the Company's South Carolina retail electric operations, which the Commission finds fair and reasonable.

The Commission considers 13.17% to represent the reasonable expectation for the equity owner, and therefore, consistent with the standards of the Hope decision. The return found fair and reasonable is sufficient to protect the financial integrity of the Company, to preserve the property of the investor, and to permit the Company to continue to provide reliable service to present and future customers at reasonable rates.

The Commission is influenced that 13.17% is a reasonable rate of return for three (3) additional reasons. First, in the second quarter of this year regulatory Commissions have granted other electric utilities rates of return averaging 12.9%. Included in that figure is the 13% and 13.5% rates of return granted to Virginia Power and Appalachian Power by the Virginia Corporation Commission. (Tr. Vol. 5, p. 302) Second, the electric utilities with a double A bond rating earned, on average, in excess of 13% on equity over the last three (3) years. (Tr. Vol. 5, p. 304) These are comparable companies with which Duke must compete for capital. Third, this Commission granted Duke a 13% rate of return in its last general rate increase case. When that rate order was granted, the rates of return recommended by the Commission's Staff and the Consumer Advocate did not differ a great deal from the recommendations in this case. Since 1986, inflation has increased and Duke's interest coverage has decreased. (Tr. Vol. 2, p. 48) We believe that interest coverage is a significant financial indicator. Fixing a lower rate of return would likely cause a further decline, which this Commission does not believe should occur.

In arriving at a rate of return herein, the Commission is concerned only with the return to be earned on the common equity allocated to that portion of the Company's operations subject to the Commission's jurisdiction in this proceeding.

An important function of ratemaking is the determination of the overall rate of return which the utility should be granted. This Commission has utilized the following definition of "rate of return" in previous decisions, and continues to do so in this proceeding:

For regulatory purposes, the rate of return is the amount of money earned by a regulated company, over and above operating costs, expressed as a percentage of the rate base. In other words, the rate of return includes interest on long-term debt, dividends on preferred stock, the earnings on common stock and surplus. As Garfield and Lovejoy have put it "the return is that money earned from operations which is available for distribution among the various classes of contributors of money capital. In the case of common stockholders, part of their share may be retained as surplus."

Phillips, The Economics of Regulation, pp. 260-261 (1969).

The amount of revenue permitted to be earned by the Company through its rate structure depends upon the rate base and the allowed rate of return on the rate base. As discussed in the preceding section of this Order, the primary issue between the regulated utility and regulatory body most frequently involves the determination of a reasonable return on common equity, since the other components of the overall rate of return, i.e., dividends on preferred stock and cost of debt, are fixed. Although the determination of the return on common equity provides necessary component from which the rate of return on rate base can be derived, the overall rate of return, as set by this Commission, must be fair and reasonable.

The United States Supreme Court's landmark decision in Bluefield Water Works and Improvement Co. v. Public Service Commission of West Virginia, 262 U.S. 679 (1923), delineated general guidelines for determining the fair rate of return in utility regulation. In the Bluefield decision, the Court stated:

What annual rate will constitute just compensation depends upon many circumstances and must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts. A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risk and uncertainties; but it has no constitutional rights to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. A rate of return may be reasonable at one time, and become too high or too low by changes affecting opportunities for investment, the money market, and business generally.

262 U.S. at 692-693.

We held in Federal Power Commission v. Natural Gas Pipeline Co. that the Commission was not bound to the use of any single formula or combination of formulae in determining its rates. Its ratemaking function, moreover involves the making of 'pragmatic adjustments' (cite omitted)...Under the statutory standard of 'just and reasonable' it is the result reached, not the method employed which is controlling (cites omitted).... The ratemaking process under the Act, i.e., the fixing of 'just and reasonable' rates involves a balancing of the investor and the consumer interests. Thus we stated in the Natural Gas Pipeline Co. case, that regulation does not insure that the business shall produce net revenues. (cite omitted) But such considerations aside, the investor interest has a legitimate concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. (cite omitted.) By that standard the return to the equity owner should be commensurate with returns on investments in other

enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.

320 U.S. at 602-603

The vitality of these decisions has not been eroded, as indicated by the language of the more recent decision of the Supreme Court in IN RE: Permian Basin Area Rate Cases, 390 U.S. 747 (1968). This Commission has consistently operated within the guidelines set forth in the Hope decision. See, also, Southern Bell, supra, 244 S.E. 2d at 280-3.

The rate of return which the Commission has herein found to be fair and reasonable should enable the Company to maintain and enhance its position in the capital markets. Patently, however, the Company must insure that its operating and maintenance expenses remain at the lowest level consistent with reliable service and exercise appropriate managerial efficiency in all phases of its operations. The Commission has consistently manifested its abiding concern for the establishment and continuation of efficiency programs on the part of its jurisdictional entities. By its Directive of August 27, 1974, the Commission urged the derivation of cost control studies, the adoption of cost reduction programs, and the elimination and reduction of costs "in all possible ways." The continued awareness of the potential efficacy of such programs and their implementation is consistent with the conscious national and State policies to limit the deleterious effects of inflation.

Company witness Lee described the considerable effort made by the Company to reduce its costs of construction and its operations and maintenance expenses. (Tr. Vol. 1, pp. 53, 54, 68-69) (Tr. Vol. 2, pp. 11-18) The Company's construction policies and programs have resulted in favorable comparisons with the construction costs of other electric utilities. In addition, the standards for the measurement of economical generating operations manifest that the

Company has generally demonstrated an ability to produce electrical energy in a measurably efficient manner.

The record of this proceeding indicates that the Company has generally undertaken its cost reduction efforts in the spirit of the Commission's Directive and consistent with our previous Orders, especially the Order in Duke's last rate case in 1986. Since that time Duke has eliminated more than 1,200 work positions and is on a program to eliminate about 600 positions per year over the next three years mainly through attrition. (Tr. Vol. 1, pp. 50-51, 53) The Commission feels that Duke is serious about cost savings. Nonetheless, the Commission cannot ignore the effect of the Company's increasing operating expenses. The Company and the parties before us may take notice of the fact that the Commission is not inclined to be completely satisfied with the cost reduction and efficiency programs of any jurisdictional utility. The Commission will continue to expect the Company to design and implement such programs in the future as an index of good management practice in the interests of its customers and of the Company itself. With the full array of its resources at its disposal, the Company should be able to assure us that such programs produce identifiable and measurable results consistent with the provision of economical and adequate service to the Company's ratepayers. The Commission has found a fair and reasonable return on common equity which the Company should be allowed the opportunity to earn, and has herein set rates to produce revenues to reach that return. The Commission considers that effective programs of cost reductions can operate to enable the Company to improve its financial posture and earn the return approved. In addition to the review of the Company's cost of service in the context of this proceeding and our express expectations of efficient and effective management, the Commission considers the accepted regulatory devices of the use of a year-end rate base, adjustments for customer growth and annualized depreciation, together with adjustments for identifiable

and measurable changes in revenues and expenses to combine to represent a reasonable regulatory approach to the earnings erosion attributable to inflation.

The Commission has found that the capitalization ratios as of December 31, 1990, are appropriate and should be used in the instant proceeding. The Commission has likewise found that the respective embedded cost rates for long-term debt of 8.78% and for preferred stock and preference stock of 7.74%, should be utilized in the determination of a fair overall rate of return. For the purpose of this proceeding, the Commission has herein found the proper cost rate for the Company's common equity capital to be 13.17%.

Using these findings, the overall fair rate of return on rate base for the Company's South Carolina retail electric operations may be derived as computed in the following table:

OVERALL RATE OF RETURN

	<u>Rate</u>	<u>Cost</u>	<u>Weighted Cost</u>
Long-Term Debt	40.50%	8.78%	3.56%
Preferred Stock	9.68%	7.74%	.75%
Common Equity	49.82%	13.17%	6.56%
TOTAL	100.00%		10.87%

EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NO. 21

This evidence pertaining to the proper amount of materials and supplies investment is found in the testimony of Company witness Stimart. The Company proposed that \$73,668,000 be included for materials and supplies, consisting of \$25,495,000 of fuel stock and \$48,173,000 of other electric materials and operating supplies as presented on Hearing Exhibit 4, Stimart Exhibit 1, page 4c. No party challenged the reasonableness of this figure. The Commission finds that the proper total materials and supplies investment is \$73,668,000.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 22

The evidence pertaining to the proper amount of investment for plant held for future use is found in the testimony of Company witness Stimart. As shown on Hearing Exhibit 4, Stimart Exhibit 1, page 4, the Company proposed that \$4,402,000 be included in rate base to reflect investment in plant held for future use. No party challenged this figure. The Commission therefore finds it appropriate to include \$4,402,000 in rate base for plant held for future use.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 23

The evidence related to the proper working capital investment is contained in the testimony of Company witness Stimart, Commission witness Price, and Consumer Advocate witness Miller. An analysis of the total working capital investment proposed by the parties is set forth in the following table:

Working Capital Investment

(000's)

	<u>Company</u>	<u>Commission Staff</u>	<u>Consumer Advocate</u>
Operating Funds	\$48,489	\$48,489	\$48,489
Average Taxes Accrued	(16,366)	(16,366)	(16,366)
Bank Balances	2,120	2,120	700
Bond Reacquisition Premiums	10,906	10,906	7,890
Prepayments	2,839	2,839	2,839
Miscellaneous Deferred			
Debits and Credits	9,844	-0-	-0-
Deferred Costs	-0-	17,448	-0-
	-----	-----	-----
Total Working Capital	<u>\$57,832</u>	<u>\$65,436</u>	<u>\$43,552</u>
Difference		\$ 7,604	\$(14,280)

The Company computed the cash component (operating funds) of working capital using the Commission's formula method which reflects 1/8 of operation and maintenance expenses exclusive of purchased power and nuclear fuel expense. This amount is then reduced by the average tax accrued balance. No party

contested this component of working capital or the prepayments of \$2,839,000 included in working capital investment. The Commission concludes therefore that the amounts proposed by the Company for operating funds, taxes accrued, and prepayments are appropriate for use in this proceeding. The following components of working capital are in dispute:

Analysis of Differences

(000's)

	<u>Commission Staff</u>	<u>Consumer Advocate</u>
1. Miscellaneous deferred debits and credits	\$(9,844)	\$(9,844)
2. Bad Creek Deferred Costs	15,607	-0-
3. Catawba Deferred Costs	1,841	-0-
4. Required Bank Balances	--	(1,420)
5. Bond Reacquisition Premiums	--	(3,016)
	-----	-----
Total Difference	\$ 7,604	\$(14,280)

Item 1. Miscellaneous Deferred Debits and Credits

The Company proposed that \$9,844,000 be included in working capital for miscellaneous deferred debits and credits. Consumer Advocate witness Miller made an adjustment to exclude this component of working capital from rate base. Commission Staff witness Price did not include miscellaneous deferred debits and credits as a per book item of working capital.

The Staff did not provide any testimony supporting its exclusion of miscellaneous deferred debits and credits from the working capital investment included in rate base.

In support of his adjustment, Consumer Advocate witness Miller testified that such items are more appropriate for inclusion in a lead-lag study. (Tr. Vol. 5, p. 12) Witness Miller's opinion as to the appropriate treatment of deferred debits and credits in a lead-lag study, with no discussion of his reasoning, does not provide sufficient evidence to support his adjustment.

Likewise, his statement that the Commission does not regularly include deferred debits and credits in working capital investment provides no evidence that these items are not appropriate for inclusion in rate base in this proceeding. No party has offered evidence in this proceeding as to why the particular miscellaneous deferred debits and credits included in working capital by the Company are inappropriate for rate base inclusion in this proceeding. The Commission's decisions in prior cases were specific to the items of miscellaneous deferred debits and credits presented in those proceedings. The Commission is aware that the components of miscellaneous deferred debits and credits change over time. Therefore, any party taking exception to the inclusion of such items in rate base must present evidence regarding the specific items proposed to be included in rate base. No party has provided such evidence in this proceeding.

The Commission finds that \$9,844,000 of miscellaneous deferred debits and credits is appropriately included in working capital.

Item 2. Bad Creek Deferred Costs

The difference between the Company and Commission Staff on this item relates to different proposals regarding the recovery of return during the amortization period of the Bad Creek deferred costs. The Company calculated a levelized annual amortization which included a return component based on a three year amortization period. The Staff proposed that the deferred costs be amortized over ten (10) years and that the unamortized balance be included in rate base. (Tr. Vol. 5, p. 81)

The Commission has already determined in the Evidence and Conclusions for Finding of Fact No. 16 that a three-year amortization period for the Bad Creek deferred costs is appropriate. Further, the Commission determined that it was appropriate to calculate a levelized amortization which includes a return component, rather than to include an unamortized balance in rate base. This

treatment recognizes and accounts for the fact that the unamortized balance will decline over time. Inclusion of the unamortized balance in rate base, especially in conjunction with a ten-year amortization period, would overstate the Company's ongoing cost of service. Such a situation can only be resolved by annual rate changes or by use of a levelized amortization as proposed by the Company. The Commission concludes, therefore, that the unamortized Bad Creek deferred costs should not be included in rate base in this proceeding.

Item 3. Catawba Deferred Costs

Commission Staff witness Price has included \$1,841,000 of unamortized Catawba deferred costs in working capital. This adjustment corresponds to his proposal to reflect the Catawba deferred costs amortization in the cost of service. (Tr. Vol. 5, p. 86, Hearing Exhibit 37, Accounting Exhibit A-3)

Based on the Commission's prior discussion concerning Bad Creek deferred costs, the Commission rejects this adjustment.

Item 4. Required Bank Balances

The Company proposed to include bank balances of \$2,120,000 in working capital. The Commission Staff did not dispute this proposal. Consumer Advocate witness Miller disagreed with the Company's inclusion of end-of-period cash balances held in each account. Miller contended that if no adjustment were made, the Company would earn carrying costs on all cash on hand even though not all of that cash is required to maintain minimum and compensating balances and to meet daily cash requirements. Miller recommended that the amount included be limited to compensating balance requirements, working funds needed for daily operations, and miscellaneous special deposits. (Tr. Vol. 5, p. 13)

The Consumer Advocate attempted to show through cross-examination of Mr. Stimart that the cash in banks over and above the approximately \$508,000 required as compensating balances is not appropriately included in cash working capital. (Tr. Vol. 4 at pp. 66-69) In support of its position, the Consumer

Advocate presented Hearing Exhibit 30, copies of portions of data responses provided to the North Carolina Public Staff. Mr. Stimart acknowledged that Hearing Exhibit 30 was a Company provided response, but he did not know what the question was. (Tr. Vol. 4, p. 68) The Commission is not persuaded by the Consumer Advocate's testimony regarding this issue. Further, the Commission cannot rely on portions of data responses provided in another jurisdiction without having access to the entire question and answer as well as all other related questions and answers which may have been raised regarding that issue.

The Commission finds Mr. Stimart's testimony regarding the necessity of having cash balances in the magnitude of \$6,000,000 in view of the \$4 billion worth of activity at its banks annually to be reasonable. (Tr. Vol. 4, pp. 68-69)

Based on the foregoing, the Commission finds that it is appropriate to include bank balances of \$2,120,000 in working capital investment in rate base.

Item 5. Bond Reacquisition Premiums

The Company included \$10,906,000 for bond reacquisition premiums in its working capital investment. (Hearing Exhibit 4, Stimart Exhibit 1, page 4c) The Commission Staff did not take exception to the Company's position. Consumer Advocate witness Miller proposed to adjust this amount in order to allocate a portion to nonelectric operations. Miller contended that reacquisition of bonds benefits all of the Company's operations, not just electric. (Tr. Vol. 5, p. 14)

Mr. Stimart testified that the bonds in question were issued to finance electric operations. (Tr. Vol. 4, p. 65) The Company's treatment of this item is consistent with past Commission practice in Docket Nos. 86-188-E and 85-78-E. The Consumer Advocate's reference to portions of testimony presented in the Company's North Carolina rate case does not constitute sufficient evidence in this proceeding on which the Commission can rely. (Tr. Vol. 4, pp. 65-66) The

Commission would have to have all pertinent evidence from the North Carolina proceeding in the record in this proceeding. The Consumer Advocate made no such offer of evidence in this proceeding.

The Commission finds that the treatment of bond reacquisition premiums proposed by the Company and agreed to by the Commission Staff is appropriate. Therefore, \$10,906,000 of bond reacquisition premiums should be included in working capital investment.

Thus, the Commission concludes that the appropriate allowance for working capital for use in this proceeding is \$57,832,000, as set forth in the table below:

Working Capital Investment

Operating Funds	\$48,489,000
Average Taxes Accrued	(16,366,000)
Bank Balances	2,120,000
Bond Reacquisition Premiums	10,906,000
Prepayments	2,839,000
Miscellaneous Deferred Debits and Credits	9,844,000

Total Working Capital Investment	<u>\$57,832,000</u>

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 24

The evidence supporting this finding concerning the proper value for rate base is found in the testimony of Company witness Stimart, Staff witnesses Price and Watts, and Consumer Advocate witness Miller.

The difference between the Company, the Commission Staff, and the Consumer Advocate concerning rate base is summarized below:

	<u>Rate Base</u> (000's)		
	<u>Company</u>	<u>Commission</u> <u>Staff</u>	<u>Consumer</u> <u>Advocate</u>
Electric Plant in Service	\$3,390,362	\$3,384,892	\$3,404,002
Less:			
Accumulated Depreciation and Amortization	(1,357,590)	(1,357,607)	(1,357,860)
Net Electric Plant	2,032,772	2,027,285	2,046,142
Materials and Supplies	73,668	73,668	73,668
Plant Held for Future Use	4,402	4,402	4,402
Working Capital Investment	57,832	65,436	43,552
Less:			
Accumulated Deferred Taxes	(315,569)	(315,569)	(315,569)
Operating Reserves	(14,180)	(14,180)	(14,180)
Customer Deposits	(3,953)	(3,953)	(3,953)
Unclaimed Funds	-0-	-0-	(214)
Construction Work in Progress	-0-	-0-	-0-
Total Rate Base	\$1,834,972	\$1,837,089	\$1,833,848
Difference		\$2,117	\$(1,124)

Areas of Difference

1. Electric Plant in Service	\$ (5,470)	\$13,640
2. Accumulated Depreciation and Amortization	(17)	(270)
3. Working Capital Investment	7,604	(14,280)
4. Unclaimed Funds	-0-	(214)
Total Difference	\$ 2,117	\$(1,124)

Item 1. Electric Plant

The difference between the Company, the Staff, and the Consumer Advocate regarding this item stems from the difference in the amount of Bad Creek included in plant in service. The Commission has already determined the prudence of all four units of Bad Creek in the Evidence and Conclusions for Finding of Fact No. 7. The issue remaining to be decided is the appropriate cost of Bad Creek to include in rate base.

The Company originally proposed an adjustment of \$275,391,000 (Hearing Exhibit 4, Stimart Exhibit 1, page 4a) to reflect all four units of Bad Creek in electric plant in service. The Staff originally included \$238,765,000 for Units 1, 2, and 3 in electric plant in service and included \$17,640,000 for Unit 4 in construction work in progress. (Hearing Exhibit 37, Accounting Exhibit A-1, p. 9 of 9) The Staff's reasoning was that Units 1, 2, and 3 were all that could reasonably be expected to be in commercial operation at the date of testimony. (Tr. Vol. 5, p. 81) The Consumer Advocate did not propose any changes to the Company's original adjustment.

The Company subsequently revised its adjustment in order to reflect the actual in service dates of Units 3 and 4. As presented on Stimart Supplemental Exhibit 3, page 4a, the Company's revised adjustment to include Bad Creek in electric plant in service is \$261,751,000. The Commission Staff also revised its recommendation to recognize the fact that Unit 4 began commercial operation on September 13, 1991. The Staff now proposes that \$256,281,000 be included in electric plant in service for Bad Creek. (Tr. Vol. 5, p. 89) The (\$5,470,000) difference between the Company's and Staff's revised adjustments is due to the Staff's exclusion of amounts it has not audited. (Tr. Vol. 5, p. 88) The Commission concludes that the revised adjustment proposed by the Company which reflects the total costs for all four units is appropriate. Based on the "Report of Accounting Department Administration Division" pages 3 and 4 (Hearing Exhibit 37), the Commission finds that there is no reason to conclude that the amounts proposed by the Company would be found to be unreasonable when audited.

Item 2. Accumulated Depreciation and Amortization

The differences between the parties' proposals are set forth below:

	(000's)		
	<u>Company</u>	<u>Commission Staff</u>	<u>Consumer Advocate</u>
Accumulated Depreciation and Amortization	\$(1,357,590)	\$(1,357,607)	\$(1,357,860)
Difference		\$(17)	\$(270)

Analysis of Differences

Difference in Bad Creek Electric Plant In Service	\$109	(\$270)
Depreciation Rate Change	\$(126)	-0-
	-----	-----
TOTAL DIFFERENCE	\$(17)	\$(270)

The Commission has previously determined that the adjustment to electric plant in service for Bad Creek proposed by the Company is appropriate. Therefore, the adjustments proposed by the Commission Staff and the Consumer Advocate regarding accumulated depreciation associated with their respective proposed levels of investment in Bad Creek are inappropriate.

Staff adjusted accumulated depreciation by the amount of the adjustment to depreciation expense for the Company's proposed depreciation rates. Although the Commission has previously found the Company's proposed depreciation rates to be appropriate for use in this proceeding, there is no evidence in the record supporting this adjustment to accumulated depreciation; therefore, the Commission rejects it. The appropriate level of accumulated depreciation and amortization to be reflected in rate base in this proceeding is (\$1,357,590,000).

Item 3. Working Capital Investment

The differences among the parties concerning working capital have already been discussed in the Evidence and Conclusions for Finding of Fact No. 22 and will not be repeated here.

Item 4. Unclaimed Funds

Consumer Advocate witness Miller testified that unclaimed funds are a noninvestor source of funds which should be subtracted from rate base like other noninvestor sources of funds. Miller therefore deducted \$214,000 from rate base. Witness Miller stated that he believes his recommendation is consistent with Commission precedent on this matter. (Tr. Vol. 5, p. 52) However, he failed to cite a particular case where this Commission had made such a ruling. The Commission concludes that the adjustment proposed by witness Miller is not appropriate for use in determining the level of original cost rate base for use in this proceeding.

Based upon the foregoing discussion, the following table provides the appropriate jurisdictional amounts for rate base as approved by the Commission:

(000's)

Electric Plant in Service	\$3,390,362
Less:	
Accumulated Depreciation and Amortization	(1,357,590)
Net Electric Plant	2,032,772
Materials and Supplies	73,668
Plant Held for Future Use	4,402
Working Capital Investment	57,832
Less:	
Accumulated Deferred Taxes	(315,569)
Operating Reserves	(14,180)
Customer Deposits	(3,953)
Construction Work in Progress	-0-

Total Rate Base	\$1,834,972
	=====

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 25

The Commission has previously set forth the evidence supporting its findings of fact and conclusions regarding the fair rate of return which Duke Power Company should be afforded an opportunity to earn.

The following schedules summarize the gross revenues and the rates of return which the Company should have a reasonable opportunity to achieve based upon the determinations made herein. Such Schedules, illustrating the Company's gross revenue requirements incorporate the Findings of Fact and the Conclusions made herein by the Commission.

SCHEDULE I

DUKE POWER COMPANY
SOUTH CAROLINA RETAIL OPERATIONS
Docket No. 91-216-E
STATEMENT OF OPERATING INCOME
Twelve Months Ended December 31, 1990
(Thousands of Dollars)

<u>Item</u>	<u>Before Increase</u>	<u>Approved Increase</u>	<u>After Increase</u>
Electric Operating Revenue	\$994,450	\$68,384	\$1,062,834
<u>Electric Operating Expenses:</u>			
Operation and Maintenance:			
Fuel Used in Electric Generation	197,625		197,625
Purchased Power and Nonfuel			
Net Interchange	141,680		141,680
Wages, Benefits, Materials, etc.	274,563		274,563
Depreciation and Amortization	121,499		121,499
General Taxes	48,755	278	49,033
Interest on Customer Deposits	468		468
Income Taxes	57,562	25,403	82,965
Amortization of ITC	(4,395)		(4,395)
Total Electric Operating Expenses	837,757	25,681	863,438
Operating Income	\$156,693	\$42,703	\$199,396

SCHEDULE II

DUKE POWER COMPANY
SOUTH CAROLINA RETAIL OPERATIONS
Docket No. 91-216-E
STATEMENT OF RATE BASE AND RATE OF RETURN
Twelve Months Ended December 31, 1990
(Thousands of Dollars)

<u>Item</u>	<u>Amount</u>
Electric Plant In Service	\$3,390,362
Less: Accumulated Depreciation and Amortization	(1,357,590)
Net Electric Plant	2,032,772
Add: Materials and Supplies	73,668
Working Capital Investment	57,832
Plant Held for Future Use	4,402
Less: Accumulated Deferred Taxes	(315,569)
Operating Reserves	(14,180)
Customer Deposits	(3,953)
Construction Work in Progress	0
TOTAL RATE BASE	<u>\$1,834,972</u>

RATE OF RETURN

Present	<u>8.54%</u>
Approved	<u>10.87%</u>

SCHEDULE III

DUKE POWER COMPANY SOUTH CAROLINA RETAIL OPERATIONS Docket No. 91-126-E STATEMENT OF CAPITALIZATION AND RELATED COSTS Twelve Months Ended December 31, 1990 (Thousands of Dollars)

Item	Capital- ization Ratio	Original Cost Rate Base	Embedded Cost	Net Operating Income
<u>Present Rates - Original Cost Rate Base</u>				
Long-Term Debt	40.50%	743,164	8.78%	65,250
Preferred Stock	9.68%	177,625	7.74%	13,748
Common Equity	49.82%	914,183	8.50%	77,696
Total	100.00%	\$1,834,972		\$156,693
<u>Approved Rates - Original Cost Rate Base</u>				
Long-Term Debt	40.50%	743,164	8.78%	65,250
Preferred Stock	9.68%	177,625	7.74%	13,748
Common Equity	49.82%	914,183	13.17%	120,399
Total	100.00%	\$1,834,972		\$199,396

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 26

The evidence supporting this finding of fact is contained in the testimony and exhibits of Company witness Denton, Staff witness Watts, Consumer Advocate witness Lanzalotta and SCEUC witness Phillips. Mr. Denton described the changes Duke proposes for the Company's various rate schedules. The Company proposes to consolidate its three non-time-of-use residential rates into two new rate schedules: (1) RS, residential service; and (2) RE, residential service, electric water heating and space conditioning. Both rates include conservation discounts. These proposed rate schedules eliminate present rate Schedules R, RC, and RA and reassign customers to new Schedules RS and RE. Schedule RS consists of four categories. Category 1 applies to any residential

customer. Category 2 applies to residential customers with qualifying electric water heaters. Category 3 applies to residential customers meeting certain thermal conditioning requirements. Category 4 applies to residential customers meeting both the requirements for Categories 2 and 3. Schedule RE applies to residential customers where all energy required for water heating, cooking, clothes drying, and space conditioning is supplied electrically. This schedule consists of two categories. Category 1 applies to customers meeting specific requirements for electric water heaters and electric space conditioning. Category 2 applies to customers meeting the same specific thermal conditioning requirements as those required by Schedule RS, Category 3 and 4. Mr. Denton explained that the new schedules place customers in more homogeneous groups based on the equipment installed in their homes and permits targeted price signals to these homogenous groups.

As a result of the proposed residential rate design charges, some customers on each rate schedule will receive bill increases greater than the percentage increase for the residential class. Duke proposes to create Schedule RB for these customers who would otherwise receive an increase of 5% or more above the ~~average residential class increase~~, and limit the magnitude of the increase to Schedule RB customers to 5% above the average residential increase. Duke also plans to encourage customers who will receive an increase greater than the increase for the class to move to time-of-use Schedule RT, which may minimize the impact of the proposed increase.

Mr. Denton also explained the proposed modifications to general service and industrial rate schedules. Duke proposes to modify Schedules G, GA, and I to eliminate the confusion caused by GA being available to both general service and industrial customers. Under the current rate design, it is sometimes difficult for customers to determine the appropriate rate for their usage. Duke proposes that industrial customers be served on Schedule I, and that general

service customers be served on Schedules G and GA. The billing demand provision of Schedule GA currently applied to industrial customers would be maintained for Schedule GA customers moving to Schedule I. For general service customers, Duke proposes to retain Schedules G and GA with certain modifications. Under each rate, the price during April through November will be the same. The months of December through March will have lower energy charges for Schedule GA. These changes will reduce customer confusion in the general service class over which rate is more advantageous. Bills under Schedule GA will always be equal to or lower than bills under Schedule G.

The Company proposes to reduce the Schedule OPT summer on-peak hours from ten to eight, with the on-peak period beginning at 1:00 p.m. and ending at 9:00 p.m. The reduction is proposed to make it easier for customers to shift production off-peak by allowing them to operate two eight-hour shifts during the off-peak period. SCEUC witness Phillips agrees with the proposed change, in on-peak hours. (Tr. Vol. 4, p. 125) No other party expressed opposition to the modified hours. Therefore, the Commission concludes that the modified summer on-peak hours on Schedule OPT proposed by the Company should be adopted.

The Company proposes to increase closed rate schedules GB, GT, and IT 2% more than the overall general increase to encourage customers to move from these rates to open rate schedules. This proposal was opposed by SCEUC witness Phillips, who proposes that Schedule OPT be revised by lowering demand and energy charges to make it more attractive to Schedule I and IT customers, rather than simply increasing the rate to move customers. Mr. Phillips also proposes that the increase for Schedule GB, GT, IT, and I be limited to the average of the industrial class increase. (Tr. Vol. 4, pp. 126-127)

Mr. Denton also described the proposed changes to lighting schedules. Duke currently has four lighting schedules, Schedules T, T2, T2X, and FL. Schedule T, Street Lighting Service, is available to governments for public

lighting. Duke proposes to change the name to Schedule PL, Street and Public Lighting Service. Schedule T2, Outdoor Lighting Service, would be designated Schedule OL. The designation of Schedule FL, Floodlighting Service, would not change.

Duke is proposing additional pricing levels for Schedules OL and FL to cause new customers to pay the higher cost of installing lights when a pole installation is requested by the customer. The proposed rates include pricing for a new luminaire on an existing pole, for the installation of a new pole, and a price for a new pole installation and underground service. Existing installations would be served on the luminaire-only rate. Schedule T2X, Subdivision Entrance Lighting Service, is currently available for lighting entrances to subdivisions and other public areas. Duke is proposing to cancel Schedule T2X and offer new mercury vapor and high pressure sodium vapor post-top luminaires on Schedule OL.

Finally, Duke proposes that a pilot program named "Limited Demand Charge Days" (LDCD) be approved. The pilot program will be used to determine to what extent industrial customers will change their consumption characteristics during times of adequate supply by limiting demand charges during these periods. Customers would be able to increase their consumption during these periods without incurring an increased billing demand.

Staff witness Watts testified that the Electric Department reviewed Duke's rates, tariffs and service regulations, and verified the requested increase by rate schedule. Based on the Staff's review and audit, it concurs with the Company's proposed rate design changes.

Consumer Advocate witness Lanzaletta testified that the increase in Schedule RS should be no larger than the increase for the residential class, and that the proposed tailblock rate in Schedule RE should not be less than the tailblock rate in Schedule RS. This proposal would eliminate the discount for

efficient air conditioning and high levels of insulation. Mr. Lanzalotta testified that Duke's residential rate design improperly encourages the use of electric space heating, water heating, and air conditioning. Mr. Lanzalotta is correct when he asserts that Duke's rate design will encourage electric heating and water heating. Duke has encouraged efficient heat pumps on its system to create off-peak winter sales. Such sales improve Duke's load factor, which enables fixed costs to be spread over a large number of kilowatt/hours. This benefits all customers by lowering the unit cost of electricity. (Tr. Vol. 4, pp. 106-107; 110-111) Mr. Lanzalotta's recommendations are inconsistent with Duke's efforts that are clearly beneficial to Duke's customers. Mr. Lanzalotta's criticisms of Duke's discounts for efficient air conditioning and high levels of insulation is also misplaced. Duke is a summer peaking utility, with a significant air conditioning load. The discount in Schedule RE which Mr. Lanzalotta criticizes will encourage efficient air conditioning and conservation. These are appropriate goals of rate design which the Commission has adopted in prior cases and will continue.

The parties have made other proposed revisions to the rate schedules proposed by Duke which are not specifically addressed in this Order. The Commission has carefully considered the testimony and exhibits of each party. The remaining proposals, while not specifically addressed, must be rejected by the Commission. Duke's proposed rate design, rate schedules, miscellaneous charges, and terms and conditions should be approved, except as specifically modified in this Order.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 27

The evidence supporting this finding of fact is contained in the testimony and exhibits of Company witness Denton, Staff witness Watts, and SCEUC witness Phillips. In his direct testimony, Mr. Denton explained that different percentage increases were applied to customer classes to help move the

Residential and Industrial classes toward the "band of reasonableness", a band or range of plus or minus 10% of the average retail rate of return. Mr. Denton testified that the industrial class is experiencing a significantly higher rate of return than average, and the residential class is experiencing a significantly lower return than average. Duke proposes to allocate the increase in revenue to trend toward equal rates of return.

SCEUC witness Phillips testified that Duke's proposed allocation of the revenue increase does not adequately move class rates of return toward equality. Under Mr. Phillips proposal, the remaining difference would be reduced in future rate cases. Mr. Phillips proposed as an alternative that the Commission utilize the difference between Duke's requested increase and the actual increase granted to reduce or eliminate overpayments made by the industrial class. (Tr. Vol. 4, pp. 121-122)

Staff witness Watts recommended adoption of the Company's Cost of Service Studies with certain modifications. (Tr. Vol. 5, p. 238)

The Commission concludes for purposes of this proceeding that the revenue increase should be allocated to the extent practical to bring the Industrial class return to the band of reasonableness.

EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 28

The evidence supporting this Finding of Fact is contained in the testimony and exhibits of Company witness Denton and SCEUC witness Phillips. Rider IS is the interruptible service rider under which general service and industrial customers receive a credit from Duke to curtail their load at Duke's request. Duke proposes to increase the cost to the customer in each situation where the customer does not interrupt his load at Duke's request. The current cost to the customer for failing to interrupt is \$1.58/KW. Under the proposed revised Rider IS, each time the customer fails to interrupt, approximately one third of the credits paid to the customer during the year are to be repaid to Duke.

If a customer fails to interrupt three times during the year, all credits paid during the prior twelve months would be repaid to Duke and the customer would be removed from Rider IS. Mr. Denton testified that this change will send a much stronger price signal to customers so that when Duke requests an interruption of load, the Company can expect customers to reduce their load to the level agreed to in their Rider IS contracts. Duke also proposes to make the exposure period consistent with Schedule OPT by reducing the exposure hours during the summer to equal the proposed summer on-peak hours.

No party objected to the proposed change in penalty provision. However, SCEUC witness Phillips proposes that the credit rate be increased from the present \$3.50/KW to a range of \$6.25/KW to \$7.50/KW per month. (Tr. Vol. 4, pp. 129-130). Duke is attracting a sufficient amount of interruptible load at the present credit and has requested an increase in the system cap to 1100 megawatts.

The Commission agrees with the Company that an increase in the Rider IS credit is not necessary to attract a sufficient level of interruptible load.

IT IS, THEREFORE, ORDERED AS FOLLOWS:

1. That Duke Power Company be, and is hereby, allowed to adjust its electric rates and charges so as to produce, based upon the adjusted test year level of operations, an increase in annual gross revenues of \$68,384,000 from its South Carolina retail operations. This increase shall be effective for service rendered on and after the date of this Order.

2. That within _____ working days after the date of this Order, the Company shall file with the Commission _____ copies of computations showing the overall South Carolina retail rate of return which will be produced by the revenues approved by this Order. Such computations shall be based on the cost allocation methodology approved herein.

3. That the Company shall give appropriate notice of the rate increase approved herein by mailing a notice to each of its South Carolina retail customers during the next normal billing cycle following the filing and approval of the rate schedules described in Decretal Paragraph No. 2 above.

4. That the following holidays shall be classified as off-peak periods for Schedules RT and RTE: New Year's Day, Good Friday, Memorial Day, July 4, Labor Day, Thanksgiving (Thursday and Friday), and Christmas Day.

5. That the Company shall provide a separate statement to residential time-of-use customers showing on-peak and off-peak kwh usage and savings over non-time-of-use rates.

6. That the Company shall offer a time-of-use comparative billing program to its residential customers, and that such program may be limited to 1,000 volunteers on the system at a time.

7. That the Company's pilot program, "Limited Demand Charge Days", is approved as filed.

8. That the Stipulation dated September 23, 1991, between the Commission Staff, the Consumer Advocate, and Duke relating to Demand-Side Management cost deferral, attached to this Order as Appendix 1, is approved by the Commission and is hereby incorporated as a part of this Order.

9. That the request for deferral accounting as described in the Stipulation is allowed. Duke shall include as a deferred debit in Account No. 186, Miscellaneous Deferred Debits, the DSM program costs up to \$6.475 million (South Carolina Retail) as described in the Stipulation which have not been reflected in cost of service in this docket. A return on the deferred balance shall be computed monthly and added to the balance. The rate of return will equal the net of tax rate of return approved by the Commission in this proceeding or in subsequent rate cases.

10. That Duke will include as a deferred credit in Account No. 253, Other Deferred Credits, all collections it receives from CP&L pursuant to Schedule J and will accrue carrying costs on such amounts net of tax at the then applicable allowed rate of return.

11. That any motions, contentions or proposed adjustments filed in this proceeding and not previously ruled upon, are hereby denied.

12. That this Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:

Chairman

ATTEST:

Executive Director

(SEAL)

APPENDIX 1

STATE OF SOUTH CAROLINA

BEFORE THE SOUTH CAROLINA PUBLIC SERVICE COMMISSION

DOCKET NO. 91-216-E

IN THE MATTER OF:

Application by Duke Power Company
for Authority to Adjust and Increase
Its Electric Rates and Charges

STIPULATION

The Public Service Commission Staff (Staff), Duke Power Company (Duke), and Steven W. Hamm, Consumer Advocate for the State of South Carolina (Consumer Advocate) enter this Stipulation for approval by the South Carolina Public Service Commission (Commission) in the above-captioned case as follows:

1. On or about May 17, 1991, Duke Power Company (Duke or the Company) filed an Application requesting that the Commission approve an increase in the Company's South Carolina retail electric rates and charges.

2. The Commission has assigned Docket No. 91-216-E to this matter and has scheduled a public hearing to begin in the Commission's offices Monday, September 23, 1991.

3. As part of its Application in Docket No. 91-216-E, Duke is proposing approximately \$6.475 million for additional expenditures in what it refers to as Demand-Side Management (DSM) programs, including ongoing programs, pilot programs, end-use metering and program evaluations, and funding for the Industrial Electrotechnology Laboratory (IEL). See Denton Prefiled Testimony at 15. Duke is also proposing to recover approximately \$5.6 million in 1990 test year costs for these DSM programs already booked.

4. Recently in Docket No. 87-223-E, the parties to this Stipulation, as well as other parties, have agreed to comprehensive integrated resource planning

procedures for use by utilities and other interested parties subject to the Commission's jurisdiction, including the requirement that utilities are to submit by April 30, 1992 Integrated Resource Plans (IRPs) in accordance with the procedures agreed to and approved by the Commission therein.

5. In consideration of these recent developments, the parties agree that the test year (1990) expenditures including advertising expense in South Carolina already incurred and booked may be recovered as proposed in Docket No. 91-216-E. DSM costs for the programs listed on page 15 of Mr. Denton's prefiled testimony actually incurred above this 1990 level up to a total of \$6.475 million may be booked into a deferred account for possible inclusion in the cost of service and rates in a subsequent rate case or IRP docket. Advertising expenditures for these programs that are at a reasonable level and type in light of the actual net program benefits may be deferred as well, provided that they are designed, as well, to achieve the goals of the respective DSM program. At the time the Company seeks to expend funds higher than the cumulative total of \$6.475 million for new or existing programs or at the time the Company seeks approval of new or modified DSM programs, the Company will enumerate the nature and level of the costs contemplated to be deferred by program as a part of obtaining Commission approval. The Company will credit the deferred account for found revenues to the extent lost revenues resulting from lost kwh sales due to ~~conservation~~^{DSM} programs are included in the deferred account and for appropriate DSM costs recovered from ratepayers. The parties will have an opportunity for discussion and discovery as provided in the IRP rules prior to the Commission decision. The parties shall in good faith cooperate toward expeditious consideration of any new programs proposed and any additional amounts deferred between formal IRP and STAP filings.

~~A return on the deferred balance will be computed monthly and added to the~~
balance. Interest will be compounded annually. The rate of return will equal
the net of tax rate of return approved by the Commission in Docket No. 91-216-E
or subsequent rate cases. If it is determined that the expenditures were
prudent and for used and useful DSM programs, the balance in the deferred
account will be reflected in Duke's next rate case or appropriate IRP docket
by amortizing the then existing balance over a period of five years, except the
Commission may order a different period if the amount in the deferred account
would have a significant impact on rates.

6. In consideration of Commission approval of this Stipulation prior to
the close of the evidentiary portion of the instant rate case docket, they
agree: (a) to entry of this Stipulation into evidence; (b) to allow all
relevant prefiled testimony, as well as any rebuttal and surrebuttal testimony,
to be entered into the record as if given orally; (c) not to cross examine
witnesses on these expenditures or IRP; (d) not to have this Stipulation
considered as a waiver of any objections to Duke's approach to IRP or to the
prudence of any of its DSM programs or expenditures to be deferred; and (e) that
the cost recovery methodology set forth in this Stipulation does not represent
the cost recovery methodology Duke will propose in the IRP proceeding and that
~~this cost recovery process may apply only until the Commission establishes an~~
appropriate cost recovery plan for Duke.

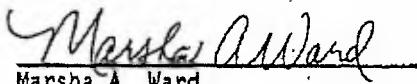
7. The parties agree, however, that the Commission's approval of this
Stipulation does not bind these parties or others not party to it to challenge
the reasonableness of any of the programs or deferred expenditures above the
~~level in rates in the future when their approval or cost recovery is requested.~~

8. The parties further agree that the Commission may consider based on the
record for inclusion in rates in some manner over and above 1990 test year

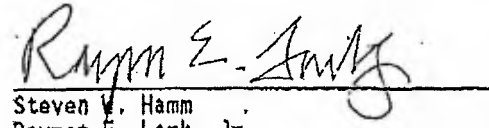
costs, in cost of service as a separate component not subject to this deferral method, in Docket No. 91-216-E, the additional DSM costs it finds are actual and prudently incurred or prudently committed costs in 1991 attributable to the Duke Interruptible Service Program, Stand-by Generator Program, Water Heater and Air Conditioner Load Control Programs and associated advertising costs as described in Paragraph 5, above, for these programs. The additional costs subject to possible inclusion in rates are identified on Appendix 1.

This 23rd day of September, 1991.

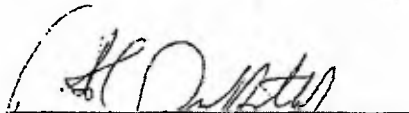
Respectfully submitted,


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APPENDIX 1

DUKE POWER COMPANY
SCPSC DOCKET NO. 91-216-E

1991 Demand Side Program Costs
Which May be Considered for
Inclusion in Rates Approved in
SCPSC Docket No. 91-216-E

Interruptible Service Credits	\$ <u>3,668,342</u>
Standby Generator Payments	<u>-0-</u>
Water Heater and Air Conditioner Load Control Costs	<u>242,472</u>
Advertising Costs	<u>-0-</u>
	\$ <u>3,910,814</u>

**STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT**

DUKE ENERGY CORPORATION,

Petitioner,

vs.

**SOUTH CAROLINA DEPARTMENT OF
REVENUE,**

Respondent.

Docket No.: 10-ALJ-17-0270-CC

STIPULATION OF FACTS AND ISSUES

Pursuant to the South Carolina Revenue Procedures Act, Section 12-60-3320 (2000), and Rule 25(C) of the Rules of Procedure of the Administrative Law Court, the parties agree to this stipulation of facts and issues under the general terms of this preamble, unless specifically expressed otherwise. Petitioner, Duke Energy Corporation, is a corporation duly organized under the laws of the state of North Carolina, headquartered in Charlotte, North Carolina, and qualified to do business in the state of South Carolina. Respondent, the South Carolina Department of Revenue, administers and enforces the tax and revenue laws of the State of South Carolina and has authority to adopt rules to carry out provisions of the tax and revenue laws of the State. Petitioner and Respondent are hereinafter referred to collectively as the Parties.

The Parties hereby stipulate to the following facts and issues. All exhibits referred to herein and attached hereto may be accepted as authentic and are incorporated in this stipulation

and made a part hereof. All evidentiary objections related to facts and exhibits set forth in this stipulation are waived unless specifically expressed in this stipulation. A party's stipulation as to a particular fact or issue is not a concession that such fact or issue is relevant to the legal issues in this case.

Preliminary Definitions

1. "Gross-receipts apportionment formula" refers to South Carolina's method of income apportionment prescribed under S.C. Code Ann. § 12-6-2290 and former S.C. Code Ann. § 12-7-1190.
2. "Multi-factor apportionment formula" refers to South Carolina's method of income apportionment prescribed under S.C. Code Ann. § 12-6-2250 and former S.C. Code Ann. § 12-7-1140.
3. "Petitioner" means Duke Energy Corporation (formerly known as Duke Power Company) and any predecessor or successor and any other entity owned by Duke Energy Corporation.
4. "Respondent" means the South Carolina Department of Revenue.
5. "1978-2001 tax periods" means the Petitioner's tax years 1978 through 2001, all of which were reported on a calendar-year basis.

The Parties

6. Respondent is administrative Cabinet-level agency of the State of South Carolina responsible for administering and enforcing the state's revenue laws.
7. Petitioner is, and was during the 1978-2001 tax periods, engaged in the generation, transmission, distribution, and sale of electricity in portions of North Carolina and South Carolina.

8. True and correct copies of Petitioner's restated corporate charters filed with the North Carolina Secretary of State on July 26, 1977, October 6, 1993, and June 18, 1997 are attached as Exhibits A-1, A-2, and A-3, respectively.
9. True and correct copies of Petitioner's Form 10-Ks for the 1978-2001 tax periods are attached as Exhibits B-1 through B-24.
10. During the 1978-2001 tax periods, Petitioner was regulated by the South Carolina Public Service Commission as an "electric utility" pursuant to Title 58-27-10(7).

Procedural History

11. Petitioner timely filed its South Carolina corporate income tax returns (including license tax returns) for the 1978-2001 tax periods.
12. On its originally filed South Carolina corporate income tax returns for the tax periods 1978-2001, Petitioner filed using the multi-factor apportionment formula.
13. On December 12, 2002, Petitioner filed South Carolina amended corporate income tax returns for the 1978-2001 tax periods seeking a refund of corporate income taxes plus applicable interest ("1978-2001 Refund Claims").
14. True and correct copies of Petitioner's South Carolina amended corporate income tax returns filed December 12, 2002 for the 1978-2001 tax periods are attached as Exhibits C-1 through C-24.
15. The 1978-2001 Refund Claims reflected use of the gross-receipts apportionment formula to apportion Petitioner's income to South Carolina.
16. On February 12, 2003, Respondent denied Petitioner's 1978-2001 Refund Claims. A true and correct copy of Respondent's notice denying Petitioner's refund claims is attached as Exhibit D and by this reference incorporated herein.

17. On March 13, 2003, Petitioner timely appealed from the denial of its 1978-2001 Refund Claims. A true and correct copy of Petitioner's appeal is attached as Exhibit F and by this reference incorporated herein.
18. On February 4, 2010, Respondent issued a Determination denying Petitioner's refund claims for tax periods 1978-2001. A true and correct copy of said Determination is attached as Exhibit F and by this reference incorporated herein.
19. On March 3, 2010, Petitioner timely filed a Request for Contested Case Hearing with the Clerk's Office of the South Carolina Administrative Law Court in Columbia, South Carolina contesting the Determination. A true and correct copy of said Request is attached as Exhibit G and by this reference incorporated herein.
20. Petitioner and Respondent timely filed their Prehearing Statements and Amended Prehearing Statements. True and correct copies of said Prehearing Statements are attached as Exhibits H-1 through H-5 and by this reference incorporated herein.

DATED this 4th day of September, 2012.

Counsel for Duke Energy Corporation

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Counsel for the South Carolina Department
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permission*

**STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT**

DUKE ENERGY CORPORATION,

Petitioner,

vs.

SOUTH CAROLINA DEPARTMENT OF
REVENUE,

Respondent.

Docket No.: 10-ALJ-17-0270-CC

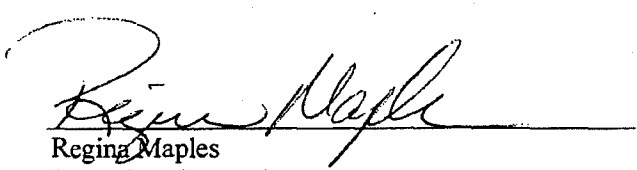
CERTIFICATE OF SERVICE

The undersigned, being an employee of Nexsen Pruet, LLC, hereby certify that on the 4th day of September, 2012 the following document was served upon the following by U.S. Mail:

STIPULATION OF FACTS AND ISSUES

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Milton Kimpson, Esquire
J. Abraham Gutting
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Columbia, SC 29201

John M.S. Hoefer, Esquire
Tracey C. Green, Esquire
John Roberts, Esquire
Willoughby & Hoefer, P.A.
930 Richland Street
Columbia, SC 29201


Regina Maples
Legal Practice Assistant

September 4th, 2012
Columbia, South Carolina

**STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT**

Duke Energy Corporation,	)	Docket No. 10-ALJ-17-0270-CC
	)	
Petitioner,	)	
	)	
vs.	)	
	)	
South Carolina Department of	)	
Revenue,	)	
	)	
Respondent,	)	
_____	)	

**Memorandum Opposing Duke Energy's Motion for Reconsideration of
the Order Granting Partial Summary Judgment to the Department**

The South Carolina Department of Revenue (the "Department" or "DOR") opposes Duke Energy Corporation's ("Duke Energy") motion and supporting memorandum to reconsider ("Motion") the Court's August 9, 2012 Order granting partial summary judgment in favor of the Department. For the reasons set forth in the Court's Order and in this memorandum, as well as those previously stated by the Department in various memoranda or during argument, the Court should deny the Motion.

Argument

1. The Court correctly decided that Duke Energy's amended income tax return filings were untimely.

In the Motion, Duke Energy merely repeats in vastly abbreviated form the arguments it previously made regarding the timeliness issue. This repetition

affords no credible basis for reconsidering the Court's argument with respect to this issue. Therefore, for the reasons previously set forth to the Court and in the Court's Order, the Court should deny Duke Energy's motion and affirm its Order as to the timeliness issue.

2. The Court correctly rejected Duke Energy's attempt to include the return of principal in its standard apportionment formula.

A. The Court correctly determined that, as a matter of law, interpreting the pertinent statutory terms to encompass Duke Energy's position would achieve an absurd result and would inappropriately elevate the role of Section 12-6-2320 in apportioning taxable income.

In the Order, the Court correctly undertook to determine whether the meaning of the terms "gross receipts" and "sales" contemplated including the return of the principal invested by Duke Energy in various short-term securities transactions. As Duke Energy admits, its securities transactions are not "in any way special or unique" and "[c]orporate treasury departments that sell securities on a regular basis are not a new phenomenon." [Motion at 12.] In other words, there is nothing unique about Duke Energy's principal-inclusion transactions that require any factual or evidentiary consideration in the context of determining the meaning of the statutes. Moreover, because the parties filed cross-motions for summary judgment with respect to the definition of the statutory terms, no factual analysis was required and the Court was entitled "to assume that there is no evidence which needs to be considered other than that which has been filed by the parties." *Alltel Communications, Inc. v. S. Carolina Dept. of Revenue*, 27156,

2012 WL 3205174 n.2 (S.C. Aug. 8, 2012) (quoting *Harrison W. Corp. v. Gulf Oil Co.*, 662 F.2d 690, 692 (10th Cir.1981)), *mot. for reh'g filed on other grounds*.

Thus, there is no dispute regarding the factual nature of the transactions at issue and the Court was required to interpret the statutory terms as a matter of law, an interpretative process that necessarily includes a consideration as to whether Duke Energy's principal-inclusion argument achieves an absurd result. *See, e.g., Kiriakides v. United Artists Communications, Inc.*, 312 S.C. 271, 275, 440 S.E.2d 364, 366 (1994) (holding that a statutory interpretation should be rejected if it "would lead to a result so plainly absurd that it could not possibly have been intended by the legislature or would defeat the plain legislative intention"). Throughout its argument, Duke Energy ignores the point correctly evaluated by this Court: viewed objectively, the short-term investment transactions at issue are in essence secured loan transactions or the repeated depositing and withdrawing of money from a bank account. "It is no true reflection of the scope of [a taxpayer's] business done within and without [this State] to allocate to the numerator or the denominator of the ["gross receipts" or "sales" factor] the full amount of money returned to [the taxpayer] upon the sale or redemption of investment paper." *Am. Tel. & Tel. Co. v. Dir., Div. of Taxation*, 476 A.2d 800, 802 (N.J. App. Div. 1984). This absurdity is the arbitrary result that the Court's consideration and rejection of the principal-inclusion argument correctly avoids.

Contrary to Duke Energy's primary argument, the Court properly considered the impact that principal-inclusion would have on the apportionment

factors. Duke Energy erroneously contends that the Court's use of the term "distortion" equates to conflating the absurd result analysis and the "fairly represents" statute, South Carolina Code Section 12-6-2320. Duke Energy's argument presumes that any reference to "distortion" implies a factual inquiry and the invocation of section 12-6-2320 and that the only way to conduct this inquiry is by separately determining an alternative apportionment formula. That is incorrect on several levels. The Court's use of the term distortion to describe its evaluation does not equate to a factual analysis and, because section 12-6-2320 does not use the term distortion, also does not equate to an invocation of that statute. The concept of distortion is broader than section 12-6-2320 and, in this context, equates to a determination that the principal-inclusion position advanced by Duke Energy is objectively unreasonable and, thus, absurd. As the Court correctly recognized, it is not the amount of distortion that determines this issue, but rather the inherent distortion or absurdity that would result from Duke Energy's interpretation. [Order at 36.] Like courts in New Jersey, Indiana, and Arizona, the Order recognizes the arbitrariness of Duke Energy's principal-inclusion argument and rejects it as absurd.¹

¹ For the first time in this case, Duke Energy acknowledges the "absurd results" approach and cites several cases in its motion for reconsideration discussing the application of the "absurd results" approach in South Carolina. Previously, Duke Energy rested solely on its own proffered strict interpretation of the terms "gross receipts" and "sales" and the illogical reasoning of the California and Tennessee courts that recognized the absurdity of including the return of principal in the standard apportionment formula but did not deem it "necessary" to properly interpret the statute because the alternative relief provision would fix the problem. But even under the line of cases now cited by

At bottom, Duke Energy's argument is that even if its principal-inclusion argument leads to an absurd result, the Court should nonetheless accept it because section 12-6-2320 exists to cure the problem. Duke Energy in fact states that "[t]he Court is required by South Carolina law to apply the standard apportionment statute in a manner that gives full effect to the legislative intent of enacting the alternative apportionment statute and does not render it meaningless." [Motion at 8.] The question before the Court is the meaning of the statutory terms at issue and section 12-6-2320 comes into play only if the court rules in favor of Duke Energy's principal-inclusion argument. [See Motion at 5 (asserting that the Court must determine whether, as a matter of law, the standard apportionment formula includes the "principal realized from sales of securities.".)] As the Court correctly noted, the standard apportionment formula should not be construed to allow absurdity just because a relief provision exists to remedy that absurdity.

Properly interpreting and applying the standard apportionment formula consistent with South Carolina law and the rules of statutory construction does not render section 12-6-2320 meaningless. Section 12-6-2320 necessarily is dependent upon the result mandated by sections 12-6-2250 through -2290 in the first

Duke Energy, the principal-inclusion argument would lead to "patently absurd results." Additionally, in *Blue Moon*, the Court discusses how a statutory interpretation should not result in a standard rule that requires the Department to make subjective decisions on a case-by-case basis. *S. Carolina Dept. of Rev. v. Blue Moon of Newberry, Inc.*, 397 S.C. 256, 264, 725 S.E.2d 480, 485 (2012) (discussing interpretation of Department regulation and stating "[the opposing] interpretation would undoubtedly lead down the slippery slope of the Department assessing the subjective relationship between the member and his guest").

instance. In other words, the statute presumes that the apportionment factors have been defined and applied and that the apportioned taxable income has been determined.² Sections 12-6-2250 through -2290 effectively are conditions precedent that first must be determined before section 12-6-2320 is invoked. Although it tries to avoid it elsewhere, Duke Energy at some level recognizes this two-step process, stating that “[w]hether the inclusion of the principal in the **standard apportionment formula** produces an absurd result does not require evaluation of the **alternative apportionment statute**.” [Motion at 15 (emphasis in original).] Duke Energy, however, transforms this analysis into a contention that the Court can ignore any arbitrariness because section 12-6-2320 will remedy it. Thus, Duke Energy implicitly advances the assertion that the apportionment factors and section 12-6-2320 are not a two-step process, but instead are two parts of the same step and, thus, are interrelated. [See Motion at 6 (stating that “distortion falls under the second part of a two-part analysis”).] This ignores the

² The fact that the Court is required to define the statutory terms distinguishes this case from *Eastman Kodak Co. v. S. Carolina Tax Comm’n*, 308 S.C. 415, 418 S.E.2d 542 (1992), where the question was whether the correctly-determined apportionment factors reasonably represented the taxpayer’s trade or business within South Carolina. *Id.*, 308 S.C. at 419, 418 S.E.2d at 544. Unlike this Court, the *Kodak* Court was not required to engage in statutory interpretation of the terms “gross receipts” or “sales” or, indeed, of any terms. Moreover, the transactions at issue in that case expressly were authorized by provisions of the Internal Revenue Code, which is not the case with respect to Duke Energy’s proposed principal-inclusion treatment, and the question at issue in that case did not involve inclusion of the basis of the leased assets in the gross receipts or sales apportionment formulas. Finally, it is unclear why *Eastman Kodak* is “simply irrelevant” in one part of the Order based on Duke Energy’s argument, [see Motion at 20,] but pertinent to Duke Energy’s discussion elsewhere, [see Motion at 12-13].

proper status of the standard apportionment formulas in the multi-state context and elevates section 12-6-2320 to a role it never was designed to play.

The Order correctly recognizes the secondary nature and limited application of section 12-6-2320 through its determination that the statute should not become a routine device for evaluating the inclusion of principal. The Court's analysis is correct because the statute operates broadly to provide options to the Department and the taxpayer alike when, in the unusual case, the standard apportionment factors result in unfair representation. Section 12-6-2320 also was not enacted solely to cure the distortion and absurdity necessarily resulting from Duke Energy's principal-inclusion argument. In short, section 12-6-2320 does not serve as a catchall remedy designed to eliminate the need to define terms and was not enacted by the Legislature with the purpose of eliminating the absurdity analysis when interpreting tax statutes.

The Court's analysis therefore correctly assigns that statute its proper role in the apportionment process, one that is secondary to a correct interpretation and application of the apportionment statutes in the first instance. Moreover, should the principal-inclusion argument prevail, Duke Energy almost certainly would argue that invocation of section 12-6-2320 by the Department would not be appropriate because the taxpayer is only doing what the statutes require in the first instance. Duke Energy's efforts to conflate two different concepts correctly viewed as separate in the Order only serve to obfuscate the arbitrariness of its principal-inclusion argument.

The Court's interpretation of the statutory terms as a matter of law also does not equate to "presuppos[ing] that the inclusion of gross receipts in the apportionment factor is absurd." [Motion at 9.] The Court's use of the term distortion to describe the objective problems resulting from Duke Energy's position does not equate to imputing an equitable apportionment method into the statutory terms and affords no basis for reconsidering the Court's ruling in this regard. The Court correctly recognized that, based on the nature of the transactions at issue here, a distorted result wholly at odds with the purposes of the apportionment statute will occur. This is so either in the context of what is likely for the vast majority of situations, in which excess income would be apportioned away from this state, or in some situations, which could result in excess income being apportioned to this state. In short, Duke Energy's interpretation, rather than resulting in the "fair representation" that implicitly is the objective of the apportionment statutes, would result in extremes for or against a state.³ Duke Energy's interpretation also would afford large corporate taxpayers a benefit not enjoyed by smaller corporate taxpayers with limited treasury resources at their disposal. Every appellate decision addressing this issue has reached the same conclusion as this Court in one form or another, further reflecting the absurdity of the principal-inclusion argument.

³ Thus, contrary to Duke Energy's argument, the Court's analysis is directed not to the amount of taxes that it pays but instead to whether the principal-inclusion argument is an absurd interpretation of the apportionment statutes.

It indeed would be absurd for an apportionment statute to encompass the principal-inclusion view advanced by Duke Energy regarding its routine investment and recovery of principal from various typical securities transactions by its corporate treasury department.⁴ Duke Energy implicitly concedes the nature of these transactions through its repeated use of the term “principal” throughout the Motion. This is a concession that its transactions in these securities are nothing more than the return of the investment of principal in these securities. The Court correctly concluded that it could not have possibly been the General Assembly’s intention to allow a taxpayer to so easily manipulate the amount of its business activity represented in, and amount of taxes paid to, South Carolina through transactions such as these when the purpose of the formula in the first instance is to “reasonably represent the proportion of the trade or business carried within this State.” S.C. Code Ann. § 12-6-2210.

In fact, a further consideration of the types of transactions at issue reflects the patent absurdity of Duke Energy’s argument. Because Duke Energy’s interpretation of “gross receipts” and “sales” has no inherent limitations, a

⁴ See *Walgreen Arizona Drug Co. v. Arizona Dept. of Revenue*, 97 P.3d 896, 902 (Ariz. Ct. App. 2004) (agreeing with comparison of return of principal from short-term investment transactions to money deposited into and withdrawn from an interest-bearing account); *Am. Tel. & Tel. Co.*, 476 A.2d at 802 (“To include such receipts in the fraction would be comparable to measuring business activity by the amount of money that a taxpayer repeatedly deposited and withdrew from its own bank account. The bulk of funds flowing back to [the taxpayer] was simply its own money”); *Sherwin-Williams Co. v. Indiana Dept. of State Revenue*, 673 N.E.2d 849, 853 (Ind. T.C. 1996) (holding that “‘gross receipts’ for the purpose of the sales factor includes only the interest income, and not the rolled over capital or return of principal, realized from the sale of investment securities”).

taxpayer such as Duke Energy, not in the business of making loans, might nonetheless make substantial short-term loans to shareholders or other entities and include the repayment of principal from these loans in the standard apportionment formula. The return of principal from transactions such as these has no substantial connection to the taxpayer's tax base and actual business activity. *See Walgreen*, 97 P.3d at 899 (transactions such as these have no connection to the taxpayer's exploitation of a sales market). Allowing the transactions at issue to impact the apportionment process would result in the standard apportionment factors becoming a footnote to applying section 12-6-2320.

As the Court correctly recognized, Duke Energy's position necessitates a conclusion that it would never be appropriate to define any statutory term for multi-state taxpayers because section 12-6-2320 would be available to fashion a result determined appropriate in that particular case, which in turn would result in section 12-6-2320 becoming a routinely-applied provision. Duke Energy's argument throughout this matter implicitly accepts that section 12-6-2320 would be invoked, a position consistent with the decisions from California and Tennessee. Duke Energy's interpretation would thereby increase the expenditure of court resources, state agency resources, and taxpayer resources. It also would increase uncertainty due to the inherently factual nature of the "fairly represent" analysis. In effect, Duke Energy's position would necessitate the application of an individualized apportionment method for many taxpayers, a result obviously at odds with the legislative intent of applying the standard apportionment factors in

the vast majority of cases. *See Hertz Corp. v. S. Carolina Tax Comm'n*, 246 S.C. 92, 96, 142 S.E.2d 445, 447 (1965) (stating with respect to predecessor of S.C. Code Ann. § 12-6-2250 that “the legislative classification ... should be liberally construed in favor of the inclusion of business to which the formula is appropriate.”). Succinctly put, Duke Energy’s position should be rejected in part because section 12-6-2320 is not part of statutory interpretation and does not operate to alleviate issues in defining statutory terms.

Moreover, despite Duke Energy’s suggestions to the contrary, there are no differing views as to the policy that Court’s Order is serving to protect. It cannot be credibly argued that interpreting a statute to prevent arbitrariness or to prevent the inevitable manipulation of the tax statutes is establishing bad policy or that there is any acceptable alternative to this policy. Duke Energy contends that the Department should have to determine on a case-by-case basis (1) whether to invoke the alternative apportionment formula, and (2) whether a taxpayer’s inclusion of the return of principal is distortive based on some subjective standard. A standard apportionment formula that requires a case-by-case and subjective determination is ineffectual. As the Court correctly points out, the alternative apportionment formula would become the new standard apportionment formula.

Duke Energy’s position also implies that the standard apportionment formula should be construed differently now than it was before the enactment of the alternative apportionment formula. Section 12-6-2320 was enacted in 1995, but sections 12-6-2250 to -2290 existed in substantially the same form for many

years prior to 1995. In other words, these statutes were not enacted as part of a single statutory scheme. There consequently is no basis to conclude that the General Assembly's intent with respect to the standard apportionment formula somehow changed by its enactment of the alternative apportionment statute, or that the process of interpreting statutes changed with that enactment. The question is whether the legislature ever evinced any intent to implement Duke Energy's principal-inclusion argument. The Court correctly analyzes the issues presented to it and concludes that the statutes do not incorporate and, in fact, are wholly inconsistent with the principal-inclusion argument.⁶

B. Contrary to Duke Energy's argument, the Court correctly determined that the terms "Gross Receipts" and "Sales" do not logically encompass the return of principal invested in the securities transactions at issue.

Duke Energy evades the point of the Court's analysis regarding the Court's logical definitions of "gross receipts" and "sales." Duke Energy rested its entire case on its proffered "strict" or "plain meaning" interpretations of the terms "gross receipts" and "sales." However, the Court, in examining the possible definitions of these terms, determined that the terms "gross receipts" and "sales" do not reasonably encompass Duke Energy's principal-inclusion argument. Duke Energy

⁶ This conclusion is confirmed by the enactment of section 12-6-2295 in 2007, which specifically excluded the "repayment, maturity, or redemption of the *principal* of a loan, bond, or mutual fund or certificate of deposit or similar marketable instrument" and "the *principal* amount received under a repurchase agreement or other transaction properly characterized as a loan." S.C. Code Ann. § 12-6-2295. Duke Energy argues that the Department's interpretation and the Court's Order are inconsistent with section 12-6-2295, but that is wrong because section 12-6-2295 excludes only the principal, not the income, from securities transactions like those at issue here.

concedes this point in its memorandum by agreeing that, “[a]s the Court correctly notes, ‘gross income’ equals gross receipts [minus] expenses and other deductions.” [Motion at 19.] Duke Energy attempts to avoid the point of the Court’s analysis by apparently comparing the return of principal to either an expense or deduction. [Motion at 19.]. However, as the Court discussed, principal is neither a deduction nor an expense, and thus, cannot be a “gross receipt.” The question is what is included in gross receipts, which the Court correctly determined does not encompass principal invested in securities by corporate treasury departments.

Duke Energy equally misinterprets the Court’s analysis regarding the definition of “sales.” Again, Duke Energy’s entire argument relied on its “plain meaning” interpretation of the term “sales.” But, as the Department argued, and the Court found, a reasonable or logical interpretation of “sales” excludes the return of principal from short-term investment transactions. The Department argued that Duke Energy’s “plain meaning” interpretation makes little sense with respect to “sales” because the short-term transactions Duke Energy entered into are not “sales,” but instead include loan repurchase agreements and the redemption of commercial paper and bonds. Similarly, the Court rightly found that section 12-6-2280’s “emphasis on income production suggests that principal is excluded from the definition of ‘sales.’” [Order at 33.] Therefore, in addition to the fact that Duke Energy’s interpretation leads to absurd results, the “strict” interpretation it contends is correct does not even lead to the result it seeks.

C. The Court did not engage in *sua sponte* decision-making but instead properly evaluated the parties' arguments to interpret the statutory terms as a matter of law.

Duke Energy misapprehends the concept of *sua sponte* decision-making. The cases cited by Duke Energy either deal with a trial court granting a new trial *sua sponte* or an appellate court's review of issues not argued and ruled upon at trial. [Motion at 15-16 ("an *appellate court* cannot address an issue unless it was raised to, and ruled upon by, the trial court") (citing *Smith v. Phillips*, 318 S.C. 453, 455 (1995)) (emphasis added).] Neither of these situations applies here

The Department specifically argued that Duke Energy's interpretation would lead to absurd results, cited the law that supported this determination, and discussed the practical concerns with Duke Energy's interpretation. The Court accepted this reasoning and cited to the same case law the Department offered in support. In further support of the Court's conclusion, the Court explored additional practical considerations. The Court's analysis is only a logical extension of the positions advanced by the parties.

Conclusion

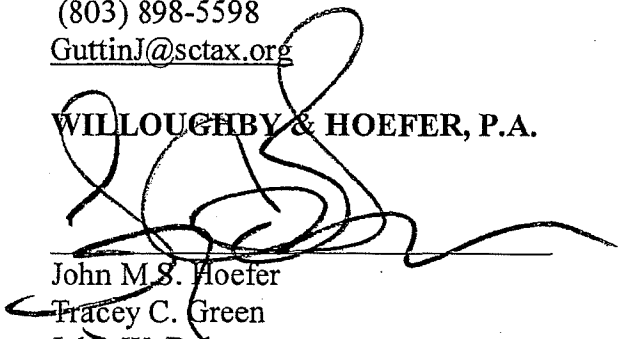
The Court should deny the Motion for the reasons set forth above, in the Order, and in the previous memoranda and arguments submitted by the Department.

Respectfully submitted,

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Columbia, South Carolina
September 14, 2012

**STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT**

DUKE ENERGY CORPORATION,

Petitioner,

vs.

**SOUTH CAROLINA DEPARTMENT OF
REVENUE,**

Respondent.

Docket No.: 10-ALJ-17-0270-CC

**DUKE ENERGY CORPORATION'S RESPONSES TO THE INQUIRIES PRESENTED
BY THE COURT ON SEPTEMBER 19, 2012**

On September 19, 2012, this Court inquired regarding the following statement made by Duke Energy Corporation ("Duke Energy") in its Motion for Reconsideration: **"This legislative change** made clear that the sales of securities are excluded from the factor entirely." (Emphasis added by the Court). Specifically, the Court requested responses regarding the following two inquiries: (1) "To which subsection of 12-6-2295 is "legislative change" referring?"; and (2) "How, specifically, does this subsection exclude Duke Energy's sales of securities, e.g. municipal bonds and commercial paper?"

I. To which subsection of 12-6-2295 is "legislative change" referring?

With regard to the first inquiry, the legislative change referred to in Duke Energy's Motion for Reconsideration relates to subsection (B)(1) of S.C. Code. Ann. § 12-6-2295, which was enacted to statutorily define the term "gross receipts" for the first time in 2007. Specifically, in accordance with subsection (B)(1) of S.C. Code. Ann. § 12-6-2295, "(1) repayment, maturity, or redemption of the principal of a loan, bond, or mutual fund or certificate of deposit or similar

marketable instrument” are excluded from “gross receipts” and “sales,” and thus are also excluded from the South Carolina apportionment formula.

This 2007 amendment represented a significant law change. Prior to the legislative change, South Carolina law required taxpayers to apportion their income to South Carolina based on “gross receipts” or “sales.” The plain language of these terms requires the inclusion of all receipts from all sales, including sales of securities, in the computation of “gross receipts” or “sales” for purposes of the apportionment formula. *See Alltel Commc’ns., Inc. v. S.C. Dep’t of Revenue*, 27156, 2012 WL 3205174 *3 (2012), quoting *S.C. Energy Users Comm. v. S.C. Pub. Serv. Comm’n*, 388 S.C. 486, 491, 697 S.E.2d 587, 590 (2010) (“Where the statute’s language is plain, unambiguous, and conveys a clear, definite meaning, the rules of statutory interpretation are not needed and the court has no right to impose another meaning.”).

The 2007 amendment changed South Carolina’s apportionment regime by explicitly including and excluding certain receipts. The gross receipts apportionment formula excludes ten different categories of receipts.¹ The South Carolina Department of Revenue’s (“Department”)

¹ S.C. Code Ann. § 12-6-2295 was enacted to exclude the following receipts from “gross receipts” and “sales”:

- (1) repayment, maturity, or redemption of the principal of a loan, bond, or mutual fund or certificate of deposit or similar marketable instrument;
- (2) the principal amount received under a repurchase agreement or other transaction properly characterized as a loan;
- (3) proceeds from the issuance of the taxpayer’s stock or from sale of treasury stock;
- (4) damages and other amounts received as the result of litigation;
- (5) property acquired by an agent on behalf of another;
- (6) tax refunds and other tax benefit recoveries;
- (7) pension reversions;
- (8) contributions to capital, except for sales of securities by securities dealers;
- (9) income from forgiveness of indebtedness; or
- (10) amounts realized from exchanges of inventory that are not recognized by the Internal Revenue Code. S.C. Code Ann. § 12-6-2295(B).

auditor who conducted the Duke Energy audit interpreted the 2007 legislative amendment as constituting a law change.²

The South Carolina Supreme Court has held that in adopting an amendment to a statute that effectuates a **material** change, there is a presumption that the Legislature intended to change the existing law rather than to clarify its original intent. *Key Corporate Capital, Inc. v. County of Beaufort*, 373 S.C. 55, 60-61, 644 S.E.2d 675, 678 (2007) (acknowledging the “presumption that in adopting an amendment to a statute, the Legislature intended to change the existing law” and finding that the amendment at issue did in fact change the law because “to hold otherwise would indicate that this amendment essentially was a futile act”); *see also Kerr v. State*, 345 S.C. 183, 189, 547 S.E.2d 494, 497 (2001) (adoption of an amendment which materially changes a statute’s terminology raises the presumption that departure from original law was intended); *Denene, Inc. v. City of Charleston*, 352 S.C. 208, 212, 574 S.E.2d 196, 198 (2002) (“The Court must presume the Legislature did not intend a futile act, but rather intended its statutes to accomplish something”).

For example, in *Key Corporate Capital*, the South Carolina Supreme Court held that a subsequent legislative amendment effectuated a change in prior law. 373 S.C. at 60-61, 644 S.E.2d at 678. Prior to the amendment, South Carolina law required that the “amount paid” be refunded to a successful bidder when a tax sale was voided. The legislature later amended the statute to expressly provide that when a tax sale was voided, the purchaser would be entitled to actual interest earned. At issue before the court was whether under prior law, the “amount paid”

² During depositions, Mr. Joseph Southard testified that prior to 2007, proceeds from sale of treasury stock were included in the apportionment formula at “net,” or only to the extent of the gain realized from the transaction. Southard Dep. Tr. 113:8-113:18 (Exhibit A). After the 2007 law change, such proceeds are now excluded from “gross” receipts” and “sales” and thus from the apportionment formula. S.C. Code Ann. § 12-6-2295(B)(3). Furthermore, Ms. Sally Major, a Revenue law Consultant for the Department’s Office of General Counsel for Policy, testified that at least some of the provisions of S.C. Code Ann. § 12-6-2295 were changes in the law. Major Dep. Tr. 23:10-:12; 24:16-25:8 (Exhibit B).

included any interest. The court explained that “[i]f a statute’s language is plain, unambiguous, and conveys a clear meaning, the rules of statutory interpretation are not needed and the court has no right to impose another meaning.” *Id.* at 59, 644 S.E.2d at 677 (citation omitted). It then reasoned that the plain language of the original statute limited the remedy to the “amount paid” and did not provide for the refund of interest. The court further acknowledged the “presumption that in adopting an amendment to a statute, the Legislature intended to change the existing law.” *Id.* at 60, 644 S.E.2d at 678. It then held that “[b]ecause the amendment materially changed the terminology of the statute, a departure from existing law clearly was intended, rather than a clarification of original intent. ... In fact, to hold otherwise would indicate that this amendment essentially was a futile act, which we are disinclined to do.” *Id.* at 61, 644 S.E.2d at 678 (internal citation omitted).

Similar to the law change at issue in *Key Corporate Capital*, 373 S.C. 55, the 2007 legislative amendment added a significant set of changes to South Carolina apportionment – many of which were never addressed by the Department or the South Carolina courts. For instance, we are aware of no South Carolina decisions or Department promulgations excluding debt forgiveness from the apportionment formula, as was accomplished via the law change. S.C. Code Ann. § 12-6-2295(B)(9). We are not aware of any South Carolina authority (prior to the law change) governing the exclusion of any of the other now excluded items, such as pension reversions. S.C. Code Ann. § 12-6-2295(B)(7). Moreover, the statute now explicitly includes items in the sales factor, including receipts from the sale or rental and receipts from the sale of accounts receivable, S.C. Code Ann. §§ 12-6-2295(A)(1), (2). These specific inclusions were no doubt the result of advocating by parties interested in ensuring that this South Carolina law change prevented the Department from taking a recently abandoned position in this case – that

its alleged long-standing policy is to exclude certain gross receipts irrespective of the fact that the statute had included all receipts. The Department's abandonment of the argument of having any "long standing" policy "to require only the inclusion of the net gain or interest from short-term investment transactions in the calculation of the apportionment formula" reflects the fact that the Department did not – and could not – have legitimately interpreted gross receipts as anything other than all receipts. Department's Memorandum in Support of Motion for Summary Judgment at 33.

Notably, the Department has advocated a completely inapposite position as it advances here. The Department in other cases contended that a legislative amendment that was more limited than the original statute is a change in the law. In particular, the Department argued that the 1985 statutory amendment to the South Carolina license tax, which imposed the tax on "the entire gross receipts from business" and was later changed to include "the gross receipts from services rendered from regulated business," limited the scope of the tax and was thus a change in the law. Br. App't at 8-9, *Duke Power Co. v. S.C. Tax Comm'n*, No. 86-344, 292 S.C. 64; 354 S.E.2d 902 (1987) ("The new language of § 12-19-110 now states that the tax levied therein is restricted to 'receipts derived from services rendered.' This indicates that the prior language of § 12-19-110 was not limited in this respect.") (Exhibit C). Like the 1985 amendment to the license tax, the 2007 legislative amendment to the apportionment statute had a restrictive effect and specifically excluded, for the first time, certain receipts from the definition of "gross receipts."

II. How, specifically, does this subsection exclude Duke Energy's sales of securities, e.g. municipal bonds and commercial paper?

S.C. Code. Ann. § 12-6-2295(B)(1) excludes certain treasury receipts from the apportionment formula. Specifically, the amendment excludes: "repayment, maturity, or redemption of the principal of a loan, bond, or mutual fund or certificate of deposit or similar

marketable instrument.” On its face, this language does **not** exclude the “sales” of securities. Rather, the application of this exclusion is limited to the repayment, maturity or redemption of a security. Therefore, a plain reading of the statute makes clear that the sales of securities are not subject to this exclusion and therefore, remain includible in the apportionment formula. However, the Department’s auditor stated that the law change does apply to sales of securities.³ This ambiguity advanced by the Department is further evidence that the amendment is a law change – one whose scope is in doubt.

Now, the Department contends that the law change only excludes the principal, and not the gross receipts, from securities transactions. Department’s Memorandum Opposing Duke Energy’s Motion for Reconsideration at 12, fn. 12. This interpretation does not reflect the language of the statute. S.C. Code. Ann. § 12-6-2295(B)(1) states that “gross receipts” and “sales” exclude “repayment, maturity, or redemption of the principal of a loan, bond, or mutual fund or certificate of deposit or similar marketable instrument.” The statute requires the exclusion of the “**principal**” of “**a loan, bond, or mutual fund.**” In contrast, “certificate of deposit” and “similar marketable instrument” are not similarly modified. The word “or” is a disjunctive particle and its use before “certificate of deposit” and before “similar marketable instrument” signifies an alternative. *Michau v. Georgetown County*, 396 S.C. 589, 595, 723 S.E.2d 805, 808 (2012). Therefore, the term “principal” relates **only** to “a loan, bond or mutual fund.” The Departments misreading of its own statute provides further evidence that the 2007

³ “Q. Let’s turn the page, Joe, to Part B. The terms sales as used in 12-6-2280 and gross receipts as used in 12-6-2290 did not include. The first item, number 1 listed is the repayment, maturity or redemption of the principal of a loan, bond or mutual fund or certificate of deposit or similar marketable instrument. So if I were to sell an item that qualified in that list in number 1, it’s called a marketable instrument, and I had a fair market value, sold it for 100, I had a basis of 90, I had a gain of 10, net of 10.

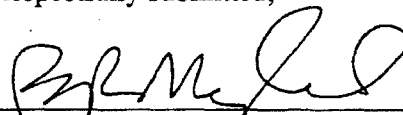
A. Net of 10.

Q. Which amount goes into the sales factor?

A. Ten.” Southard Dep. Tr. 112:18-113:5 (Exhibit D).

legislative enactment materially changed South Carolina law, whose scope is unclear due to the Department's inability to apply it accurately.

Respectfully submitted,



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Attorneys for Petitioner Duke Energy Corporation.

Exhibit A

State of South Carolina
In the Administrative Law Court
No. 10-ALJ-17-0270-CC

DUKE ENERGY CORPORATION,)
)
Petitioner,)
)
vs.)
)
SOUTH CAROLINA DEPARTMENT OF REVENUE,)
)
Respondent.)
)

D E P O S I T I O N

WITNESS: JOE SOUTHARD
DATE: December 2, 2011
TIME: 9:00 a.m. - 12:50 p.m.
LOCATION: Willoughby & Hoefer
930 Richland Street
Columbia, South Carolina

TAKEN BY: Attorney for the Petitioner
REPORTED BY: KATHRYN J. LINDLER

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Joe Southard 12/2/2011

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Attending: T. Cooper Monroe, Duke

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1 Jeffrey Friedman Company would be a trade name and I sold
2 the name Jeffrey Friedman Company if somebody were willing
3 to buy it for \$100 and I have a basis in Jeffrey Friedman
4 Company of \$5.

5 A. Oh, in that particular -- if you're selling your
6 trade name.

7 Q. Right.

8 A. Outright, yes, you would have a basis and then
9 whatever the difference is would be a gain or a loss.

10 Q. I would have a basis in my hypothetical of 5 in
11 Jeffrey Friedman and Company and I sold it for 100, does
12 100 go in the factor or 5 go in the factor or 95?

13 A. 95.

14 Q. 95, because that would be the net, Joe?

15 A. That would be the net gain.

16 Q. Net on the trade names?

17 A. Right.

18 Q. Let's turn the page, Joe, to Part B. The terms
19 sales as used in 12-6-2280 and gross receipts as used in
20 12-6-2290 did not include. The first item, number 1 listed
21 is the repayment, maturity or redemption of the principal
22 of a loan, bond or mutual fund or certificate of deposit or
23 similar marketable instrument. So if I were to sell an
24 item that qualified in that list in number 1, it's called a
25 marketable instrument, and I had a fair market value, sold

1 it for 100, I had a basis of 90, I had a gain of 10, net of
2 10.

3 A. Net of 10.

4 Q. Which amount goes into the sales factor?

5 A. Ten.

6 Q. So the net goes in?

7 A. The net goes in.

8 Q. I'll jump down to number 3. Proceeds from the
9 taxpayer's stocks or from sale of treasury stock. The same
10 kind of example, Joe, in terms of numbers at least. I'm
11 going to sell some treasury stock for 100, I have a basis
12 in it of 90, because I acquired it originally for 90, so
13 gain of 10. Does it go in the sales factor at one of those
14 numbers or how would you include it in the sales factor?

15 A. Go in as 10.

16 Q. That's how you read the statute?

17 A. Yes. How we've always interpreted the statute
18 that way.

19 Q. We have one more document to give you, Joe,
20 related to this topic. At least one more.

21 (WHEREUPON, Petitioner's Exhibit
22 No. 17 was marked for
23 identification only.)

24 Q. This is actually 12-6-2290, the statute we were
25 talking about before. Does this one look familiar to you?

Exhibit B

1 STATE OF SOUTH CAROLINA
2 ADMINISTRATIVE LAW COURT

3

4 DUKE ENERGY CORPORATION,
5 Petitioner(s),

6 vs.

Case No: 10-ALJ-17-0270-CC

7 SOUTH CAROLINA DEPARTMENT OF REVENUE,
8 Respondent(s).

9

10 D E P O S I T I O N

11 WITNESS: SARAH G. MAJOR

12 DATE: Wednesday, March 14, 2012

13 TIME: 1:23 p.m.

14 LOCATION: Willoughby & Hoefer, P.A.
15 930 Richland Street
Columbia, South Carolina

16 TAKEN BY: Attorneys for the Petitioner

17 REPORTED BY: SHERI L. BYERS
18 Registered Professional Reporter

19 - - - - -

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16
17 ALSO PRESENT:

18 HARRY A. HANCOCK, ESQ.
19 T. COOPER MONROE
20

21 (INDEX AT REAR OF TRANSCRIPT)
22
23
24
25

1 sale."

2 Is that correct?

3 A. Which is the property -- which is the kind of
4 property that would be included in the inventory?

5 Q. Yeah.

6 A. Which is not the kind of property -- yeah.

7 Q. Okay. And would it be your testimony that
8 everything in 12-6-2295 was a clarification, or were
9 some of these changes?

10 A. I would say that some of them -- some of them
11 were changes. In (B), I don't think we always had all
12 of these. Meaning these were from an MTC model
13 regulation, and some of them were things that we were
14 always doing. Like one was something we were always
15 doing; two is something that we had already been doing;
16 three was something we had already been doing; four,
17 the damages amount, I think that -- I'm not sure what
18 we were doing in that case. Pension reversions, I'm
19 not sure what we were doing in that.

20 So some of these things I don't think had
21 necessarily come up, but the decision was made to go
22 uniformly with the MTC rules.

23 Q. So some of these items -- prior to this
24 enactment in 2007, some of these items, it would be
25 your testimony that it reflected the position of the

1 Department and some of these items were just
2 statutorily enacted?

3 A. I wouldn't say they worked -- I would say the
4 Department didn't necessarily have a position on some
5 of them.

6 Q. So --

7 A. Meaning that like pension reversion, I'm not
8 sure that had ever come up. So I don't think that we
9 had a position on pension reversions, for example.

10 Q. Would it be your testimony that none of these
11 items in here would reflect a change to the
12 Department's policies prior to the enactment of this
13 statute?

14 MR. GREEN: Objection as to form.

15 BY MR. TRESH:

16 Q. Let me rephrase. Is it your testimony or do
17 you believe in your role as policy --

18 A. Right.

19 Q. -- for the Department, policy counsel --

20 A. Right.

21 Q. -- that all of the items in (B)(1) through
22 (10) would have reflected the Department's policy? In
23 other words, that none of them reflected a change in
24 law?

25 MR. GREEN: Objection as to form.

1 THE WITNESS: I would say that there are not
2 all longstanding administrative policy with regard to
3 all of those, and that some of them had not come up
4 before. And, for example, damages, I do think that
5 they -- that there might have been cases where we
6 actually looked at the damages and decided what the
7 damages -- what kind of damages they were. And we
8 might have included them in the factors before.

9 But for the most part, I would say either
10 they hadn't been considered before or they were the
11 Department's position.

12 BY MR. TRESH:

13 Q. So prior to 2007 some damages would have been
14 included in gross receipts and some damages wouldn't
15 have?

16 A. I think that's possible. Yes.

17 Q. Okay. And so how would a taxpayer have known
18 which portions of this statute reflected a change,
19 which portions reflected a clarification of
20 longstanding Department policy, and which portions of
21 this statute represented just new law, new policy,
22 whatsoever, things the Department hadn't considered in
23 your view?

24 A. I don't know.

25 Q. Is there any --

Exhibit C

THE STATE OF SOUTH CAROLINA

IN THE SUPREME COURT

APPEAL FROM RICHLAND COUNTY

HONORABLE DAVID F. MCINNIS, JUDGE

CASE NO. 86-344

Duke Power Company,

Respondent,

vs.

South Carolina Tax Commission,

Appellant.

BRIEF OF APPELLANT

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JOE L. ALLEN, JR.
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QUESTIONS

1. Did the lower court err in limiting the application of § 12-19-110 solely to customer charges and thereby precluding from taxation the receipts derived from the sale of the nuclear facility?

2. Does § 12-19-110, as applied to the respondent, violate the Equal Protection Clauses of the South Carolina and United States Constitutions?

3. Did the lower court err in awarding costs to the respondent?

STATEMENT

The matter before the court arises out of a transaction whereby the respondent sold to various parties a portion of its nuclear generating facility located in York County, South Carolina. The appellant took the position that the gross receipts derived from this sale should be included within the respondent's tax base for purposes of calculating its corporate license tax liability under § 12-19-110. The respondent excepted to such and the matter proceeded to the lower court.

At the lower court there was a disagreement as to what issues were actually raised by the respondent's Complaint.¹ It would now appear that this disagreement is irrelevant in that the lower court's decision was based solely on an issue that was properly before it. Since the respondent prevailed on this particular point, the court found it unnecessary to address the other issues. (See Tr., p. 24.)

The substance of the lower court's decision was that § 12-19-110 was limited to imposing a license tax on receipts from customer charges. (See Tr., p. 24.) Accordingly, the court determined the receipts from the sale

¹See the Statement (Tr., pp. 2 and 3), the respondent's Complaint (Tr., pp. 6 and 7) and the appellant's Exceptions #15 and #16 (Tr., pp. 27 and 28).

of the nuclear facility should not be included in the respondent's license tax base.

The appeal now before this court presents two major issues. The first is whether § 12-19-110 is limited in its application to customer charges thus precluding from taxation the receipts derived from the sale of the nuclear facility.

The second issue is raised by the respondent's additional sustaining ground. That issue is whether § 12-19-110 is unconstitutional under the Equal Protection Clauses of the State and Federal Constitutions.²

A lesser issue is also presented regarding the lower court awarding costs to the respondent. That issue is simply whether such an award was proper.

²Although properly before the lower court, this issue was one that the court declined to address.

ARGUMENT

I

THE LOWER COURT ERRED IN LIMITING THE APPLICATION OF § 12-19-110 SOLELY TO CUSTOMER CHARGES AND THEREBY PRECLUDING FROM TAXATION THE RECEIPTS DERIVED FROM THE SALE OF THE NUCLEAR FACILITY. (Exceptions 1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, 14, 17 and 18)

Chapter 19 of Title 12 sets forth a taxing scheme that imposes a franchise tax upon the privilege of doing business as a corporation in South Carolina. United States Rubber Co. v. Query, 19 F.Supp. 191 (1937). Included within that Chapter are §§ 12-19-100 and 12-19-110, both of which levy a license tax on regulated corporations such as the respondent. In the instant situation, it is the provisions of § 12-19-110 that are in question. During the relevant tax year,³ those provisions provided as follows:

"In addition to the license fee provided by § 12-19-100 and any and all other license taxes and fees or taxes of whatever kind, there is hereby levied an annual license fee of three mills upon the entire gross receipts from business within this State during the calendar year next preceding by every railroad company, express company, street railway company, navigation company, waterworks company, power company, distribution electric cooperative, light company, gas company, telegraph company, telephone company, parlor, dining or sleeping car company, tank car company, refrigerating car company, fruit growers' express car company, and all other privately operated car lines. The license fee provided for by this section shall be paid at the time of filing the reports required by this chapter.

³Section 12-19-110 was amended in 1985.

Electric cooperatives subject to the license fee imposed by § 12-19-100 and distribution electric cooperatives subject to the license fee provided by this section shall file reports pursuant to the provisions of §§ 12-19-20 and 12-19-130. Provided, however, that the first report of electric cooperatives, together with the payment of the fee, shall be made between March 15, 1970 and June 30, 1970." (Emphasis added)

The above language clearly indicates that the license tax on corporations, such as the respondent, is based on entire gross receipts and not just receipts from customer charges. Accordingly, the lower court's attempt to apply such a limitation here was improper. Where a statute is clear and unambiguous, there is no room for construction and the terms of the statute must be given their literal meaning. Southeastern Fire Ins. Co. v. South Carolina Tax Commission, 253 S.C. 407, 171 S.E.2d 355 (1969); Green v. Zimmerman, 269 S.C. 535, 238 S.E.2d 323 (1977).

The broad import of the words "entire gross receipts" was not lost on the Ohio Supreme Court in Sandusky Gas and Electric Co. v. State, 114 O.S. 479, 151 N.E. 685, 71 A.L.R. 260 (1926). When reviewing a statute similar to § 12-19-110, the court there commented that a tax based on such words would go beyond customer charges.

"The levy of an excise tax upon the gross receipts of public utility companies is made pursuant to the provisions of sections 5417, 5474, 5475, and 5483, General Code, and the words 'entire gross receipts,' as there employed, mean and include the entire

receipts of such company from the intrastate business done by it, under the exercise of its corporate powers, whether from the operation of the utility itself or from any other business done by it."

*Said by
still not broad
enough to cover
all of assets
not in course
of business*

Moreover, contrary to the lower court's conclusion, the language "from business in this state" does not necessarily limit § 12-19-110's application to customer charges. This is similar to the argument made by the taxpayer in State v. United Electric Light & Water Co., 90 Ct. 452, 97 A. 857 (1916). There, Connecticut levied a corporation license tax on gross earnings from operations in that state. The taxpayer attempted to exclude from such tax the earnings received from the sale of various residual products by claiming that the only earnings subject to taxation were those earnings received by it from the sale of electricity to its customers. The court rejected this argument by noting that the statutory language of the tax statute was broad enough to include gross earnings from all sources.

Although there is no South Carolina case law directly on point, it should be noted that for purposes of allocating and apportioning income, the word "business" has been interpreted as including income derived from the sale of property connected with a taxpayer's business. In Texaco, Inc. v. Wasson, 269 S.C. 255, 237 S.E.2d 75 (1977), the court held that royalties received by Texaco from its sulfur and salt mines in Texas must be apportioned to South

*Recurring
activity
regular
source of
revenue*

Carolina because such were derived from properties connected with Texaco's oil business.

The appellant's Regulation 117-89.1 also requires that the receipts from the sale of the nuclear facility should be included within the measure of the tax levied by § 12-19-110. That Regulation states:

"Gross receipts, as used in § 12-19-110 of the South Carolina Income Tax Act of 1926, as amended, shall include all receipts from operations within the State, (and also other profit and loss items with a local situs) Intangible income from intangibles used in the conduct of the business within this State shall be included in gross receipts."

This Regulation, along with the appellant's Finding (Tr., p. 12), demonstrate that the appellant has long interpreted § 12-19-110 as applying to more than the mere receipts from customer charges. Such a construction of § 12-19-110, by the agency charged with executing it, is entitled to the most respectful consideration and should not be overruled without cogent reasons. Faile v. S. C. Employment Security Commission, 267 S.C. 536, 230 S.E.2d 219 (1976); Stephenson Finance Company v. South Carolina Tax Commission, 242 S.C. 98, 130 S.E.2d 72 (1963).

Additionally, the fact that Tax Regulation 117-89.1 makes reference to "other profit and loss items" does not imply that the appellant interprets § 12-19-110 as being limited to taxing the gain on the sale of an asset.

The appellant's Finding clearly states that such term "is used to identify certain items and does not relate to the manner of taxation". (Tr., p. 13) In this instance, such would identify the nuclear facility.

It is also noteworthy that § 12-19-110 was amended in 1985. A review of this amended version and an application of the rules of statutory construction lend support to the appellant's position that prior to its amendment § 12-19-110 was not limited to customer charges. The relevant provision of § 12-19-110 now reads:

"In addition to the license fee provided by § 12-19-100 and any and all other license taxes and fees or taxes of whatever kind, there is levied an annual license fee of three mills upon the gross receipts derived from services rendered from regulated business within this State during the calendar year next preceding by every railroad company, express company, street railway company, navigation company, waterworks company, power company, distribution electric cooperative, light company, gas company, telegraph company, telephone company, parlor, dining or sleeping car company, tank car company, refrigerating car company, fruit growers' express car company, and all other privately operated car line. * * *."

The new language of § 12-19-110 now states that the tax levied therein is restricted to "receipts derived from services rendered". This indicates that the prior language of § 12-19-110 was not limited in this respect. Where the General Assembly has adopted an amendment to a

statute, it is presumed that it intended to change the existing law. Vernon v. Harleyville Mutual Casualty Company, 244 S.C. 152, 135 S.E.2d 841 (1964); North River Insurance Company v. Gibson, 244 S.C. 393, 137 S.E.2d 264 (1964).

For the most part, the lower court relied upon the original enactment of § 12-19-110⁴ to arrive at its decision. The court reasoned that the use of the word "operations" therein indicated that the corporate license tax is limited to customer charges. This reasoning is incorrect for two reasons.

First, a reading of that Act in its entirety reveals that the term "gross earnings from operations" applies only to railroads. Section 1 of the Act requires various corporations to report differing items of information to the Comptroller General for purposes of levying the subject tax. At subsection 12 of § 1, it is stated that each railroad must report the "gross earnings from its operation". On the other hand, subsection 13 of that same section requires power companies such as Duke to report their "entire gross receipts". From that point on, all regulated corporations, to include railroads and power companies, are addressed together in the same sections with the phrases "gross earnings from operations" and "entire

But key point is no more

(for business done)

⁴See Act No. 269, Acts of 1904.

"from business done"

gross receipts" both appearing therein. It stands to reason that each of these phrases must be applied only to those corporations to which they relate. To do otherwise would make the reporting system of § 1 of no value. It must be remembered that in construing legislation, it is a rule that the General Assembly did not intend to do a futile thing. Gaffney v. Mallory, 186 S.C. 337, 195 S.E. 840 (1938); McLeod v. Montgomery, 244 S.C. 308, 136 S.E.2d 778 (1964).

Second, even if the word "operation" does apply to utilities, such does not necessarily imply that the tax here is restricted to customer charges. As previously stated, the court in State v. United Electric Light and Water Co., supra, refused to apply such an interpretation even though the tax there was levied "on gross earnings from operations" (emphasis added). Similarly, the appellant's Finding also points out that "operations" usually relate to the whole process of planning for and operating a business. Liller v. Logsdon, 261 Md. 367, 275 A.2d 469 (1971). In view of such, it is foreseeable that the operations of a corporation would include the buying and selling of assets either used or anticipated for use by that corporation in the conduct of its business.

Finally, the appellant's interpretation of § 12-19-110 does not lead to absurd results.⁵ There is

⁵See the lower court's Order at Tr., p. 21.

nothing in the record to indicate that the appellant would consider both the principal and interest of a redeemed bond as being gross receipts under § 12-19-110. In point of fact, the appellant's own Regulation, 117-89.1, shows a different result. It states that "Intangible income from intangibles used in the conduct of the business within this state shall be included in gross receipts", thus inferring the appellant would only consider the income of the bond as gross receipts. A similar result would also be reached with regard to any loans made by the respondent.

Likewise, the appellant's interpretation of § 12-19-110 does not have the effect of taxing the same subject matter twice.⁶ The subject matter of the tax levied by § 12-19-110 is gross receipts while that of § 12-19-100 is the fair market value of all property owned by a corporation such as the respondent. This same situation arises with telephone companies. They are also subject to both §§ 12-19-100 and 12-19-110. Naturally, any receipts received from the sale or renting of telephones would be included within the measure of the tax levied by § 12-19-110, while at the same time the fair market value of such phones would be included within § 12-19-100.

⁶See the lower court's Order at Tr., p. 22.

ARGUMENT

II

SECTION 12-19-110, AS APPLIED TO THE RESPONDENT, DOES NOT VIOLATE THE EQUAL PROTECTION CLAUSES OF THE SOUTH CAROLINA AND UNITED STATES CONSTITUTIONS. (Respondent's Additional Sustaining Ground)

The respondent raises the additional sustaining ground that § 12-19-110 is unconstitutional under the Equal Protection Clauses of the Federal and State Constitutions. As a basis for such, the respondent argued before the lower court that utilities have to pay more license tax than other corporations thus creating an unconstitutional situation.

The fact the respondent is classified differently than certain other corporations and must pay a higher license tax as a result of this classification does not necessarily indicate that § 12-19-110 is unconstitutional. It is a basic fundamental of taxation that the Equal Protection Clause does not prohibit states from drawing lines that treat one class of taxpayers differently from others. Lehnhausen v. Lake Shore Auto Parts Co., 410 U.S. 356, 93 S.Ct. 1001 (1973). This principle applies likewise to corporations. 71 Am.Jur.2d, State and Local Taxation, § 186, p. 505.

In the instant situation, the General Assembly has chosen to divide all corporations into two classes for purposes of levying its corporate license tax. The first class is unregulated corporations⁷ while the second, of

⁷See § 12-19-70 for the tax rate imposed on this class.

which the respondent is a member, is composed of those corporations regulated by the South Carolina Public Service Commission. Such a classification scheme is presumed constitutional with the burden being on the respondent to show that there is no conceivable basis supporting the same.

" * * *. There is a presumption of constitutionality which can be overcome only by the most explicit demonstration that a classification is a hostile and oppressive discrimination against particular persons and classes.' * * *. 'The burden is on the one attacking the legislative arrangement to negative every conceivable basis which might support it.' * * *." Lehnhausen v. Lake Shore Auto Parts Co., supra.

"An ordinance is a legislative enactment and is presumed to be constitutional. The burden is upon the taxpayer to prove unconstitutionality beyond a reasonable doubt. The burden requires the attacker to ' . . . negative every conceivable basis which might support it.'" North Charleston Land Corp. v. The City of North Charleston, et al., South Carolina Supreme Court's Opinion No. 22079, April 9, 1984.

Moreover, the courts have long recognized that there is a rational basis for taxing regulated corporations at a higher rate than unregulated corporations. In so doing, they have justified such upon the grounds that these corporations enjoy the right of eminent domain, exercises relative freedom from competition and have other advantages over the general business community. New York Rapid Transit Corp. v. City of New York, 303 U.S. 573, 82 L.Ed. 1024, 58

S.Ct. 721, reh. den., 304 U.S. 588, 82 L.Ed. 1548, 58 S.Ct. 939 (1938); New York Steam Corp. v. New York, 268 N.Y. 137, 197 N.E. 172, 172 A.L.R. 1157 (1935). A review of Title 57 of the South Carolina Code of Laws indicates that corporations such as the respondent receive similar benefits.⁸

Contrary to the argument made by the respondent before the lower court, Southern Bell Tel. & Tel. Co. v. City of Aiken, 279 S.C. 269; 306 S.E.2d 220 (1983), is not applicable. In that case, the taxpayer was taxed at 24 times the average rate. Although the lower court there upheld the ordinance imposing this tax, the matter was reversed on appeal because the lower court's Order failed to state a rational basis for taxing the taxpayer at a higher rate.

Here, unlike the situation in Southern Bell Tel. & Tel. Co., not only is there a rational basis for supporting the classification in question but the respondent itself has failed to meet its burden of proof. All the respondent has done is allege that it pays more taxes under § 12-19-110 than it would if it were paying taxes under § 12-19-70. Certainly, this does not meet the burden of negating every conceivable basis which might support South Carolina's corporate license tax classification scheme.

⁸See for example § 58-27-130 (condemnation powers) and § 58-27-1230 (limiting establishment of new utilities).

ARGUMENT

III

THE LOWER COURT ERRED IN AWARDING COSTS TO THE RESPONDENT.
(Exception 19)

Pursuant to Rule 54(d), South Carolina Rules of Civil Procedure, costs against the appellant can be imposed only to the extent provided for by law. In the instant situation, the respondent's action was brought under § 12-47-440. (Tr., pp. 1 and 2) As to those remedies found in Chapter 47 of Title 12, § 12-47-270 controls the awarding of costs.⁹ That provision states:

"In any action brought under the provisions of § 12-47-220 or 12-47-230, no costs or disbursements shall be taxed or allowed in favor of either party, except for the service of process and procuring the attendance of witnesses."

The above indicates that costs are only appropriate when actions are brought under § 12-47-220 or § 12-47-230. Inasmuch as the action here is by way of § 12-47-440, the awarding of costs was improper.

However, even if § 12-47-270 could be construed as applying to § 12-47-440, the costs recoverable would be limited to those for service of process and the procurement of witnesses. Pendarvis v. S. C. Tax Commission, Davis Advance Sheets, Opinion No. 2239. This would afford the

⁹None of the remedies found in Chapter 47 of Title 12 provide for costs. It is only by way of § 12-47-270 that such is afforded.

respondent very little since there were no witnesses (Tr., p. 15) and the cost of service was minimal.

CONCLUSION

It is respectfully submitted that the Order of the lower court should be reversed and the proceeds derived from the sale of the nuclear facility included within the respondent's corporate license tax base. Such is premised upon the language of § 12-19-110, Tax Regulation 89.1, the rules of statutory construction and relevant case law.

It is additionally submitted that § 12-19-110 does not violate the Equal Protection provisions of either the Federal or State Constitutions. As shown above, there is a rational basis for taxing the respondent at a higher rate.

Finally, the lower court erred in awarding costs to the respondent. An award of costs against a state agency is permissible only when provided for by law. Here the law does not make such a provision.

T. TRAVIS MEDLOCK
Attorney General of South Carolina

JOE L. ALLEN, JR.
Chief Deputy Attorney General

RONALD W. URBAN
Assistant Attorney General
Attorneys for Appellant

Columbia, South Carolina
_____, 1986

Exhibit D

State of South Carolina
In the Administrative Law Court
No. 10-ALJ-17-0270-CC

DUKE ENERGY CORPORATION,)
)
Petitioner,)
)
vs.)
)
SOUTH CAROLINA DEPARTMENT OF REVENUE,)
)
Respondent.)
_____)

D E P O S I T I O N

WITNESS: JOE SOUTHARD
DATE: December 2, 2011
TIME: 9:00 a.m. - 12:50 p.m.
LOCATION: Willoughby & Hoefer
930 Richland Street
Columbia, South Carolina

TAKEN BY: Attorney for the Petitioner
REPORTED BY: KATHRYN J. LINDLER

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Joe Southard 12/2/2011

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By: Burl F. Williams, Esquire,

Attorneys for the Respondent:

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By: Tracey C. Green, Esquire, and
John W. Roberts, Esquire, and

South Carolina Department of Revenue
301 Gervais Street
Columbia, South Carolina 29201

By: Harry A. Hancock, Esquire.

Attending: T. Cooper Monroe, Duke

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1 Jeffrey Friedman Company would be a trade name and I sold
2 the name Jeffrey Friedman Company if somebody were willing
3 to buy it for \$100 and I have a basis in Jeffrey Friedman
4 Company of \$5.

5 A. Oh, in that particular -- if you're selling your
6 trade name.

7 Q. Right.

8 A. Outright, yes, you would have a basis and then
9 whatever the difference is would be a gain or a loss.

10 Q. I would have a basis in my hypothetical of 5 in
11 Jeffrey Friedman and Company and I sold it for 100, does
12 100 go in the factor or 5 go in the factor or 95?

13 A. 95.

14 Q. 95, because that would be the net, Joe?

15 A. That would be the net gain.

16 Q. Net on the trade names?

17 A. Right.

18 Q. Let's turn the page, Joe, to Part B. The terms
19 sales as used in 12-6-2280 and gross receipts as used in
20 12-6-2290 did not include. The first item, number 1 listed
21 is the repayment, maturity or redemption of the principal
22 of a loan, bond or mutual fund or certificate of deposit or
23 similar marketable instrument. So if I were to sell an
24 item that qualified in that list in number 1, it's called a
25 marketable instrument, and I had a fair market value, sold

1 it for 100, I had a basis of 90, I had a gain of 10, net of
2 10.

3 A. Net of 10.

4 Q. Which amount goes into the sales factor?

5 A. Ten.

6 Q. So the net goes in?

7 A. The net goes in.

8 Q. I'll jump down to number 3. Proceeds from the
9 taxpayer's stocks or from sale of treasury stock. The same
10 kind of example, Joe, in terms of numbers at least. I'm
11 going to sell some treasury stock for 100, I have a basis
12 in it of 90, because I acquired it originally for 90, so
13 gain of 10. Does it go in the sales factor at one of those
14 numbers or how would you include it in the sales factor?

15 A. Go in as 10.

16 Q. That's how you read the statute?

17 A. Yes. How we've always interpreted the statute
18 that way.

19 Q. We have one more document to give you, Joe,
20 related to this topic. At least one more.

21 (WHEREUPON, Petitioner's Exhibit
22 No. 17 was marked for
23 identification only.)

24 Q. This is actually 12-6-2290, the statute we were
25 talking about before. Does this one look familiar to you?

WILLOUGHBY & HOEFER, P.A.

ATTORNEYS & COUNSELORS AT LAW

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*ALSO ADMITTED IN TX

September 21, 2012

The Honorable Ralph King Anderson, III
South Carolina Administrative Law Court
Edgar A. Brown Building
1205 Pendleton Street, Suite 225
Columbia, South Carolina 29201

RE: *Duke Energy Corp. v S. Carolina Dep't of Rev.*, NO. 10-ALJ-17-0260-CC

Dear Judge Anderson:

Please allow this letter to serve as the Department of Revenue's ("Department") response to the Court's inquiry on September 19, 2012 regarding South Carolina Code Section 12-6-2295. As previously explained, the Department's position is that section 12-6-2295 codified the long-standing administrative position that the return of principal from securities transactions like those at issue here is excluded from the terms "sales" and "gross receipts," but that any gain from these transactions is part of "sales" and "gross receipts."

Subsection (B)(1) of section 12-6-2295 excludes the return of *principal* to the investor in securities transactions like those at issue in this matter: "The terms 'sales' ... and 'gross receipts' ... do not include ... repayment, maturity, or redemption of the principal of a loan, bond, or mutual fund or certificate of deposit or similar marketable instrument." In Duke Energy's memorandum opposing the summary judgment, subsection (B) is the only subpart of section 12-6-2295 cited in support of its contention that the "legislature statutorily changed the apportionment formula to eliminate certain gross receipts, including receipts from the sale of securities." [Duke Energy Mem. Law. Opp'n to Mot. Sum. J., p.35.]

On the other hand, any gain from these transactions is included in the terms "sales" and "gross receipts." Subsection (A)(4) of section 12-6-2295 expressly includes in these terms "net gain from the sale of property used in the trade or business." The statute defines this terminology to include "intangible property used in the trade or

The Honorable Ralph King Anderson, III
September 21, 2012
Page 2

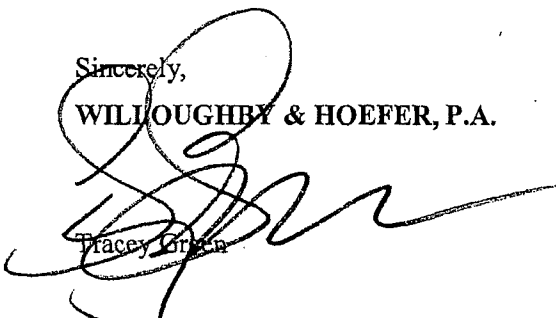
business which is ... not property of a kind that would be includible in inventory of the business if on hand at the close of the taxable year; or [] held by the business primarily for sale to customers in the ordinary course of the trade or business." The parties already have agreed that these securities are connected to Duke Energy's trade or business. [See Dep't Response to Questions Presented by Court on July 13, 2012 (July 17, 2012); Duke Energy Ltr. Re: Questions Presented by Court (July 17, 2012).] Therefore, any gain from these transactions is expressly included by section 12-6-2295(A)(4).

For these reasons, it is the Department's position that section 12-6-2295 codifies the long-standing administrative position regarding the treatment of securities transactions like those at issue here: the terms "sales" and "gross receipts" exclude the return of principal from these securities transaction, but include any gain resulting from the transactions.

If you have any questions, or need additional information, please contact me at your convenience.

Sincerely,

WILLOUGHBY & HOEFER, P.A.



Tracey Griffin

TG/lg

NEXSEN|PRUET

Burnet R. Maybank, III
Member
Admitted in SC

October 9, 2012

BY HAND DELIVERY

The Honorable Jenny Abbott Kitchings
Clerk of Court
South Carolina Court of Appeals
1015 Sumter Street
Columbia, SC 29201

Re: Duke Energy Corporation v. South Carolina Department of Revenue
10-ALJ-17-0270-CC

Dear Ms. Kitchings:

Enclosed for filing is a Notice of Appeal in the above case. Also enclosed are the following:

Charleston

Charlotte

Columbia

Greensboro

Greenville

Hilton Head

Myrtle Beach

Raleigh

1. Proof of Service of the Notice of Appeal on the Respondent;
2. A copy of the Order which is to be challenged on appeal as well as Duke's Motion for Reconsideration; and
3. Our firm's check in the amount of \$100.00 for filing fee.

We are filing this appeal out of an abundance of caution. In the Final Order issued on August 9, 2012, the ALC granted in part the South Carolina Department of Revenue's ("Department") Motion for Summary Judgment with respect to the Waiver Issue. On August 20, 2012, Duke Energy timely filed a Motion for Reconsideration in accordance with ALC Rule 29(D), appealing the Final Order's granting of the Department's Motion for Summary Judgment. A true copy of the Motion for Reconsideration is attached hereto and incorporated herein by reference. On August 29, 2012, the ALC suspended the Final Order ("Suspending Order") pending a decision on Duke Energy's Motion for Reconsideration. A true copy of the Suspending Order is attached hereto and incorporated herein by reference. The ALC did not act upon Duke Energy's Motion for Reconsideration within 30 days after its

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NPCOL1:3062780.1-LT-(BMAYBANK) 011413-00041

The Honorable Jenny Abbott Kitchings
October 9, 2012
Page 2

filing and pursuant to ALC Rule 29(D)(2), Duke Energy's Motion For Reconsideration was deemed denied on September 19, 2012.

Section 1-23-610(A)(1) authorizes judicial review of ALC decisions and mandates that "a *final* decision" of the ALC must be appealed to this Court within 30 days after the aggrieved party receives the final decision and order of the administrative law judge. S.C. Code Ann. § 1-23-610(A)(1) (emphasis added). The 30-day period for appeal is stayed by a timely motion for reconsideration and if no order is filed regarding the motion, the 30-day period begins running from the time the motion is deemed denied. ALC Rule 29(D)(4).

The South Carolina Supreme Court has opined that a *final* decision "disposes of the whole subject matter of the action or terminates the particular proceeding or action, leaving nothing to be done but to enforce by execution what has been determined." See, e.g., *Charlotte-Mecklenburg Hosp. Auth. v. S. C. Dep't of Health & Envtl. Control*, 387 S.C. 265, 267, 692 S.E.2d 894, 895-6 (2010). An ALC order is interlocutory in nature and not immediately appealable "if there is some further act which must be done by the court prior to a determination of the rights of the parties ... [or] if a judgment ... determine[s] the applicable law, but leaves open questions of fact." *Id.*

The Waiver Issue determines the rights of the parties with respect to the tax years 1978-1993 because it dismisses Duke Energy's refund claims for those years and thus, there is no further act to be done by the ALC with respect to Duke Energy's claims for refund for those years. While the determination of the Waiver Issue in the Final Order disposes of Duke Energy's claims for refund for the tax years 1978 through 1993, it has no relevance to Duke Energy's refund claims for the tax years 1994 through 2001, which are part of the same action and remain pending before the ALC. As a result, the ALC's Final Order with respect to the Waiver Issue is not a final decision for purposes of Section 1-23-610 with respect to the tax years 1994-2001 because it does not terminate the proceeding or dispose of the whole subject matter of the action before the ALC.

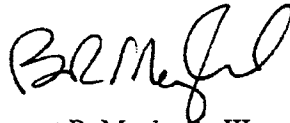
Therefore, in the event this Court were to conclude that the Final Order constitutes a *final* decision with respect to the tax years 1978 through 1993 for purposes of Section 1-23-610, Duke Energy files this Notice of Appeal out of an abundance of caution to preserve its right to appeal from the Final Order with respect to the Waiver Issue. Should the Court determine that the Final Order is a final decision that is properly before the Court pursuant to Section 1-23-610, Duke Energy respectfully requests that this Court stay further proceedings in this appeal from the Final Order, pending resolution of the remainder of Duke Energy's refund claims for the tax years 1994 through 2001, following the trial which was held before the ALC

The Honorable Jenny Abbott Kitchings
October 9, 2012
Page 3

on September 5-6, 2012. Staying review of Duke Energy's Notice of Appeal will allow this Court to review the ALC Order together with any other issues that might be appealed following the resolution of the entire case by the ALC, thus promoting efficiency, conserving judicial resources, and reducing expense and delay.

Please return one clocked copy to me via our courier.

Very truly yours,

A handwritten signature in black ink, appearing to read "BRM", followed by a stylized flourish.

Burnet R. Maybank, III

BRM/caa
Enclosures

cc: The Honorable Ralph K. Anderson III
Harry Hancock
Milton Kimpson
John M. S. Hoefer
Tracey C. Green
John Roberts

THE STATE OF SOUTH CAROLINA
In The Court of Appeals

APPEAL FROM THE ADMINISTRATIVE LAW COURT

Ralph K. Anderson III, Administrative Law Judge

Case No. 10-ALJ-17-0270-CC

Duke Energy Corporation..... Appellant,
v.
South Carolina Department of Revenue..... Respondent.

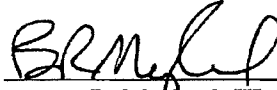
NOTICE OF APPEAL

Duke Energy Corporation (hereinafter "Appellant") hereby appeals the following two orders of the Honorable Ralph K. Anderson III of the Administrative Law Court ("ALC"): (1) Final Order and Decision filed on August 9, 2012 ("Final Order"), a copy of which is attached hereto as Exhibit A; and (2) The ALC's deemed denial of Appellant's Motion for Reconsideration ("Motion") which was filed on August 20, 2012, a copy of which is attached as Exhibit B.

The ALC did not act upon Duke Energy's Motion for Reconsideration within 30 days after its filing and pursuant to ALC Rule 29(D)(2), Duke Energy's Motion For Reconsideration was deemed denied on September 19, 2012.

Thus, pursuant to ALC Rule 29(D)(4), this Notice of Appeal is timely filed within 30 days of the deemed denial of the Motion for Reconsideration.

RESPECTFULLY SUBMITTED,



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October 9, 2012

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*Attorneys for Respondent South Carolina
Department of Revenue*

Exhibit A

**STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT**

Duke Energy Corporation,	)	
	)	
Petitioner,	)	Docket No. 10-ALJ-17-0270-CC
	)	
vs.	)	ORDER GRANTING SUMMARY
	)	JUDGMENT IN PART AND DENYING
	)	SUMMARY JUDGMENT IN PART
South Carolina Department of Revenue,	)	
	)	
Respondent.	)	
	)	

Appearances:

For the Petitioners: Burnet R. Maybank, III, Esq.; Eric S. Tresh, Esq.; Jeffrey A. Friedman, Esq.; and Maria M. Todorova, Esq.

For the Respondent: Tracey C. Green, Esq.; John W. Roberts, Esq.; Harry Hancock, Esq.; and J. Abraham Gutting, Esq.

This matter is before the Administrative Law Court (ALC or Court) upon a Motion for Summary Judgment filed by Respondent Department of Revenue (Department) and a Cross-motion for Partial Summary Judgment filed by Petitioner Duke Energy Corporation (Duke Energy). The underlying case arises from the Department's denial of amended corporate income tax returns filed by Duke Energy in 2002 for income tax years 1978-2001.¹ In its Motion for Summary Judgment, the Department contends that prior to the effective date of the Revenue Procedures Act (RPA), August 1, 1995, it lacked authority to extend the limitation period during which a taxpayer could file a refund claim and therefore, as a matter of law, the Forms FS-43 executed by Duke Energy and the Department prior to that time were ineffective in extending the refund-claim filing periods, rendering Duke Energy's filing of amended corporate income tax returns for tax years ending 1978-1993 untimely.² The Department also contends that Duke Energy, as a matter of law, is a "manufacturer" under the applicable apportionment statute and must therefore use a multi-factor apportionment formula, consisting of property, sales, and

¹ These are the tax periods at issue in this case.

² Both parties stipulate that Duke Energy's amended return for tax year 1994 was timely filed.

FILED

August 9, 2012

SC ADMIN. LAW COURT

payroll factors, not a single-factor gross-receipts formula.³ The Department further contends that as a matter of law, Duke Energy cannot, in its calculation of corporate income tax owed to South Carolina, include in the apportionment formula the return of principal from its sales of securities and other investment transactions. Finally, Duke Energy, in its Cross-Motion for Summary Judgment, argues that it was required to include in the apportionment formula the return of principal from its sales of securities and other investment transactions.

A hearing regarding these motions was held before this Court on June 26, 2012, in Columbia, South Carolina. For the reasons set forth below, I conclude that the Department's Motion for Summary Judgment as to the timeliness of Duke Energy's amended refund claims for tax years ending 1978-1993 must be granted; that the Department's Motion for Summary Judgment as to whether Duke Energy is considered a "manufacturer" under the applicable apportionment statute must be denied; and that the Department's Motion for Summary Judgment as to Duke Energy's inclusion of the return of principal in its apportionment formula must be granted and Duke Energy's Cross-Motion for Partial Summary Judgment on this issue must be denied.

FACTUAL BACKGROUND

The Department began auditing Duke Energy's corporate income taxes for income tax year ending 1978. That audit was extended a number of times, over a period of years due to the pending results of an audit of Duke Energy by the Internal Revenue Service (IRS), and also due to the health issues experienced by the Department's auditor and changes in the Department's personnel. These extensions were approved by Forms FS-43, each entitled "Field Services Division – Consent to Extend the Time to Assess Tax." The first Form FS-43, executed in August 1988, pertained to the income tax years ending December 31, 1983 and 1984. Significantly, the income tax years ending December 31, 1978 through December 31, 1982 were incorporated into the executed Forms FS-43 in May 1996. Additional Forms FS-43 periodically

³ Between the tax years ending 1978-1993, taxpayers whose principal business in South Carolina was "(a) manufacturing or a form of collecting, buying, assembling, or processing goods and materials within this State, or (b) selling, distributing, or dealing in tangible personal property within this State," were required to apportion their income based on a multi-factor apportionment formula, consisting of property, sales, and payroll factors. S.C. Code Ann. § 12-6-2250 (applicable to tax years after 1995); S.C. Code Ann. § 12-7-1120 (applicable to tax years prior to 1996). In this case, no party argued that Duke Energy engaged in collecting, buying, assembling, or processing of goods and materials within South Carolina, or that Duke Energy engaged in selling, distributing, or dealing in tangible personal property within South Carolina. Therefore, the Court will only focus its discussion on whether Duke Energy was a manufacturer for purposes of Section 12-6-2250.

were executed and additional income tax years added until the execution of the final Form FS-43 in June 2002.

In December 2002, Duke Energy filed amended corporate tax returns for the income tax years 1978-2001 seeking a total refund of \$126,240,645 plus interest.⁴ Duke Energy sought to change the apportionment formula – the mechanism for determining how much income is associated with Duke Energy’s South Carolina’s business activities – to the single-factor gross-receipts apportionment formula instead of the three-factor formula that it had previously used. It also sought to include the gross receipts, including the return of principal, from its sales of securities and other capital investments in the denominator of the gross-receipts formula for tax years 1978-1999.⁵ However, on February 4, 2010, the Department denied Duke Energy’s refund claims, after which Duke Energy filed a request for a contested case hearing with this Court on March 3, 2010.

STANDARD OF REVIEW

Rule 68 of the Administrative Law Court Rules provides that “[t]he South Carolina Rules of Civil Procedure . . . may, in the discretion of the presiding administrative law judge, be applied in proceedings before the Court to resolve questions not addressed by these rules.” ALC Rule 68. Rule 56(c) of the South Carolina Rules of Civil Procedure states that summary judgment is properly granted when the “pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that any party is entitled to a judgment as a matter of law.” Rule 56(c), SCRCR.

“The purpose of summary judgment is to expedite disposition of cases which do not require the services of a fact finder.” George v. Fabri, 345 S.C. 440, 452, 548 S.E.2d 868, 874 (2001). “In determining whether summary judgment is proper, the court must construe all ambiguities, conclusions, and inferences arising from the evidence against the moving party. Byers v. Westinghouse Elec. Corp., 310 S.C. 5, 7, 425 S.E.2d 23, 24 (1992). Because it is a

⁴ This is the amount set forth by the Department. However, Duke Energy stated in its Memorandum in Opposition to the Department’s Motion for Summary Judgment and in Support of Duke Energy’s Cross-Motion for Partial Summary Judgment that the Department’s refund calculations in its Memorandum were incorrect, and that damages would need to be resolved should the Court find in the Department’s favor on any issue.

⁵ For 2000 and 2001, Duke Energy’s original tax returns included receipts from sales of securities in the sales factor in the denominator of the three-factor formula.

drastic remedy, summary judgment should be cautiously invoked to ensure that a litigant is not improperly deprived of a trial on disputed factual issues. Helena Chem. Co. v. Allianz Underwriters Ins. Co., 357 S.C. 631, 644, 594 S.E.2d 455, 462 (2004). However, “when plain, palpable, and indisputable facts exist on which reasonable minds cannot differ, summary judgment should be granted.” Bayle v. S.C. Dep’t of Transp., 344 S.C. 115, 120, 542 S.E.2d 736, 738 (Ct. App. 2001).

S.C. Code Ann. § 1-23-600(A) (Supp. 2010) grants jurisdiction to the ALC to hear contested cases under the Administrative Procedures Act. Additionally, Section 12-60-460 grants the ALC the authority to conduct contested case hearings in matters concerning tax assessment and refunds.

DISCUSSION

I. Timeliness of Duke Energy’s Amended Income Tax Return Filings

The Department asserts that Duke Energy did not timely file its request for tax refunds for tax years ending 1978-1993, and therefore this case should be summarily dismissed. Undisputedly, in every instance Duke Energy’s amended tax returns for tax years ending 1978-1993 do not meet the statutory deadline to file its amended tax returns. Duke Energy nevertheless argues that its amended tax returns for the disputed tax years were timely filed because the Forms FS-43 extended the statutory deadlines for filing claims for tax refunds and waived any refund limitation periods. In this case, there is no dispute that both parties executed a number of Forms FS-43 periodically between the years 1988 and 2002. The parties also stipulated in their respective memoranda regarding the motions for summary judgment and in the hearing held before this Court on June 26, 2012 that the Form FS-43 executed on December 19, 1997 for the tax year ending 1994 effectively extended the period for filing a refund claim.⁶

Duke Energy argues that the execution of the Forms FS-43 covering the income tax years ending 1978-1993 extended the deadlines for filing claims for tax refunds and waived any refund limitation periods. Duke Energy also argues that because the Department could order a refund if

⁶ Pursuant to S.C. Code Ann. § 12-47-440 (****), which applied to the tax years ending 1990-1994, the period for filing a refund claim was three years. Moreover, S.C. Code Ann. § 12-6-4970(B), which was also applicable during these years, allowed a three-year time period for filing a refund claim for the tax year ending 1994 which would have begun on March 15, 1995. Therefore, because the filing of the Form FS-43 for the year 1994 was executed on December 19, 1997- after the enactment of the RPA and, and thus before March 15, 1998 - the period for filing a refund claim was still open. Consequently, the extension of the deadline was effective.

it discovered that a taxpayer had overpaid a tax, a penalty, or interest, even after a refund limitation period, this allows Duke Energy to file a claim for a refund after the limitation period. The analysis of Duke Energy's arguments is addressed in three parts: A) Did S.C. Code Ann. § 12-54-80 grant authority to the Department to extend the time to file an amended tax return; B) did S.C. Code Ann. § 12-54-30 authorize Duke Energy to file an amended tax return requesting a refund beyond the statutorily-prescribed timeframe; and C) did the language in the Form FS-43 executed by the Department extend the time for Duke Energy to file an amended tax return?

A. Statutory Authority to Extend the Time to File an Amended Tax Return

Duke Energy contends that Section 12-54-80 authorizes a taxpayer to request a refund once an extension is granted pursuant to that provision. Section 12-54-80, which applied to the tax periods prior to August 1, 1995 (the enactment date of the Revenue Procedures Act (RPA)), provided:

If, before the expiration of the time prescribed in this section for the mailing of a notice of assessment, the taxpayer has consented in writing to the mailing of the notice after the time, **notice of assessment may be mailed** at any time prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

S.C. Code Ann. § 12-54-80 (1978) (repealed in 1995) (emphasis added).

In general, when interpreting a statute, the sole function of the Court is to determine and give effect to the intent of the legislature. Hodges v. Rainey, 341 S.C. 79, 85, 533 S.E.2d 578, 581 (2000). The starting point in doing so should always be the text of the statute itself. Id. (holding that "[w]hat a legislature says in the text of a statute is considered the best evidence of the legislative intent or will"); Wigfall v. Tideland Utils., Inc., 354 S.C. 100, 110, 580 S.E.2d 100, 105 (2003). In interpreting the text, the plain meaning rule requires that "words must be given their plain and ordinary meaning without resort to subtle or forced construction to limit or expand that statute's operation." State v. Leopard, 349 S.C. 467, 471, 563 S.E.2d 342, 344 (Ct. App. 2002). Finally, "[w]here the statute's language is plain and unambiguous, and conveys a clear and definite meaning, the rules of statutory interpretation are not needed and the court has no right to impose another meaning." Hodges, 341 S.C. at 85, 533 S.E.2d at 581.

Moreover, in considering this issue, this Court is further bound by the rules of statutory construction relating to tax law. For instance "[a] refund of taxes is solely a matter of governmental grace, . . . and any person seeking such relief must bring himself clearly within the

terms of the statute authorizing the same. . . ,” Asmer v. Livingston, 225 S.C. 341, 344, 82 S.E.2d 465, 466 (1954) (internal citations omitted); Guar. Bank & Trust Co. v. S. Carolina Tax Comm’n, 254 S.C. 82, 173 S.E.2d 367 (1970) (“A refund of taxes is solely a matter of governmental or legislative grace and any person seeking such relief must bring himself clearly within the terms of the statute authorizing the same.”). The Court’s analysis in Guaranty Bank, also offers guidance in this case. In Guaranty Bank, the taxpayer claimed it was entitled to recover income tax paid on gain from an involuntary conversion of property. However, the law at the time prescribed a specific timeframe in which the proceeds from the converted property must be reinvested. In construing whether the taxpayer’s claim was timely the Court held that the “statutory language creating exemption from taxation will not be strained or liberally construed in favor of the taxpayer claiming an exemption, and he must, in order to be entitled to such exemption, clearly bring himself within the exemption on which he relies.” 254 S.C. at 89, 173 S.E.2d at 370.⁷ Furthermore, in making that determination, the Court recognized its previous holding that “a taxpayer who seeks to take advantage of a tax deduction must meet the conditions of the statute creating such.” Id.

Here, the plain language of Section 12-54-80 does not establish any authority to extend a taxpayer’s right to seek a refund but rather allowed the Department, with the taxpayer’s consent, to extend the time for it to mail its assessment of the tax owed by the taxpayer. Clearly, when speaking of mailing an assessment, the statute is speaking to an action by the Department. Thus, the plain language of the form extends the timeframe for the Department to mail an assessment to the taxpayer.

Moreover, Section 12-54-80 does not use the word “refund” anywhere within that provision. As explained below, the legislature set forth specific provisions expressing the timeframe to seek a refund for tax years ending 1978-1993. In Spectre, LLC v. S.C. Dep’t of Health & Envtl. Control, 386 S.C. 357, 372, 688 S.E.2d 844, 852 (2010), the South Carolina Supreme Court held that: “Where there is one statute addressing an issue in general terms and another statute dealing with the identical issue in a more specific and definite manner, the more specific statute will be considered an exception to, or a qualifier of, the general statute and given

⁷ The court in Guaranty Bank, likewise held that “in order for a taxpayer to avail himself of a deduction in the calculation of a tax, he must bring himself squarely within the terms of the statute expressly authorizing it.” 254 S.C. at 89-90, 173 S.E.2d at 370.

such effect.” Here, it is incredulous that the legislature intended to grant an exception to the timeframe to seek a refund without even mentioning the term.

The Court nevertheless recognizes that the **application** of Section 12-54-80 could result in a refund of taxes paid by the taxpayer, but clearly such a refund would occur within the context of fulfilling the purpose of the statute. The purpose of Section 12-54-80 is to provide an option for the Department to extend the time during which the “notice of assessment may be mailed.” If, after the extension of time to make its determination, the Department decided that a taxpayer owed additional taxes, it would notify the taxpayer of that assessment and seek payment based upon that assessment. Conversely, if the Department’s assessment of the taxes owed was less than the taxes proffered by the taxpayer, the taxpayer would be refunded the difference.⁸ However, there is simply no language in Section 12-54-80 that provides that if the Department requests to extend its time to mail a notice of assessment—or determination of the taxes owed—this request, in turn, creates a right for a taxpayer to amend its previous filing and seek a refund upon its revised request.

This Court cannot simply by implication extend the time to file a refund request. Duke Energy must establish a statutory right to make that claim. To the contrary, Duke Energy failed to meet the required timeframes to request a refund for tax years 1978 to 1993. The timeframes for making those refund requests fell into two distinct regulatory periods: 1) 1978 to 1989; and 2) 1990 to 1993.

1. Income Tax Years Ending 1978-1989

The South Carolina Supreme Court set forth in Bass v. State that Section 12-47-440 only applied to property taxes and that “the exclusive remedy for contesting an alleged erroneous assessment of *income taxes* [is] by payment under protest of the tax claimed as illegal and a suit at law for recovery of the sum so paid, in accordance with Sections 65-2661 and 65-2662 of the Code. [predecessors of §§ 12-47-210 and 12-47-220].” 307 S.C. 113, 117, 414 S.E.2d 110, 112 (1992), (internal quotation marks omitted) (emphasis in the original), cert. granted, judgment vacated on other grounds by Bass v. South Carolina, 509 U.S. 916 and abrogated by Harper v. Virginia Dep’t of Taxation, 509 U.S. 86 (1993); see also Perpetual Bldg. & Loan Ass’n of Columbia v. S.C. Tax Comm’n, 255 S.C. 523, 527, 180 S.E.2d 195, 197 (1971). Thus, the

⁸ As addressed more fully below, S.C. Code Ann. § 12-54-30 (****) granted the Department the authority to issue a refund under those circumstances.

timeliness of Duke Energy's refund claims for the years 1978-1989 is governed by S.C. Code Ann. §§ 12-47-210 and 12-47-220 (****).⁹

Sections 12-47-210 and 12-47-220 required a taxpayer who sought to receive a refund of amounts paid to the state to expressly pay the taxes under protest and then institute an action in circuit court within 30 days after payment of the taxes. See S.C. Nat. Bank v. S.C. Tax Comm'n, 297 S.C. 279, 282, 376 S.E.2d 512, 514 (1989). Failure to pay the taxes under protest was fatal to a refund claim. See, e.g., City of Columbia v. Glens Falls Ins. Co., 245 S.C. 119, 139 S.E.2d 529 (1964). Here, there is no evidence that any of the payments for these years were made under protest. And even if the payments were made under protest, no action was filed in circuit court within 30 days after the payment was made. Rather, the refund claims were filed in the ALC well after the 30-day period expired.¹⁰ Therefore, none of the refund claims filed for Duke Energy's 1978-1989 tax years were timely. I thus conclude that the refund claims for the tax years 1978-1989 also are barred from consideration by this Court.

2. Income Tax Years Ending 1990-1994

As explained above, in 1992 the South Carolina Supreme Court in Bass held that Section 12-47-440 only applied to property taxes and that the exclusive remedy for obtaining a refund of income taxes was Sections 12-47-210 and 12-47-220 (****). Id. However, the General Assembly thereafter amended Section 12-47-440 to expressly apply to income tax refund claims, but only for tax years beginning in 1990 and later. See Act No. 464, 1994 S.C. Acts, Section 3(B).

⁹ (****) is used in this order in lieu of statutory years because this case involves numerous tax years, and therefore the years of the applicable statutes are equally numerous and varying, and the law applicable during many years was unchanged. The statutory law can be divided into two yearly ranges: 1978-1995 and 1996-2001, as the law regarding this issue did not change during the first range, and then did not change during the second range after the RPA changes in 1995.

¹⁰ There is also an additional reason for concluding the purported extensions of the corporate income tax years 1978-1982 are untimely. These years appeared for the first time on the face of the executed Form FS-43 effective May 30, 1996. Obviously, under either the modern era provisions or the pre-1995 provisions, these extensions were executed well after the refund periods had closed. See S.C. Code Ann. § 12-54-85 (three years from date return filed or two years after date of payment); S.C. Code Ann. §§ 12-47-210, -220 (pay under protest and file claim for refund within 30 days). The only available avenue for reviewing the taxable income of the years 1978-1982 therefore would have been the statutory provisions regarding an assessment based on a determination issued by the IRS. See S.C. Code Ann. §12-54-85(D)(1); cf. S.C. Code Ann. § 12-54-80 (prior law). However, Duke Energy did not establish that the IRS issued a final determination within 180 days of May 30, 1996. Moreover, any extension attributable to an IRS determination in that circumstance would have been limited to the tax issues raised by the IRS. Because the allocation and apportionment issues raised by the taxpayers could not have been at issue in an IRS determination, the purported extensions of the 1978-1982 tax years are untimely for purposes of the issues before this Court.

Section 12-47-440 provides for a three-year period of limitation in which to file a refund claim. Therefore, for the 1990-1994 tax years, Duke Energy was required to file its claims for refund within three years after its corporate income tax return was originally due. It is undisputed that Duke Energy filed its corporate income tax returns based on a calendar year. Thus, the returns and payment originally were due without regard to any extension on March 15th of the following year. S.C. Code Ann. §§ 12-6-4970(B) (effective for tax years beginning after 1995); 12-7-1640 (effective for tax years prior to 1996). The refund periods applicable to Duke Energy under Section 12-47-440 for the income tax years 1990-1994 were therefore as follows:

Income Tax Years	Return Originally Due	Close of Refund Period
1990	March 15, 1991	March 15, 1994
1991	March 15, 1992	March 15, 1995
1992	March 15, 1993	March 15, 1996
1993	March 15, 1994	March 15, 1997
1994	March 15, 1995	March 15, 1998

B Section 12-54-30

In its Post-Trial Brief, Duke Energy nevertheless argues that during the tax years at issue S.C. Code Ann. § 12-54-30 (****) provided a different “mechanism” by which it could file an amended tax return requesting a refund. Section 12-54-30 provided in relevant part that: “If the commission discovers on examination of a return or otherwise that the tax, penalty, or interest paid by any person is in excess of the amount legally due, the commission may order a refund or give credit for the overpayment.” The plain language of Section 12-54-30 permitted the Department to refund amounts discovered on examination of a return. See Anders v. S.C. Parole & Cmty. Corr. Bd., 279 S.C. 206, 305 S.E.2d 229 (1983) (“[T]he Court’s primary function in interpreting a statute is to ascertain the intention of the legislature, and when the terms of the statute are clear and unambiguous, the Court must apply them according to the literal meaning.”). Section 12-54-30 does not reference whatsoever the timeframe for a taxpayer to file a request for a refund. To the contrary, as set forth above, there were specific statutes that articulated the timeframe in which a taxpayer could file for a refund for tax years 1978 to 1993. As aforementioned, the statute which deals with an issue in a more specific and definite manner prevails over a statute which addresses the issue in general terms, Spectre, 688 S.E.2d 844. Furthermore, “[w]hen construing statutory language, the statute must be read as a whole, and sections which are part of the same general statutory law must be construed together and each

one given effect.” Duvall v. S.C. Budget and Control Bd., 377 S.C. 36, 42, 659 S.E.2d 125, 127 (2008).

Thus, Section 12-54-30 allowed the Department to grant relief to a taxpayer if it discovered an overpayment on examination of a return or otherwise, even if a claim for refund would be untimely. It did not, however, change the fact that the taxpayer had to strictly comply with the provisions of the refund statutes if it wanted to file a claim for refund that would be subject to judicial review. See Hodges v. Rainey, 341 S.C. 79, 533 S.E.2d 578 (2000) (“The canon of construction ‘*expressio unius est exclusio alterius*’ or ‘*inclusio unius est exclusio alterius*’ holds that ‘to express or include one thing implies the exclusion of another, or of the alternative.’”). The logic of this interpretation of Section 12-54-30 was reflected in Argent Lumber Co. v. Query, 178 S.C. 1, 182 S.E. 93 (1935), overruled on other grounds by McCall by Andrews v. Batson, 285 S.C. 243, 329 S.E.2d 741 (1985). The Court in Argent Lumber held that under a statute similar to the one in the present case, the taxpayer had no right to judicial review of the Tax Commission’s refusal to grant the taxpayer a refund notwithstanding the Commission’s discovery of overpaid taxes and the Commission’s authority to grant refunds at the time of the tax periods at issue. The reason for this, aside from a lack of statutory authority at the time to compel the Commission to issue a refund of overpaid taxes, was that the taxpayer had failed to comply with the refund statute but instead waited more than ten years after the overpayment and almost four years after the amount of the claim was ascertained to bring suit. Id. at 94-95.

C. Form FS-43

In light of the statutory timeframes for filing an amended return requesting a refund, Duke Energy’s case centers upon the implications of the Department’s Form FS-43. Duke Energy contends that the Forms FS-43 executed in this case allowed it additional time to file a claim for a refund, an extension that would run for more than twenty years in some cases. At the outset, I do not find that the Forms FS-43 authorized a party to seek a refund after the statutory time for filing such a request.

The language contained in the Form FS-43 prior to August 1, 1995 was as follows:

This agreement extends the time for mailing the notice of assessment or refund of the above tax pursuant to the provisions of Section 12-54-80 of the 1976 South Carolina Code of Laws, as amended.

(Emphasis added).

Clearly, when referencing the mailing of the notice of an assessment or refund, Form FS-43 is speaking to an action by the Department. Thus, the plain language of the form extends the timeframe for the Department to mail the notice of a refund or assessment to the taxpayer in keeping with Section 12-54-80. That purpose is reflected by the title of the Form FS-43: "Consent to Extend the Time to Assess Tax." The purpose also logically flows from the operation of the tax laws. Because a notice of assessment is issued and mailed by the Department, it necessarily follows that Form FS-43 applies only to extend the time in which the Department may issue and mail a notice of assessment or refund that it determines is due. Thus, the refund language in Form FS 43 refers **not** to allowing a taxpayer additional time in which to file a claim for a refund—which, as explained above, the statutory provisions did not permit—but to affording the Department additional time to review the taxpayer's records and issue a notice of assessment or refund, as it determines appropriate based on a review of the taxpayer's records.

Furthermore, Form FS-43 does not **infer** that a taxpayer has a right to amend its previous tax filing and seek a refund upon alternative grounds. Duke Energy's proposition is not supported by a specific statutory grant of the authority to extend the timeframe to file an amended request for a refund. Rather, Duke Energy reasons that the use of the term "refund" in the Form FS-43 language infers the grant of an extension to file its request for a refund. However, Form FS-43 reflects its limited purpose by referencing the time an assessment or refund is allowed "pursuant to the provisions of Section 12-54-80." As explained above, Section 12-54-80 does not authorize a taxpayer to file a request for a refund outside of the statutes that specifically set forth that timeframe.

Duke Energy nonetheless contends that since the Department agrees that Form FS-43 had that effect for 1995 and later, it must have had that effect before 1995. Duke Energy avers that since the "refund" language is absent in S.C. Code Ann. § 12-54-85(C)(5) (****)—the section with which the RPA supplanted Section 12-54-80 as of August 1, 1995 — that indeed Section 12-54-80 must have also have granted it the right to file an amended tax return seeking a refund.¹¹

¹¹ Duke Energy also pointed out that the Forms FS-43 executed by the Department and Duke Energy from 1996 to 1999, well after the redesignation of Section 12-54-80 as Section 12-54-85, continued to make reference to Section 12-54-80, a statute that no longer existed. And the Forms FS-43 executed by the Department and Duke Energy from 2000 through 2002 incorrectly cited to subsection (C)(5) of S.C. Code Ann. § 12-54-85 instead of subsection (C)(4). Those arguments carry no legal value, but are probative as to the apparent shoddy fashion in which the Forms FS-43 were executed.

Indeed, Form FS-43 now operates to extend the time for both assessment and refunds for 1995 and later. The language contained in the Form FS-43 following August 1, 1995 is the same except that instead of reference to "Section 12-54-80," it makes reference to "Section 12-54-85(C)(5)." The language contained in Section 12-54-85(C)(5) provides the following:

the application of Section 12-54-30 in this case, the fallacy of Duke Energy's assertion is referred to as "the fallacy of denying the antecedent" and is illustrated in a hypothetical syllogism as:

If A, then B.

Not A.

Therefore, not B.

Ruggero J. Aldisert, Logic for Lawyers: A Guide to Clear Legal Thinking 160 (National Institute for Trial Advocacy 3d ed. 1997); see also Irving M. Copi, Introduction to Logic 295 (5th ed. 1978).

Stated in terms of syllogism, Duke Energy's arguments proceed as follows:

If Form FS-43 had referenced Section 12-54-30, then that section would be applicable to determining the timeframe for a refund pursuant to Form FS-43.

Form FS-43 did not reference Section 12-54-30.

Therefore, Section 12-54-30 is not applicable to determining the timeframe for a refund pursuant to Form FS-43.

Other courts have also found this reasoning to be faulty. For instance, in Crouse-Hinds Co. v. InterNorth, Inc., 634 F.2d 690, 703 (2d Cir. 1980), the court held that:

The proposition that "A implies B" is not the equivalent of "non-A implies non-B," and neither proposition follows logically from the other. The process of inferring one from the other is known as "the fallacy of denying the antecedent."

634 F.2d at 703 (cited in Logic for Lawyers).

Moreover, logic dictates a conclusion contrary to Duke Energy's assertion. The failure to reference a provision that governs when the Department may issue a refund upon its own initiative does not suggest it is inapplicable. Nevertheless, the failure to reference any statute (including Section 12-54-30) that addresses the authority of the Department to issue refunds profoundly suggests that Form FS-43 was not addressing a taxpayer's authority to amend its tax returns and seek a refund, or the Department's authority to extend the timeframe within which a refund claim could be filed. If Form FS-43 was granting the authority to extend the time to make refund claims, it would not only reference the statute upon which that authority was granted, but would presumably do so with clarity rather than making the reference: "mailing of notice of assessment or refund." To the contrary, Form FS-43 was based upon Section 12-54-80, which governs the time period in which the Department could assess taxes – a provision that says nothing about refunds or extensions of time to file refund claims.

Waiver of a Statute of Limitations

Duke Energy also contends that the Department “waived” the “statute of limitations” for filing a refund. Duke Energy bases its contention upon the language of Form FS-43; upon the alleged grant by Department employees of an extension of the time during which to file a request for a refund; and upon Duke Energy’s belief that the Department’s Revenue Procedures reflected that right. Duke Energy contends that “[f]or years, the Department advised taxpayers that it had in place a policy to execute waiver agreements extending the statute of limitations for both assessments and refunds.”¹²

However, the phrase “statute of limitations” invokes specific case law that is not applicable to this matter. Obviously, this case does not involve a “cause of action” in which the Court must first determine when the statute of limitations begins to run. In other words, it does not involve parties who possess the discretion to control when a cause of action may properly accrue. Rather, this case involves a determination of when the State of South Carolina grants a right to seek a refund pursuant to the existing tax laws. In Dep’t of Conservation v. Co-De Coal Co., 388 S.W.2d 614 (Ky. 1965), the court aptly explained the distinction between a statute of limitations and a statutory timeframe for filing a request for refund from a state. The court noted: “whereas a statute of limitations neither creates nor extinguishes any rights, but merely places a limitation upon the remedy (which can be waived or tolled), a limitation such as the one in question is a condition essential to the existence of the right.” Co-De Coal, 388 S.W.2d at 617 (internal citations omitted). The court added: “The bringing of the action within the limited time is a condition to the exercise of the right, and, if the condition is not complied with, there is neither right nor remedy.” Id. (internal citation and quotation marks omitted).

Indeed, this concept is supported by South Carolina case law. In Labruce v. City of N. Charleston, 268 S.C. 465, 234 S.E.2d 866 (1977), the appellants instituted an action to recover business license taxes paid under protest. The Court recognized that at that time, Section 65-2661 et seq., Code of Laws, 1962, provided the exclusive remedy for the recovery of contested taxes and held that “[s]trict compliance with the conditions precedent is prescribed when one

¹² In its post-hearing brief, Duke Energy alleges that the Department had respected the “waiver” agreements it had with Duke Energy for tax years 1978-1994 by agreeing, in 2002, to offset refunds of its South Carolina corporate income tax for tax years 1978-1994 against the corporate income, license, and sales taxes for those same years, resulting in a net refund owed to Duke Energy. However, this allegation was based on an affidavit referred to as the “Monroe Affidavit,” designated as “Exhibit A,” that was not submitted prior to, or during, the hearing. Therefore, this Court will not consider this information in rendering its decision.

invokes the statutory remedy.” 234 S.E.2d at 867. See also 4 S.C. Jur. Action § 13 (“One who invokes a statutory remedy must bring himself within the statute and comply with the conditions prescribed therein. Moreover, the Court of Appeals recently reiterated this principle, noting that a nonclaim statute (the sort at issue in the present case)¹³ differs from a statute of limitations in that a nonclaim statute creates no enforceable right of action “[u]nless the claim is filed within the prescribed time set out in the statute,” whereas a statute of limitations “creates a defense to an action brought after the expiration of the time allowed by law for the bringing of such an action.” Phillips ex rel. Barnett v. Quick, Op. No. 5003, 2012 WL 2913296 (S.C. Ct. App. filed July 18, 2012) (citing Estate of Decker v. Farm Credit Servs. Of Mid-Am, ACA, 684 N.E.2d 1137, 1138-39 (Ind. 1997)).

As a general rule, when a statute creates a new right and at the same time prescribes a remedy for enforcing the right, the prescribed statutory course must be followed by anyone claiming the right.”); 72 Am. Jur. 2d State and Local Taxation § 996 (“Strict compliance with conditions precedent is required to invoke the statutory remedy for recovery of contested taxes.”). When a statute both creates a cause of action and includes a time limit for its commencement, compliance with the time limit is a condition precedent to the maintenance of the action. 54 C.J.S. Limitations of Actions § 31 (updated October 2010). “Such a statutory time limit conditions the existence of the right of action, thereby creating a substantive, rather than procedural, limitation on the right. Bringing suit within the prescribed time is a condition of liability itself, not of the remedy alone.” Id.

Thus, the statutes that grant a South Carolina taxpayer a right to seek a refund are not statutes of limitations but rather conditions precedent to obtain a right to a refund. Accordingly, the courts have not adopted the doctrine of waiver involving tax claims. To the contrary, a refund of taxes is considered “solely a matter of governmental grace, . . . and any person seeking such relief must bring himself clearly within the terms of the statute authorizing the same.” Asmer v. Livingston, 225 S.C. 341, 344, 82 S.E.2d 465, 466 (1954) (internal citations omitted); see also C.W. Matthews Contracting Co., Inc. v. S.C. Tax Comm’n, 267 S.C. 548, 554, 230 S.E.2d 223, 226 (1976); Guar. Bank & Trust Co. v. S.C. Tax Comm’n, 254 S.C. 82, 173 S.E.2d

¹³ A nonclaim statute is one that creates a right of action and provides a time limit on exercising that right. It imposes a condition precedent, as the time element is part of the right of action. 54 C.J.S. Limitation of Actions §33 (updated May 2012).

367 (1970) (holding that the circuit court erred in extending the time periods under the statute because that is a legislative and not a judicial function). Therefore, the South Carolina Supreme Court held in TNS Mills, Inc. v. S.C. Dep't of Revenue, 331 S.C. 611, 623, 503 S.E.2d 471, 478 (1998) that the Department employee's erroneous interpretation of a statute was not binding on the courts, and that Department employees cannot make changes in the refund procedure established by the General Assembly or exceed the authorization granted by a statute. See also Argent Lumber Co., 182 S.E. at 95 ("[T]he agent of the tax commission could not alter, amend, or change the statute law of this state, either orally or by written agreement . . ."). The United States Supreme Court further explained that an employee of the government has no authority to waive or extend a refund period except to the extent authorized by the governing statute. U.S. v. Garbutt Oil Co., 302 U.S. 528 (1938) (Officers of the government have no power to waive statutes of limitations; and Commissioner cannot consider untimely filed returns); see also Dickow v. United States, 740 F. Supp. 2d 231, 237 (D. Mass. 2010) aff'd, 654 F.3d 144 (1st Cir. 2011) cert. denied, 132 S. Ct. 1046 (2012) ("The Executor cannot rely upon the IRS' failure to advise him of the denial to justify his purported conclusion that his second request had been granted where, as here, the IRS clearly did *not* have the authority to issue such extension.").

The only case cited by Duke Energy that involved a refund claim was Anonymous Taxpayer v. S.C. Dep't of Revenue, 377 S.C. 425, 661 S.E.2d 73 (2008). However, the relief sought by the taxpayer in that case was based on the contention that the taxpayer's right to retirement benefits was in the nature of a contract. The Supreme Court's discussion of the statute of limitations in Anonymous Taxpayer was predicated upon the taxpayer's argument that there "was a contract providing for continuing performance, thus the limitations period began anew each year." The Court noted long ago that statutes of limitations could be waived with respect to actions based on contract. See Heyward v. S.C. Tax Comm'n, 240 S.C. 347, 351, 126 S.E.2d 15, 17 (1962) ("We have held that the State may be subject to the doctrine of estoppel in its contractual relations."). Nevertheless, the Court did not hold that refund claims are in the nature of a contract and, in fact, has held the opposite. See id.; see also C. W. Matthews Contracting Co., 267 S.C. at 554, 230 S.E.2d at 226 (a tax refund claim is created by statute and is not in the nature of a debt collection claim).

In sum, since no employee or agent of the Department has any authority to waive the authorization granted by Section 12-54-80, Form FS-43 could grant no more rights than those

permitted by this statute. Thus, any statement made by a Department employee, either verbally or in writing, agreeing to waive the time to request a refund, which was inconsistent with Section 12-54-80, was outside of that employee's authority. Consequently, I conclude that the Forms FS-43 executed before August 1, 1995, and any other statements, written or oral, given by DOR's employees, were ineffective in extending the statutory filing period for Duke Energy's refund claims or in waiving that period.

Moreover, even under section 12-54-85(F)(1), with the exception of situations where there are changes made to taxable income reported to the IRS, or when the IRS changes a corporation's taxable income, "claims for . . . refund must be filed within three years of the time the return was filed, or two years from the date of payment, whichever is later. If no return was filed, a claim for refund must be filed within two years from the date of payment." S.C. Code Ann. § 12-54-85(F)(1) (1995). Also, "[a] claim for refund can be amended prior to, but not after, the expiration of the time for filing the claim for refund under Section 12-54-85(F)." *Id.* § 12-60-470(H). Read together, these sections lead to the conclusion that once a refund period expires under the terms set forth by the legislature, that period of time cannot be revived by the consent of the Department or otherwise; rather, any amendments must be made prior to the expiration of the statutory period for filing refund claims. See *Am. Legion Post 15 v. Horry County*, 381 S.C. 576, 582, 674 S.E.2d 181, 183-84 (Ct. App. 2009) (holding in part that the three-year limitations period under section 12-54-85(F)(1) barred a taxpayer's action seeking a refund). Thus, even after the RPA took effect on August 1, 1995, and the Department received its new power to extend the period for filing refund claims, the Department was unable to use this power to revive refund claims periods that had expired due to the close of the three-year limitations period applicable to the income tax years ending 1990 through 1994 or due to failure to pay under protest and file a claim for a refund within thirty (30) days for the tax years ending prior to 1990.

Equitable Estoppel

Duke Energy similarly asserts that the Department should be estopped from asserting its "statute of limitations." The basis for this contention is that the Department employees purportedly viewed Form FS-43 as waiving the statutory refund limitations period, and that Duke Energy "agreed to the waivers because the Department represented verbally and in writing that the statute of limitations was extended for both tax assessments and tax refund claims."

As with waiver of a statute of limitations, the courts have recognized that the estoppel doctrine is limited in reviewing tax claims. As a general rule, “the doctrine of estoppel will not be applied to deprive the government of the due exercise of its police power, or to effect public revenues or property rights, or to frustrate the purpose of its laws or thwart its public policy.” Heyward v. S.C. Tax Comm’n, 240 S.C. 347, 351, 126 S.E.2d 15, 17 (1962) (emphasis added). In the only South Carolina appellate decision touching upon taxation issues and equitable estoppel, the Court of Appeals held that equitable estoppel did not apply to bar a county from asserting the statute of limitations as a defense to refunding admissions fees paid in connection with bingo games. Am. Legion Post 15, 381 S.C. at 583, 674 S.E.2d at 184.

Also, to invoke estoppel in this case, the Department employees must be authorized to change the procedure for obtaining a refund. However, in Texaco, Inc. v. Wasson, the South Carolina Supreme Court explained that the Department was not estopped from assessing additional taxes based on the use of an improper accounting method even though Department employees had expressly and in writing authorized the taxpayer to use that method “until such time as the South Carolina Tax Commission grants permission to change such method.” 269 S.C. 255, 264-65, 237 S.E.2d 75, 79 (1977). Similarly, in TNS Mills, Inc., the taxpayer contended that the Department had the authority to grant a property tax exemption retroactively. Its contention was based in part on a memorandum prepared and issued by a Department employee opining that a recently-enacted statute gave the Department authority to accept exemption applications at any time. The South Carolina Supreme Court rejected that contention, holding instead that “[a]lthough [the employee] believed the Department had the authority to grant retroactive exemptions, and exemptions may have been granted under this erroneous view, neither the Commission nor the courts are bound by his erroneous interpretation.” 331 S.C. at 621-22, 503 S.E.2d at 477; see also S.C. Coastal Council v. Vogel, 292 S.C. 449, 357 S.E.2d 187 (Ct. App. 1987) (“The public cannot be estopped ... by the unauthorized or erroneous conduct or statements of its officers or agents which have been relied on by a third party to his detriment.”).

In addition, the authority that Duke Energy itself cited supports a conclusion that the Department is not estopped from rejecting actions taken by its employees that are not authorized by statute. Duke Energy cited Quail Hill, LLC v. County of Richland and quoted the following language from that case: “A governmental body is not immune from the application of the doctrine of estoppel where its officers or agents act within the proper scope of their authority.”

387 S.C. 223, 236, 692 S.E.2d 499, 506 (2010) (italics omitted). However, Duke Energy only quoted the first part of the pertinent language. The entire relevant passage was quoted by the Court as follows:

A governmental body is not immune from the application of the doctrine of estoppel *where its officers or agents act within the proper scope of their authority ... The public cannot be estopped, however, by the unauthorized or erroneous conduct or statements of its officers or agents which have been relied on by a third party to his detriment.*

Quail Hill, 387 S.C. at 236, 692 S.E.2d at 506 (italics in original) (quoting DeStefano v. City of Charleston, 304 S.C. 250, 257-58, 403 S.E.2d 648, 653 (1991)). That passage followed the Court's recognition at the beginning of the paragraph: "As a general rule, estoppel does not lie against the government to prevent the due exercise of its police power or to thwart the application of public policy." Id. (quotation marks omitted).

Following the above precedents, the Court ultimately held that: "For reasons ... discussed [in the opinion], we believe the Court of Appeals erred in reversing the circuit court's grant of summary judgment to County as to Quail Hill's claim of equitable estoppel." Id., 387 S.C. at 237, 692 S.E.2d at 506. In other words, the Supreme Court in Quail Hill affirmed that the government was not estopped from contesting erroneous statements made by its staff. See id., 387 S.C. at 238, 692 S.E.2d at 507 ("[W]e agree with County's argument that the RU zoning classification was a mistaken statement of law and, thus, could not be used to estop County from enforcing it."). That holding is entirely consistent with the holdings of Texaco, Heyward, and TNS Mills and, in fact, relies on the same rationale stated by the Court in Heyward – that the government cannot be estopped from exercising its police power. Compare id., 387 S.C. at 236, 692 S.E.2d at 506 (discussing police power rationale for not applying estoppel to governmental entities) with Heyward, 240 S.C. at 351, 126 S.E.2d at 17 (holding that "estoppel will not be applied to deprive the government of the due exercise of its police power, or to effect public revenues or property rights").

Thus, I conclude that the Department is not estopped from invoking the correct refund limitations period, even if Department employees believed they had the authority to allow the taxpayer to extend the time in which a claim for refund could be filed. This court clearly does not wish to shield a governmental agency from the doctrine of equitable estoppel where its agents **act within the scope of their authority**. Rather, this Court recognizes that however

Duke Energy seeks to characterize the evidence presented in response to the Department's summary judgment motion, the Department's employees did not have the authority to create an unauthorized refund procedure. Moreover, execution of Forms FS-43 by Department employees can provide the taxpayer with no greater remedies than those provided by the governing statutes for refund claims and the like. It is upon these principles that the court in Phillips held that "[w]hile equitable principles may extend the time for commencing an action under statutes of limitation, **nonclaim statutes impose a condition precedent to the enforcement of a right of action and are not subject to equitable exceptions.**" Supra. (citing Estate of Decker, 684 N.E.2d at 1139) (emphasis added).

In fact, even if estoppel was applicable here, Duke Energy failed to set forth a genuine issue of material fact as to its meeting those requirements. "To prove estoppel against the government, the relying party must prove: (1) the lack of knowledge and of the means of knowledge of the truth of the facts in question; (2) justifiable reliance upon the government's conduct; and (3) a prejudicial change in position." S.C. Dep't of Transp. v. Horry County, 391 S.C. 76, 83, 705 S.E.2d 21, 25 (2011). Furthermore, "[o]nce the party moving for summary judgment meets the initial burden of showing the absence of a genuine issue as to any material fact, the nonmoving party may not simply rest on the mere allegations contained in the pleadings." Grant v. Mount Vernon Mills, Inc., 370 S.C. 138, 142, 634 S.E.2d 15, 17 (Ct. App. 2006). "Rather, the nonmoving party must come forward with specific facts showing there is a genuine issue for trial." Id. (quoting Peterson v. W. Am. Ins. Co., 336 S.C. 89, 94, 518 S.E.2d 608, 610 (Ct.App.1999)). Here, there is no dispute that Duke Energy could have referenced the governing refund statutes and learned that Department employees cannot extend the time periods set forth in the applicable refund statutes. See Am. Legion Post 15, 381 S.C. at 583, 674 S.E.2d at 184. Moreover, I do not find that the Form FS-43 misinformed Duke Energy that it could file an amended tax return requesting a refund after the statutory timeframe.

Equitable Tolling

Duke Energy contends that the Department should be equitably tolled from requiring Duke Energy to comply with the statutory time frame within which to file a refund because the Department's employees induced Duke Energy to file belatedly. In support of this remedy, Duke Energy contends that it agreed to the waivers because the Department represented that the statute of limitations was extended for both tax assessments and tax refund claims.

“[T]he doctrine of equitable tolling may be applied to toll the running of the statute of limitations.” Hooper v. Ebenezer Sr. Servs. & Rehab. Ctr., 386 S.C. 108, 115, 687 S.E.2d 29, 32 (2009) (quoting 54 C.J.S. Limitations of Actions § 115 (2005)). As explained above, however, the statute requiring that refunds be filed within specific timeframes creates a condition precedent to seeking that remedy and thus is not subject to the equitable remedies for statutes of limitations. See Phillips, supra. Thus, equitable tolling is not a proper remedy in this case. Cf. United States v. Brockamp, 519 U.S. 347 (1997) (holding that the statutory limitations period on tax refund claims under the applicable provision of the Internal Revenue Code does not authorize equitable tolling).

Even if, *arguendo*, equitable tolling could apply here, in Hooper, the South Carolina Supreme Court explained that “equitable tolling is a doctrine that should be used sparingly and only when the interests of justice compel its use.” 386 S.C. at 117, 687 S.E.2d at 33. Here, however, in an attempt to invoke this extraordinary remedy, Duke Energy submitted affidavits and deposition testimony that reference the belief by Department employees that Duke Energy could seek a “refund” based upon extensions granted by the executed Forms FS-43. However, those affidavits do not contain an averment by any Department employee that he or she specifically stated to a Duke Energy representative that Duke Energy’s time to seek a “refund” was extended by Form FS-43. More importantly, there is no reference that any Department employee stated that Duke Energy could file an amended tax return seeking a refund based upon a new basis. Nor is there any sworn testimony by a Duke Energy representative that he or she was misdirected by a Department employee.

Therefore, I conclude that equitable tolling does not lie in this case.

Conclusion

Finally, the context of Duke Energy’s request is important in recognizing the proper resolution of this issue. Duke Energy asserts that there are disputed facts regarding this issue because some of the Department’s employees viewed Form FS-43 as extending the period during which a taxpayer could seek a refund. However, statements to that effect do not answer the issue in this case. This case is **not** simply about whether Duke Energy can seek a refund based upon a tax review that had been held open pending the Department’s determination of the proper tax to assess. Rather, Duke Energy originally filed as a manufacturer using the three-factor formula. Now, it seeks a refund, not based upon the initial filing, but based upon an amended tax return

using the single-factor gross-receipts apportionment formula – an entirely different basis. Duke Energy’s amended return also now includes the gross receipts from the sale of its securities and other capital investments, which further includes the principal.

Duke Energy interprets Form FS-43 as not only allowing it to question its initial filing but as allowing it to file a new (amended) tax return and claim an entirely new basis for a refund. The plain reading of the tax statutes and review of the affidavits and deposition testimony submitted by Duke Energy fail to establish a genuine issue of material fact regarding the request of Duke Energy. In other words, though there are statements regarding the right of Duke Energy to seek a refund, no evidence was presented that any Department employees interpreted Form FS-43 as allowing a taxpayer to file an amended return on an entirely different basis than the original return and then seek a refund based on that amended return.¹⁴ Therefore, the Department’s Motion for Summary Judgment as to the issue of the timeliness of Duke Energy’s amended income tax return filings is granted.

II. Apportionment Method

The next issue is whether Duke Energy is a “manufacturer” and therefore required to use the multi-factor apportionment formula pursuant to S.C. Code Ann. § 12-6-2250 (****) (applicable to tax years after 1995)/ Section 12-7-1140 (applicable to tax years prior to 1996); or whether Duke Energy was required to use the single-factor gross-receipts formula pursuant to Section 12-6-2290 (****) (applicable to tax years after 1995)/ Section 12-7-1190 (applicable to tax years prior to 1996). Duke Energy argues that it is not a manufacturer, even though it filed its original corporate income tax returns under this status. Duke Energy contends that it is actually a seller of services, and therefore amended its tax return filing using the single-factor gross receipts formula.

During the tax periods at issue, taxpayers whose principal business in South Carolina was “(a) manufacturing . . . goods and materials within this State . . .” had to apportion their income using a three-factor formula composed of property, payroll, and sales. S.C. Code Ann. § 12-6-2250 (applicable to tax years after 1995); S.C. Code Ann. § 12-7-1140 (applicable to tax years prior to 1996). All other taxpayers (except certain specific industries not relevant here) had to

¹⁴ Review of the record does not even establish the validity of the Form FS-43 agreements for tax years 1978 through 1983. In fact, Duke Energy has even conceded that it has not located the executed Form FS-43 agreements for tax years 1978 through 1983.

apportion their income using a single-factor gross-receipts apportionment formula. S.C. Code Ann. § 12-6-2290 (applicable to tax years after 1995); Id. § 12-7-1190 (applicable to tax years prior to 1996). “Manufacturing” is not, and was not during the tax periods at issue, statutorily defined for South Carolina apportionment law purposes.¹⁵

Based on the record, I find that genuine issues of material fact exist necessitating an evidentiary hearing as to whether Duke Energy, based on its activities within the State, falls under Section 12-6-2250 as a “manufactur[er],” or whether Duke Energy is a seller of services, or otherwise falls under none of the above-categories, and is therefore required to apportion its income to South Carolina based on the single-factor gross-receipts apportionment formula pursuant to Section 12-6-2290 (applicable to tax years after 1995)/ Section 12-7-1190 (applicable to tax years prior to 1996). Accordingly, the Court denies the Department’s Motion for Summary Judgment with respect to this issue.

III. Gross Receipts

The final issue is whether Duke Energy was allowed, in its calculation of corporate income tax owed to South Carolina, to include in the apportionment formula the return of principal from its sales of securities and other capital investments. Duke Energy argues that “gross receipts” in the gross receipts factor of the denominator of the single-factor gross-receipts apportionment formula and “sales” in the sales factor of the denominator of the three-factor apportionment formula include the entire amount of return capital from a sale of securities or other capital investments, **including the return of principal**. The Department, however, argues that gross receipts and sales include only the net proceeds from sales of securities or other capital investments.

South Carolina law provides that a taxpayer required to apply the single-factor gross-receipts apportionment formula must do so “using a fraction in which the numerator is gross receipts from within this State during the taxable year and the denominator is total gross receipts from everywhere during the taxable year.” See S.C. Code Ann. § 12-6-2290 (****) (applicable for tax years beginning after 1995); see also id. § 12-7-1190 (****) (applicable for tax years

¹⁵ “Manufacturing” is not statutorily defined, but it is discussed in Columbia Ry., Gas & Elec. Co. v. S.C. Tax Comm’n, 134 S. C. 319, 132 S.E. 611 (1926), a case in which the South Carolina Supreme Court held that a company engaged in the business of generating electricity was properly considered a “manufacturer” for purposes of a particular statute that imposed a corporate income tax on “a corporation engaged in the business of manufacturing.”

prior to 1996).¹⁶ “Gross receipts” was not defined for South Carolina apportionment law purposes during the tax periods at issue.

For purposes of the multi-factor apportionment formula¹⁷ the sales factor consists of “[t]he ratio of sales made by such taxpayer during the income year which are attributable to this State to the total sales made by such taxpayer everywhere during the income year” S.C. Code Ann. § 12-7-1170 (****) (for tax years prior to 1996).¹⁸ The term “sales” includes: “(1) rentals from tangible personal property located in this State which are not separately allocated; and (2) sales of intangible personal property and receipts from services if the entire income-producing activity is within this State. If the income-producing activity is performed partly within and partly without this State, sales are attributable to this State to the extent the income-producing activity is performed within this State.” *Id.*¹⁹

“The language of a tax statute must be given its plain ordinary meaning in the absence of an ambiguity therein. . . . [I]f a legislative intent is clearly apparent from the language of the statute there is no occasion for resort to the rule of statutory construction.” Beach v. Livingston, 248 S.C. 135, 139, 149 S.E.2d 328, 330 (1996) (internal citation omitted). “If the statute is ambiguous, however, courts must construe the terms of the statute.” S.C. Energy Users Comm. v. S.C. Pub. Serv. Comm’n, 388 S.C. 486, 491, 697 S.E.2d 587, 590 (2010) (internal citation omitted). “A statutory provision should be given a reasonable and practical construction consistent with the purpose and policy expressed in the statute.” Lockwood Greene Eng’rs, Inc. v. S.C. Tax Comm’n, 293 S.C. 447, 449, 361 S.E.2d 346, 347 (Ct. App. 1987). “When faced with an undefined statutory term, the term must be interpreted in accordance with its usual and customary meaning.” *Id.* at 492, 697 S.E.2d at 590 (internal citation omitted). “Courts should

¹⁶ Even though the Court finds as a matter of law that Duke Energy’s filings of tax refund claims for tax years ending 1978-1993 were untimely, and thus will not be considered here, the filing for tax year 1994 was timely, and thus statutes applicable to tax years prior to 1996 will be discussed.

¹⁷ Section 12-6-2250 (applicable to tax years after 1995) and Section 12-7-1140 (applicable to tax years prior to 1996).

¹⁸ For tax years after 1995, S.C. Code Ann. § 12-6-2280 (****) similarly provides that: “The sales factor is a fraction in which the numerator is the total sales of the taxpayer in this State during the taxable year and the denominator is the total sales of the taxpayer everywhere during the taxable year.”

¹⁹ For tax years after 1995, S.C. Code Ann. § 12-6-2280 (B) (****) similarly provides that the term “sales in this State” includes sales of goods, merchandise, or property received by a purchaser in this State. The place where goods are received by the purchaser after all transportation is completed is considered the place at which the goods are received by the purchaser. Direct delivery into this State by the taxpayer to a person designated by a purchaser constitutes delivery to the purchaser in this State.”

not merely consider the language of the particular clause being construed, but the undefined word and its meaning in conjunction with the purpose of the whole statute and the policy of the law.” Id. Finally, “[s]tatutes should not be construed so as to lead to an absurd result.” Kennedy v. S.C. Ret. Sys., 345 S.C. 339, 351, 549 S.E.2d 243, 249 (2001) (internal citation omitted).

Here, there is no genuine issue of material fact with regard to the Gross Receipts Issue. The sole question of law is whether Duke Energy could include the return of principal from its sales of securities and other investment transactions as part of the sales or gross receipts factors in the apportionment formula. This is a novel question in South Carolina, but is not unprecedented in some of our sister States.

The first approach to this issue was taken by New Jersey in Am. Tel. and Tel. Co. v. Dir., Div. of Taxation, 194 N.J. Super. 168, 476 A.2d 800 (App. Div. 1984). In that case, the New Jersey Supreme Court concluded that the inclusion of gross or full revenues from the short-term sale or redemption of investment paper in the denominator of the receipts fraction of the apportionment formula would lead to “absurd results” in that such inclusion would greatly distort the amount of business the taxpayer did within and without New Jersey and would thus defeat the intent and purpose of the apportionment statute. Id. at 172, 476 A.2d at 802. Both Indiana and Arizona have adopted similar rationales to the one used by the New Jersey court. See Sherwin-Williams Co. v. Ind. Dept. of State Revenue, 673 N.E.2d 849 (Ind. Tax 1996) (holding that “‘gross receipts’ for the purpose of the sales factor includes only the interest income, and not the rolled over capital or return of principal, realized from the sale of investment securities”); Walgreen Ariz. Drug Co. v. Ariz. Dep’t of Revenue, 209 Ariz. 71, 97 P.3d 896 (App. 2004) (holding that the return of principal from the type of short-term investments at issue was not includable in the sales factor denominator).

The other approach to this issue was taken by Tennessee and California.²⁰ In Sherwin-Williams Co. v. Johnson, 989 S.W.2d 710 (Tenn. App. 1998), the chancellor had followed the same reasoning employed by the New Jersey and Indiana courts (and later the Arizona court), holding that “to include the principal in the sales factor denominator would distort the extent of Sherwin-Williams’ business activities in Tennessee and other states in which it does business

²⁰ South Carolina’s apportionment provisions, like those in New Jersey, Indiana, Arizona, Tennessee, and California, are based on the Uniform Division of Income for Tax Purposes Act (UDITPA).

and defeat the intent and purpose of the [apportionment] statute. . .” and that “the amount of return of principal on the sale or redemption of interest bearing securities related to its, [sic] working capital investments should not be included in the denominator of the sales factor.” Id. at 714. The Tennessee Court of Appeals, though finding the chancellor’s holding “logical and appealing,” nevertheless decided not to follow the “absurd result standard.” The court instead concluded that:

An absurd result is not necessary, for in spite of the plain language of the [sales factor statute], the commissioner may opt for a different scheme of assessment whenever the resulting apportionment does not fairly represent the taxpayer’s business in this state. The very absurdity of the result sought . . . lays a sound basis for the implementation of [the alternative apportionment method statute].

Id. at 714-15.

The California Supreme Court, in Microsoft Corp. v. Franchise Tax Bd., quoted this passage with approval as it went on to hold that “gross receipts” is not limited to net proceeds. 39 Cal.4th 750, 763, 139 P.3d 1169, 1177 (2006). Referencing California’s alternative apportionment method, the court concluded that “[t]he UDITPA contains an equitable relief provision so that, in cases where application of the statutory sales definition results in excessive distortion, an ‘absurd result’ may be avoided.”

After considering the two lines of reasoning set forth by our sister States, I conclude that the law of South Carolina favors the view expressed by the courts in New Jersey, Indiana, and Arizona.

As the Tennessee Court of Appeals correctly noted, “[i]f the words of a statute plainly mean one thing they cannot be given another meaning by judicial construction.” Johnson, 989 S.W.2d at 714-15 (internal citation omitted); see also Denman v. City of Columbia, 387 S.C. 131, 138, 691 S.E.2d 465, 468 (2010) (“Under the plain meaning rule, it is not the Court’s place to change the meaning of a clear and unambiguous statute.”). However, to rearrange the order of the court’s sentences, “This sound rule . . . is met by the equally well settled rule that: . . . ‘It is presumed that the legislature enacting a statute did not intend an absurdity, and such a result will be avoided by this court if the terms of the statute admit of it by reasonable construction.’” Johnson, 989 S.W.2d at 714 (internal citations omitted).

Alternative Apportionment Method

The Tennessee and California opinions rely upon the presupposition that “an absurd result is not necessary” because the Department “may opt for a different scheme of assessment

whenever the resulting apportionment does not fairly represent the taxpayer's business in this State." Microsoft, 39 Cal.4th at 763, 139 P.3d at 1177 (quoting Johnson, 989 S.W.2d at 715). South Carolina indeed has a similar provision. S.C. Code Ann § 12-6-2320(A) (2002) provided that:

If the allocation and apportionment provisions of this chapter **do not fairly represent** the extent of the taxpayer's business activity in this State, the taxpayer may petition for, or the department may require, in respect to all or any part of the taxpayer's business activity, if reasonable: separate accounting;

- (1) the exclusion of one or more of the factors;
- (2) the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in the State; or
- (3) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

(Emphasis added).

I nevertheless find that the California and Tennessee cases, in relying upon this statutory option, miss an important distinction between the court's roles of statutory construction and application of the alternative apportionment provision. Though the alternative relief provision exists as a mechanism to correct problems caused by the application of the standard apportionment statutes (see Media Gen. Commc'ns v. S.C. Dep't of Revenue, 388 S.C. 138, 694 S.E.2d, 525 (2010)), the standard application statutes should not be so construed as to encourage excessive distortion simply because the alternative relief provision exists to remedy that distortion. In applying the principles of statutory construction, the court's function is, in part, to construe statutory law to avoid an absurd result. Ventures S.C., LLC v. S.C. Dep't of Revenue, 378 S.C. 5, 9, 661 S.E.2d 339, 341 (2008) ("[T]he Court will reject the plain meaning of the words used in a statute if it would lead to an absurd result. . . ."). If, as here, the proposed construction of a statute reaches an absurd result, our courts should recognize that absurdity and end the inquiry.

On the other hand, the function of the alternative apportionment provision is quite different. The alternative apportionment provision should be utilized only when the standard apportionment statute does not operate sensibly in a given case. As the Florida Supreme Court pointed out in Roger Dean Enters. Inc. v. State, "[t]here is a very strong presumption in favor of normal three-factor apportionment and against the applicability of the relief provisions. . . . Departures from the basic formula should be avoided except where reasonableness requires."

387 So.2d 358, 363 (internal citations omitted). Further, in St. Johnsbury Trucking Co. v. New Hampshire, the New Hampshire Supreme Court, in addressing very similar statutory language, held that:

The statutory provisions require that the three-factor formula will be used for apportioning business profits, and an alternative formula may be used if the statutory method of apportionment “does not fairly reflect the extent of the business activities of a business organization within this state.” The legislature has, therefore, specified that an alternative formula **is the exception**, and the party who wants to use an alternative formula accordingly has the burden of showing that the alternative is appropriate.

118 N.H. 209, 212, 385 A.2d 215, 217 (1978) (emphasis added).²¹

In this case, to interpret the standard apportionment formula to include the return of principal in either the sales factor or gross-receipts factor of the denominator would engender an absurd application of the standard apportionment statute simply because another statute exists which allows for another means of accounting when the standard apportionment statute does not “fairly represent the extent of the taxpayer’s business activity in this State.” In other words, such an interpretation would create the very absurdity that courts are to avoid in their statutory construction. Rather than having Section 12-6-2320(A) available as a remedial back-up, a corporation would have nothing to lose and everything to gain by adding the return of principal to the denominator and thereby reducing the amount of taxes owed to South Carolina, regardless of whether the numbers accurately reflected the corporation’s business activity within and without the State. As a result, the alternative apportionment statute, which was intended to be a remedy held in reserve for the relatively infrequent occasion that the standard formula did not result in a fair representation, would then become a standard follow-up to the application of the standard apportionment statute. Indeed, both statutes would become standard, because distortion of business activity representation would be fostered on the front end (through the principal-inclusive standard apportionment formula) so that it could, and necessarily would, be dealt with on the back end (through the alternative apportionment formula).²²

²¹ The following states have followed the holding in St. Johnsbury Trucking: Idaho - Union Pac. Corp. v. Idaho State Tax Comm’n, 83 P.3d 116, 120 (Idaho 2004); and Kentucky - Ruby Const. Co., Inc. v. Dep’t of Revenue, 578 S.W.2d 248, 253 (Ky. Ct. App. 1978).

²² In its Memorandum in Opposition to the Department’s Motion for Summary Judgment and in Support of its Cross-Motion for Partial Summary Judgment, Duke Energy argues that the definitions of “sales” and “gross receipts” set forth in S.C. Code Ann. § 12-6-2295 (2007) (effective for tax years beginning after 2006), shows the Legislature’s intent to make a “drastic” change to the existing law based on its various inclusions in, and exclusions

Of course, this “best-case scenario” assumes that the Department will be able to detect when a business is including principal in the standard apportionment formula and will be able to pursue those cases. In reality, however, limited resources would dictate the exercise of more discretion in the application of the alternative apportionment method. Consequently, much, if not all, of the smaller amounts of tax revenue that the State would have received would become avoidable by including principal in the standard formula and hiding behind the newly-targeted “bigger fish” that would be including more principal in their formulas. In the aggregate, these small amounts, which the State would otherwise have gained but would instead lose through undetected inflation of the denominator and consequent underestimation of the taxes owed to the State, will equate to a rather sizeable sum lost to the State. Thus, the distortion that inevitably results from the inclusion of principal in the standard apportionment formula will pose problems for the Department and South Carolina, regardless of the size of the distortion. This potential for abuse by corporations and the futility of going through this extra-step process needlessly is reflected in a finding by the Arizona Court of Appeals that in most of the cases that the taxpayer cited to support the inclusion of the return of principal in the sales factor denominator of the standard apportionment formula, the courts “nonetheless approved exclusion of the principal from the sales factor denominator pursuant to their states’ version of UDITPA’s ‘relief provision’ [i.e., alternative apportionment method].” Walgreen, 209 Ariz. at 901-02, 97 P.3d 896 at 76-77 (citing Union Pac. Corp. v. Idaho State Tax Comm’n, 139 Idaho 572, 83 P.3d 116, 122 (2004); Am. Tel. & Tel. Co. v. State Tax Appeal Bd., 241 Mont. 440, 787 P.2d 754, 757-58 (1990); Johnson, 989 S.W.2d at 715). Microsoft, which was decided two years after Walgreen, can be added to this list, as it applied California’s alternative apportionment method statute to

from, the definitions of “sales” and “gross receipts” that had previously not existed. According to Duke’s argument, therefore, these inclusions and exclusions did not apply prior to the enactment of Section 12-6-2295. One of the inclusions would be “net gain from the sale of property used in the trade or business[, such as] **intangible property** used in the trade or business . . .” (Section 12-6-2295(A)(4) (emphasis added)), and one of the exclusions is the “repayment, maturity, or redemption of the **principal** of a loan, bond, or mutual fund or certificate of deposit or similar marketable instrument . . .” Id. (B)(1) (emphasis added). According to the Supreme Court in Duvall, 377 S.C. at 46, 659 S.E.2d at 130: “When the Legislature adopts an amendment to a statute, th[e] Court recognizes a presumption that the Legislature intended to change the existing law. **Nonetheless, a subsequent statutory amendment may also be interpreted as clarifying original legislative intent.**” (Internal citations omitted) (emphasis added). In this case, the inclusion and exclusion quoted above demonstrate that the Legislature intended to exclude the return of principal from the sale of securities and other capital investments in the apportionment formula. In light of all of the reasons discussed above as to why the return of principal was excluded from the apportionment formula prior to the enactment of Section 12-6-2295, it is evident that the Legislature intended Section 12-6-2295 to clarify the existing law.

“fairly represent the extent of the taxpayer’s business activity in this state” after the court included principal in the sales denominator of its standard apportionment formula.²³ Thus, any benefits from this principal-inclusion method seem to be vastly outweighed by the great cost of revenue that this State would face through continuous underestimation of taxes due to distortions.

Logical Definition of Gross Receipts

The term “gross receipts” does not plausibly include the return of principal from the sale of securities and other capital investments. “Gross income”, at least in the context of self-employment or self-owned businesses, is defined as “gross receipts minus ordinary and necessary expenses required for self-employment or business operation. . . .” Spreeuw v. Barker, 385 S.C. 45, 65, 682 S.E.2d 843, 853 (Ct. App. 2009) (citing S.C. Code Ann. Regs. 114-4720(A)(4) (Supp. 2008)). This definition would logically apply to other types of businesses, too. According to this definition, gross receipts equal gross income plus ordinary and necessary expenses of business operations. The South Carolina Supreme Court in Roper v. S.C. Tax Comm’n, Title 65-Section 251 of the 1952 Code of Laws of South Carolina also defined “gross income” as: “the income of a taxpayer derived from . . . interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit” 231 S.C. 587, 598, 99 S.E.2d 377, 382 (1957) (emphasis added); see also S.C. Code Ann. § 12-7-415 (****) (adopting the Internal Revenue Code’s (I.R.C.) determination of gross income with modifications specified in Section 12-7-430 (which are not relevant here)); I.R.C. § 61(a) (****) (generally defining corporate gross income as “all income from whatever source derived” and covering many of the same categories mentioned in Roper)²⁴; S.C. Code Ann. § 12-6-1110 (****). The Court went on

²³ Paradoxically, the court went on to justify this decision to apply the alternative method statute because it was “unable to accept, even for a moment, the notion that more than 11 percent of [taxpayer’s] entire unitary business activities should be attributed to *any* single state solely because it is the center of working capital investment activities that are clearly only an incidental part of one of America’s largest, and most widespread, businesses.” This rationale highlights the precise reason why principal from the sale of securities and other capital investment activities should not be included in the standard apportionment formula in the first place: the inclusion of principal causes distortions as to the amount of business activity actually performed in a State, which, in turn, have to be remedied.

²⁴ Nowhere in South Carolina’s statutory law or in the federal statutory law adopted by South Carolina is principal from investments listed as part of gross income. In fact, principal would later be excluded in S.C. Code Ann. § 2295(B)(1) (2007), which became effective for tax years after 2006. Also, it is worth noting that even in the context of child support, gross income does not include principal in the return from the sale of investments. Indeed, the inclusion of “capital gains” in the list of items considered part of gross income for child support purposes

to point out that “the word ‘income’ as used in a tax statute, is to be taken in its ordinary sense of gain or profit.” *Id.* (reaffirmed as “well-settled” in *Scott v. S.C. Tax Comm’n*, 262 S.C. 144, 148, 202 S.E.2d 854, 856 (1974)). Because gross income includes “all income,” and income, being gain or profit, excludes principal, then gross income necessarily excludes principal. Therefore, the only remaining question is whether “ordinary and necessary expenses of business operations” includes principal.

Principal, by definition, cannot be an expense of a business operation. Since ordinary and necessary business expenses are subtracted from gross receipts to yield gross income, and neither business expenses nor gross income include principal, it is impossible for gross receipts to include principal. Put another way, because gross receipts are equivalent to gross income plus ordinary and necessary business expenses, and neither gross income nor business expenses include principal, gross receipts, being the sum of those two parts, cannot include principal.²⁵ Inversely, Duke Energy contends that the principal is a component of the gross receipts it received. If gross receipts were also a component of gross income, then, according to Duke Energy’s argument, gross income must include principal. However, inclusion of principal in gross income would create an absurd result. Generally, the taxable income of a business is its gross income minus any deductions that are allowed by state law.²⁶ Principal is not an item that is specifically excluded from gross income. *See* 26 U.S.C.A. Subt. A, Ch. 1, Subch. B, Pt. III. Thus, the logical extension of Duke Energy’s argument is that taxable income includes the

necessarily implies the exclusion of principal from the return of investment sales. *See* S.C. Code Ann. Regs. 114-4720(A)(2) (2012).

²⁵ For examples in the I.R.C. of exclusion of principal from gross receipts, *see* I.R.C. § 165(g)(3)(B) (****) (in the context of determining whether a corporation is affiliated with a taxpayer, “in computing gross receipts for purposes of [calculating the percentage of gross receipts that have come from particular sources], gross receipts from sales or exchanges of stocks and securities shall be taken into account *only to the extent of gains* therefrom.”) (emphasis added); *id.* § 1362(d)(3) (in the context of a small business corporation’s termination of its election to be an S corporation, where its passive investment income exceeds twenty-five percent of gross receipts for three consecutive taxable years and the corporation has accumulated earnings and profits at the close of each of those years, when capital assets (other than stocks or securities) are disposed of, “gross receipts from such dispositions shall be taken into account *only to the extent of the capital gain net income* therefrom[;] and in the case of sales or exchanges of stock or securities, gross receipts shall be taken into account *only to the extent of the gains* therefrom.”) (emphasis added); and *id.* § 1244 (in the context of calculating the percentage of gross receipts from particular sources for determining whether “stock” means stock in a domestic corporation for determining losses on small business stocks, “gross receipts from the sales or exchanges of stock or securities shall be taken into account *only to the extent of gains* therefrom.”) (emphasis added).

²⁶ I.R.C. § 63(a) (****).

principal and the gain. Consequently, taxpayers would be taxed not only upon the specific gains from the principal but upon the return of the principal itself.²⁷

Furthermore, a corporation's South Carolina gross income and taxable income is computed as determined under the I.R.C. with the modifications as provided in the South Carolina Tax Code. See S.C. Code Ann. §§ 12-6-580 (****) and 12-7-415 (****). The I.R.C. provides that except in the case of individuals who do not itemize deductions, "taxable income" is defined as "gross income minus the deductions allowed by this chapter (other than the standard deduction)." I.R.C. § 63(a) (****); see also U.S. v. Foster Lumber Co., 429 U.S. 32, 36-37 (1976) (recognizing this definition for taxable income as applicable to the corporate respondent in that case). For the reasons given above, gross income does not include principal. Consequently, principal cannot be included in taxable income, the remainder of gross income following deductions (other than the standard deduction). Indeed, because principal is also not a deduction allowed by state law, principal cannot even be included in the calculation of taxable income.²⁸

Therefore, because income is the gain or profit realized from principal, gross income, and thus taxable income, necessarily exclude principal.

Logical Definition of Sales

It is equally implausible to include principal from the sale of securities and other capital investments in the definition of "sales" for purposes of the standard apportionment formula. A major difference between the Tennessee case and the present case is that Tennessee's standard apportionment statute defined "the term 'sales' to include all gross receipts of the taxpayer not otherwise allocated under the Excise Tax Law." Johnson, 989 S.W.2d at 713 (emphasis in original). Likewise, the California standard apportionment statute included "all gross receipts" in the definition of "sales." South Carolina's standard apportionment statute defines the term

²⁷ In light of the above analysis, the application of the holding in Roper v. S.C. Tax Comm'n, 231 S.C. 587, 99 S.E.2d 377 (1957) is even more pertinent.

²⁸ It is worth noting that in Foster Lumber Co., the U.S. Supreme Court reasoned that the inclusion of "gains derived from dealing in property" as part of "all income from whatever source derived" in the definition of gross income under I.R.C. Section 61(a) meant that taxable income, which includes gross income according to Section 63(a), also therefore included capital gains as well as ordinary income, in the absence of a specific exclusion of capital gains. 429 U.S. at 37. The Court's inclusion of capital gains impliedly excludes principal from gross income and thus taxable income.

“sales,” but this definition does not include “gross receipts.”²⁹ Instead, under its definition of “sales,” “[i]f the income-producing activity is performed partly within and partly without this State, sales are attributable to this State to the extent the **income-producing** activity is performed within this State.” (Emphasis added). This phrase “income-producing” is used to modify “activity” several other times in the definition of “sales.” “Income” means “an actual gain or actual increase of wealth.” See Scott v. S.C. Tax Comm’n, 262 S.C. 144, 148-49, 202 S.E.2d 854, 856 (1974) (Bussey, J., dissenting) (citing 85 C.J.S. Taxation 1096, p. 730). This emphasis on income production suggests that principal is excluded from the definition of “sales.”³⁰ Moreover, this limitation of “sales” to the net income derived therefrom is not a novel interpretation. Indeed, our own Supreme Court has approved of an apportionment formula “whereby [a business’s] sales, payroll, and property in South Carolina were divided by its national net sales, payroll, and property.” See Eastman Kodak Co. v. S.C. Tax Comm’n, 308 S.C. 415, 416, 419, 418 S.E.2d 542, 542, 544 (1992) (holding in part that safe harbor lease transactions that were part of a corporation’s business “were properly included in the denominator of the apportionment formula in computing [that corporation’s] national net income from payroll, property, and sales.”) (emphasis added). The Supreme Court in Texaco, Inc. v. Wasson, referring to S.C. Code Ann. § 12-7-1140 (****), the immediate predecessor to Section 12-6-2250 (****), further noted that “[u]nder the [three-factor] apportionment method, a corporation’s entire net income is apportioned to this state by applying to that entire net income a percentage based on the ‘three-factor formula’ of property, payroll, and sales in this state to the corporation’s total property, payroll, and sales.” 269 S.C. 255, 259, 237 S.E.2d 75, 76 (1977) (emphasis added). The Court also noted that this apportionment was of the “net income” remaining after the direct allocation of certain items listed under Section 12-7-1120 (****) (currently Section 12-6-2220 (****)). Id. at 266, 237 S.E.2d at 80 (emphasis added). Using this

²⁹ “Sales” and “gross receipts” were later further defined together by S.C. Code Ann. § 12-6-2295 (2007) (effective for tax years beginning after 2006). However, the years at issue here are 1978-2001. Further, because the Court finds as a matter of law that the refund claims filed for tax years ending 1978-1993 are untimely, the only years that will be considered for the gross receipts issue will be tax years ending 1994-2001.

³⁰ Though Duke Energy is a nonresident corporation, it is worth noting that South Carolina taxable income for nonresident individuals, nonresident trusts, nonresident estates, and nonresident beneficiaries include only amounts attributable to, among other things, “income from intangible personal property, including annuities, dividends, interest, and gains that is derived from property employed in a trade, business, profession, or occupation carried on in this State.” It is interesting that nowhere is “principal” mentioned as an inclusion in taxable income.

interpretation and limiting the sales factor in the denominator of the three-part apportionment formula to net income is the more sound application of the apportionment formula.

The conclusion in this case is further supported by the fact that in the context of consolidated returns filed by multiple corporations conducting business within and without the State, the returns included in the sales factor of the standard apportionment formula must “contain such other information necessary to compute the **net income** of each taxpayer properly attributable to the state so that South Carolina can impose a tax on the taxpayers concerned.” Emerson Elec. Co. v. Wasson, 287 S.C. 394, 396-97, 339 S.E.2d 118, 120 (1986) (discussing S.C. Code Ann. § 12-7-1570 (****) (for tax years prior to 1996), the predecessor of § 12-6-5020 (****) (for tax years after 1996)) (emphasis altered). This infers that when a single corporation also conducts business within and without the State, its net income only, and not principal, is included in the sales factor for purposes of apportioning the amount of corporate income taxes the State could impose on that corporation. See, e.g., Eastman Kodak Co., 308 S.C. at 416, 418 S.E.2d at 542 (Kodak included only the net income in the sales factor in the denominator of the apportionment formula).

Criticism of the “Absurd Results Standard”

The California Supreme Court in Microsoft criticized the proponents of the “absurd results standard,” in part, because “[i]n each case, the same language governs both sales of off-the-shelf products and sales of securities. *AT&T* [(the New Jersey case)] and its progeny offer no explanation why in one instance that language should require inclusion of gross proceeds and in the other require inclusion of only net proceeds.” 39 Cal.4th at 763, 139 P.3d at 1177.³¹ Nevertheless, the resolution of this issue has been clarified in South Carolina by the Supreme Court’s holding in Hay v. Leonard, 212 S.C. 81, 46 S.E.2d 653 (1948).

Hay involved a challenge to the validity of Charleston County’s levying an annual license tax for the privilege of engaging in each and every business and occupation in Charleston County, except in the City of Charleston. In reaching its decision, the South Carolina Supreme Court explained the reason why merchandise, or “off-the-shelf products,” includes gross proceeds in its taxation, and the Court’s reasoning suggests why the sale of securities would not include gross proceeds. The Court explained: “the [license] tax is not on the property itself; it is

³¹ This is the first of the “two problems” that the California Supreme Court had with the “absurd results” cases. The second problem will be discussed in the immediately-following paragraph.

on the **privilege of dealing with it**. The value of such privilege is measured by the gross receipts therefrom, and this is a familiar and valid method of ascertaining such value.” Id. at 97, 46 S.E.2d at 660 (emphasis added). A merchant is required to possess a license in order to have the privilege of dealing in merchandise; and the tax is on this privilege, not on the merchandise. This is why “[t]he sale of all merchandise includes previous taxation” Id.; see also State ex rel. Roddey v. Byrnes, 219 S.C. 485, 514, 66 S.E.2d 33, 45 (1951) (“In general, the sales tax [a form of excise tax], is [, like a license tax,] an imposition upon the privilege of the business of selling at retail and measured by the amount of business done”). The sale of securities is altogether different in that a license is not required to purchase or sell securities,³² and no sales tax is imposed upon the sale of securities.³³ Therefore, here there exist no “privilege” grounds upon which to include principal in the gross receipts, as the value received from the sales of the securities for tax purposes would be measured by the capital gains, not by the principal. The principal would consist of the business’s “idle cash” that would presumably have been taxed already.

Conclusion

This Court hereby follows New Jersey, Indiana, and Arizona in adopting the “absurd results” approach to interpreting South Carolina’s standard apportionment statute and therefore rejects Duke Energy’s attempt to include the return of principal in the denominator of the standard apportionment formula. In sum, the alternative apportionment formula exists to remediate any nonsensical application of the standard apportionment formula. However, that remediation should not be the result of a court’s addition, through its failure to apply the rules of statutory interpretation, of a component to the standard apportionment formula that neither exists in the statute nor was intended by the Legislature. The absurdity that the alternative apportionment formula is intended to remediate is when a taxpayer follows the standard apportionment formula but the result is nevertheless an unfair representation of the extent of the taxpayer’s business activity in the State. Construing the purpose of the alternative provision to avoid an absurd use of the standard apportionment statute clearly could open the door to the abuse of the standard apportionment statute and an excessive need to apply Section 12-6-

³² This statement does not include securities brokering.

³³ Capital gains tax is imposed upon the sale of securities (assuming a profit is made from the sale). This tax is imposed on the profit, or “gains,” made on the capital originally invested, not on the returned principal.

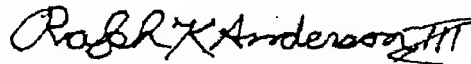
2320(A). Furthermore, to use the alternative apportionment provision as a means to avoid absurdity resulting from an interpretation of the standard apportionment provision that is not envisioned by the tax laws places upon the State a burden of policing tax returns that simply should not exist.

Importantly, it is not the amount of distortion that determines absurdity here. If it was, then there would exist an issue of material fact in this case, and indeed in every such case, as to the amount of distortion that would result from the inclusion of principal, and a hearing would be necessary to obtain facts whereby the degree of distortion could be measured so as to determine whether the results of principal inclusion would be absurd in this case. But such a case-by-case determination is not necessary where, as here, principal cannot, as a matter of law, be included in sales or gross receipts for purposes of the standard apportionment formula. Thus, no hearing is necessary on the gross receipts issue, and the Department's Motion for Summary Judgment as to this issue is therefore granted for the reasons set forth above.

ORDER

THEREFORE, IT IS HEREBY ORDERED that: (1) the Department's Motion for Summary Judgment with respect to the Timeliness Issue is **GRANTED**; (2) the Department's Motion for Summary Judgment with respect to the Apportionment Method Issue is **DENIED**; and (3) the Department's Motion for Summary Judgment with respect to the Gross Receipts Issue is **GRANTED**, and Duke Energy's Cross-Motion for Partial Summary Judgment as to this same issue is therefore **DENIED**.

IT IS SO ORDERED.

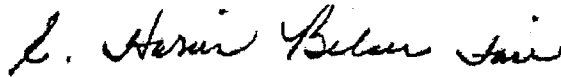


Ralph K. Anderson, III
Chief Administrative Law Judge

August 9, 2012
Columbia, South Carolina

CERTIFICATE OF SERVICE

I, E. Harvin Belser Fair, hereby certify that I have this date served this Order upon all parties to this cause by depositing a copy hereof, in the United States mail, postage paid, in the Interagency Mail Service, or by electronic mail to the address provided by the party(ies) and/or their attorney(s).



E. Harvin Belser Fair
Judicial Law Clerk

August 9, 2012
Columbia, South Carolina

Exhibit B

STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

DUKE ENERGY CORPORATION,

Petitioner,

vs.

SOUTH CAROLINA DEPARTMENT OF
REVENUE,

Respondent.

Docket No.: 10-ALJ-17-0270-CC

DUKE ENERGY'S MOTION FOR
RECONSIDERATION OF THE
COURT'S ORDER GRANTING THE
SOUTH CAROLINA DEPARTMENT
OF REVENUE'S MOTION FOR
SUMMARY JUDGMENT AS TO THE
WAIVER AND GROSS RECEIPTS
ISSUES

Pursuant to Rule 29(D) of the Rules of Procedure for the South Carolina Administrative Law Court and Rule 59(e) of the South Carolina Rules of Civil Procedure, Duke Energy Corporation ("Duke Energy") respectfully submits this Motion for Reconsideration in connection with the Court's Order of August 9, 2012, ruling *inter alia* that, as a matter of law, (1) Duke Energy's refund claims for the tax periods 1978-1993 were untimely, and (2) Duke Energy is not permitted to include its gross receipts from sales of securities in the denominator of its apportionment formula ("Gross Receipts Issue").

As more fully set out in the attached Memorandum of Authorities filed contemporaneously herewith, Duke Energy respectfully submits that the Court should reconsider its ruling with respect to (1) the Waiver Issue because an evidentiary hearing is necessary to resolve the material facts in dispute with respect to that issue, and (2) Gross Receipts Issue because Duke Energy is entitled to a judgment as a matter of law on

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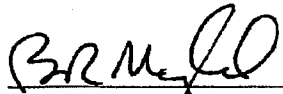
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that issue as South Carolina law requires Duke Energy to include all of its receipts from sales of securities in apportioning its income to South Carolina.

Respectfully submitted this 20 day of August 2012.



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