THE STATE OF SOUTH CAROLINA

In The Court of Appeals

APPEAL FROM THE ADMINISTRATIVE LAW COURT

Milton G. Kimpson, Administrative Law Judge
Robert L. Reibold, Administrative Law Judge (on Reconsideration)

Appellate Case No. 2024-001577

Trial Court Case No. 20-ALJ-17-0168-CC

U.S. Bank National Association, ... Appellant,

v.

South Carolina Department of Revenue, ... Respondent.

FINAL OPENING BRIEF OF APPELLANT U.S. BANK NATIONAL ASSOCIATION

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INTRODUCTION

Each state may only tax income reasonably attributable to activities taking place within its borders. Most states, including South Carolina, rely on a formula-based approach to determine the amount of income they may tax. This approach is known as apportionment of a taxpayer's income.

South Carolina's tax law specifies how distinct types of receipts are apportioned to the State as part of the apportionment process. Specifically, receipts from services are sourced to South Carolina to the extent that the income-producing activity is performed within the State. Receipts from intangible property are sourced to South Carolina to the extent that the intangible is used in the State.

This case centers on how South Carolina's apportionment provisions apply to Appellant, U.S. Bank National Association's ("U.S. Bank's") receipts related to mortgages, credit cards and credit card processing services. To produce these receipts, U.S. Bank performs many activities, including the selling and servicing of mortgages, the servicing of credit cards and the processing of credit card transactions. These activities do not occur in South Carolina.

The Administrative Law Court ("ALC") erroneously found that all of the receipts at issue should be lumped together and sourced as receipts from intangibles. Moreover, ignoring the substantial evidence presented by U.S. Bank, the ALC relied on proxies to determine the use of the mortgages and credit cards in the State.

In reaching its incorrect determinations, the ALC failed on several fronts. First, the ALC ignored the facts and misapplied the law. Moreover, the ALC's decisions violated basic principles of statutory interpretation by failing repeatedly to consider the plain meaning of the law at issue. These failures result in the mis-apportionment of U.S. Bank's receipts to South

Carolina. However, the record in this case establishes that U.S. Bank properly apportioned its receipts. Accordingly, the ALC's erroneous orders should be reversed.

STATEMENT OF THE ISSUES ON APPEAL

1. Whether U.S. Bank properly sourced its receipts related to mortgages, credit cards and credit card processing as receipts from services under South Carolina's apportionment law.

2. Whether the ALC erred under South Carolina law in lumping together U.S. Bank's receipts related to mortgages, credit cards and credit card processing and sourcing said receipts as from intangibles.

3. Whether U.S. Bank properly sourced its receipts from services by determining its income-producing activities and the extent to which those activities occurred in South Carolina.

4. Whether the ALC erred under South Carolina law by relying on proxies rather than analyzing U.S. Bank's income-producing activities or the extent to which any alleged intangible property was used in South Carolina.

5. Whether the ALC erred in upholding the Department's imposition of substantial understatement penalties.

STATEMENT OF THE CASE

Banks subject to South Carolina's Bank Tax ("Bank Tax") are required to pay an annual tax on their net income in lieu of the general corporation tax. *See* S.C. Code Ann. § 12-11-20.[1] However, banks must apply the apportionment provisions of the South Carolina Income Tax Act ("Income Tax") to calculate their Bank Tax due. *See* S.C. Code Ann. § 12-11-40.

The Department of Revenue (the "Department") audited U.S. Bank for the tax years ended December 31, 2011 through December 31, 2016 (the "Years at Issue"). As a result of its audit, the Department adjusted U.S. Bank's Bank Tax returns, including adjustments to its apportionment factor and assessing penalties and interest. These adjustments resulted in an

[1] All statutory references are to the statutes in effect during the Years at Issue, unless otherwise noted.

additional total amount due of $5,773,079.43. U.S. Bank timely appealed the Department's audit assessment. The Department issued a Determination sustaining the audit adjustments in their entirety (the "Determination").

Thereafter, U.S. Bank timely filed a request for a contested case hearing to the ALC on July 8, 2020. A hearing was held before the Honorable Milton G. Kimpson, Administrative Law Judge, on July 17 and 18, 2023. On June 25, 2024, Judge Kimpson issued an Amended Final Order (the "Order") upholding the Determination except with regard to certain substantial understatement penalties.

On July 5, 2024, U.S. Bank filed a motion requesting the ALC reconsider the Order. The matter was reassigned to the Honorable Robert L. Reibold, Administrative Law Judge and, on August 19, 2024, Judge Reibold issued an Order on Motion for Reconsideration (the "Reconsideration Order"). The Reconsideration Order granted U.S. Bank's motion to alter or amend the Order, in part, by finding that U.S. Bank's "receipts from the sale of the Visa stock should not be apportioned to South Carolina." R. p. 95.

In all other respects, the Reconsideration Order denied U.S. Bank's motion to alter or amend the Order. *Id*. In addition, the Reconsideration Order upheld all remaining penalties. As a result of the Reconsideration Order, the following amounts remain at issue:

Additional Bank Tax	$2,827,928.00
Interest	$1,559,725.86
Penalty	$582,864.29
Total	**$4,970,518.15**

Id.

STATEMENT OF THE FACTS[2]

The following are the relevant facts in the case, which are supported by the record:

A. U.S. Bank's Operations

U.S. Bank is a national bank with its headquarters and principal place of business in Minnesota. R. pp. 1160-1168. U.S. Bank has no bank branches in South Carolina and operates only one trust office in the State. R. p. 316, lines 15-16; p. 324, line 14. During the Years at Issue, U.S. Bank earned income from multiple income streams, including receipts related to: (i) the rental of tangible personal property; (ii) trust custody fees; (iii) mortgages; (iv) credit cards; and (v) credit card processing services. R. pp. 1176-1617. At issue in this case is U.S. Bank's sourcing of its receipts related to mortgages, credit cards and credit card processing services.

i. U.S. Bank's Mortgage Operations

U.S. Bank offers mortgages to customers throughout the United States. R. p. 323, line 2-p. 328, line 9. U.S. Bank earns a variety of receipts related to mortgages, including interest, fees and gains on its sale of pooled mortgages. R. p. 342, lines 2-20; p. 343, lines 20-22; p. 345, line 14-p. 346, line 5. During the Years at Issue, U.S. Bank sold approximately 95% of the retail mortgages for South Carolina borrowers that it originated to government sponsored entities ("GSEs"), including the Federal Home Loan Mortgage Corporation, the Federal National Mortgage Association and the Government National Mortgage Association, none of which are located in South Carolina. R. p. 338, lines 5-6; p. 341, lines 4-13; p. 522, lines 8-13.

After a potential borrower applies for a mortgage, U.S. Bank processes the application outside of South Carolina. R. p. 330, line 15-p. 331, line 9. If approved, the mortgage is closed and funded by U.S. Bank, all outside of South Carolina. R. p. 332, lines 2-14. After closing, the

[2] All facts relate to the Years at Issue unless otherwise indicated.

mortgage is managed and serviced by U.S. Bank's servicing group in Owensboro, Kentucky. R. p. 332, lines 15-23. Ongoing services include the processing of monthly payments, the facilitating of the payment of taxes and insurance and the performance of any necessary collection activities. No U.S. Bank employees perform servicing activities in South Carolina. R. p. 332, line 24-p. 337, line 20. In addition, U.S. Bank purchased mortgages from third parties, some of which had South Carolina borrowers. R. p. 327, line 23-p. 329, line 4.

In an effort to manage U.S. Bank's liquidity, risk and margins, U.S. Bank's capital markets group (located in Minnesota) determines which mortgages will be sold to the GSEs. R. p. 338, lines 1-8. By contract, U.S. Bank provides servicing for the mortgages owned by the GSEs in Kentucky. R. p. 342, line 24-p. 343, line 8. The GSEs pay U.S. Bank fees for these services. *Id*. at lines 20-22.

ii. U.S. Bank's Credit Card Operations

U.S. Bank also offers credit cards to customers throughout the United States. R. p. 363, line 5-p. 366, line 25; p. 392, line 1-p. 395, line 24. U.S. Bank earns a variety of receipts related to its credit card operations, including interest, late fees, annual fees and interchange fees. R. p. 379, line 11-p. 380, line 1; p. 407, lines 21-25. Consumers and small businesses pay interest, late fees and annual fees to U.S. Bank. R. p. 379, line 11-p. 380, line 1. Interchange fees are paid by the merchant to facilitate the routing of a transaction and the delivery and settlement of payment by U.S. Bank. *Id*. at lines 19-24; p. 407, line 25-p. 408, line 9. Interchange fees are earned on credit card transactions involving consumers, small businesses and larger corporate and commercial clients. *Id*.

To issue credit cards to consumers and small businesses, U.S. Bank processes each application and, if approved, a physical card is issued by U.S. Bank, all of which takes place outside of South Carolina. R. p. 370, line 3-p. 373, line 25. After issuance, U.S. Bank provides

ongoing credit card services, including: (i) issuing monthly statements; (ii) operating a customer service hotline; and (iii) managing any necessary collection activities. R. p. 373, line 25-p. 376, line 5. The servicing activities are performed by U.S. Bank in North Dakota and Kansas, not in South Carolina. *Id.*

Likewise, the process to issue credit cards to larger corporate and commercial clients involves U.S. Bank processing an application or the corporate clients negotiating a contract, all of which occurs outside of South Carolina. R. p. 396, line 16-p. 400, line 3. If approved, or once a contractual agreement is reached, physical credit cards are issued from North Dakota. R. p. 402, lines 10-14. In addition, U.S. Bank will assign relationship managers or account coordinators to larger clients. R. p. 403, line 9-p. 404, line 11. No relationship managers or account coordinators are located in South Carolina. *Id.* Thereafter, U.S. Bank provides ongoing credit card services, including: (i) providing a customer service hotline that is based in North Dakota; and (ii) conducting any necessary collection activities through U.S. Bank's collections centers in Missouri and Kansas. R. p. 402, line 14-p. 406, line 6.

In addition, U.S. Bank processes credit card transactions on an ongoing basis. R. p. 376, line 19-p. 378, line 12; p. 406, line 3-p. 407, line 20. To process each transaction, U.S. Bank receives a request for authorization from a merchant processor and determines whether to approve the request based on the cardholder's line of credit and any fraud determinations. R. p. 376, line 19-p. 377, line 9; p. 406, lines 12-16; p. 513, lines 6-24. If U.S. Bank approves the transaction, U.S. Bank will fund the transaction – *i.e.*, within 1-3 days of the original transaction request, U.S. Bank pays to the merchant the funds. R. p. 377, line 22-p. 378, line 8; p. 406, line 16-p. 407, line 16; p. 514, lines 11-22. In exchange for the transaction's approval and funding, the merchant pays U.S. Bank interchange fees. R. p. 380, lines 19-24; p. 408, lines 8-9. None of

U.S. Bank's activities occur in South Carolina, including receipt of the transaction request, the approval decision-making process, communication of the approved/denied decision, or the funding of the transaction. R. p. 382, line 25-p. 383, line 7; p. 410, lines 5-13. U.S. Bank performs these activities in Wisconsin. R. p. 378, lines 5-8.

B. U.S. Bank's Bank Tax Returns

U.S. Bank timely filed South Carolina Bank Tax returns for the Years at Issue. R. pp. 1176-1617. On its originally filed Bank Tax returns, U.S. Bank included in its gross receipts from within South Carolina the receipts from its rental of tangible personal property and receipts from trust custody fees for South Carolina customers. R. pp. 1160-1168. U.S. Bank excluded from its gross receipts from within South Carolina the mortgage and credit card related receipts. *Id*.

In July 2023, U.S. Bank filed amended Bank Tax returns to correct its sourcing for the Years at Issue. R. p. 418, lines 11-16; p. 419, lines 16-21.

C. The Department's Audit and Determination

On September 28, 2018, the Department issued a Proposed Notice of Adjustment ("Proposed Notice") based on its audit of U.S. Bank for the Years at Issue. R. pp. 1618-1658. The Proposed Notice increased the numerator of U.S. Bank's South Carolina gross receipts factor by including all receipts that relate to South Carolina borrowers, regardless of the location of the income-producing activity. *Id*. U.S. Bank timely appealed the Proposed Notice.

On June 18, 2020, the Department issued its Determination upholding the Proposed Notice in its entirety. R. pp. 1160-1168. U.S. Bank timely appealed the Determination to the ALC.

D. The ALC's Decisions

The Order concluded that the Department properly sourced U.S. Bank's receipts related to its mortgage and credit card activities to South Carolina.[3] R. p. 73. With regard to mortgage related receipts, the Order concluded that these receipts – whether in the form of interest, fees, or gain on the sale to the GSEs – are classified as receipts from intangibles and are sourced to South Carolina if the borrower is located in the State. R. pp. 52-61.

Likewise, with regard to receipts from U.S. Bank's credit card operations, the Order concluded that such receipts should be treated as receipts from intangibles and sourced to South Carolina if used in the State. R. pp. 62-64. However, to reach this conclusion, the Order interpreted South Carolina law differently than the Department did in its Determination. R. pp. 62-64, 1160-1168. Specifically, the Order found that U.S. Bank is creating accounts receivables by issuing credit cards and as a result, receipts from these accounts receivables must be from the use of intangible property in South Carolina if the cardholder is in the State. R. p. 63.

Finally, the Order upheld all substantial understatement penalties, except those related to U.S. Bank's interchange fees. R. pp. 67-73. In analyzing which penalties to abate, the ALC found U.S. Bank's "positions in the case [to be] taken in good faith," but determined that reasonable cause only existed to abate penalties related to the interchange fees because the Department failed to bring to the ALC's "attention any policy guidance it has issued to assist taxpayers with the agency's interpretation of income-producing activity issues." R. p. 72.

[3] The Order also upheld the Department's treatment of the gains from the sale of Visa stock held by U.S. Bank. R. pp. 64-67, 73. However, the Reconsideration Order reversed this determination, which the Department did not appeal. R. pp. 90-95. Thus, the treatment of the gains from the sale of the Visa stock are no longer at issue.

U.S. Bank timely requested that the ALC reconsider its Order. The Reconsideration Order upheld the Order with regard to the sourcing of U.S. Bank's income related to its mortgages and credit cards. R. p. 95. Moreover, the Reconsideration Order upheld the Order's substantial understatement penalty determinations. *Id.* This appeal followed.

STANDARD OF REVIEW

The Administrative Procedures Act governs the Court's review of the ALC's Order and Reconsideration Order. *See* S.C. Code Ann. § 1-23-310 *et. seq.; see also Original Blue Ribbon Taxi Corp. v. S.C. DMV*, 380 S.C. 600, 604, 670 S.E.2d 674, 676 (Ct. App. 2008). The Court may reverse or modify the Order and/or the Reconsideration Order if the Court determines that the substantive rights of the Appellant have been prejudiced because the findings, conclusions, or decisions are:

(a) in violation of constitutional or statutory provisions;

(b) in excess of the statutory authority of the agency;

(c) made upon unlawful procedure;

(d) affected by other error of law;

(e) clearly erroneous in view of the reliable, probative, and substantial evidence on the whole record; or

(f) arbitrary or capricious or characterized by abuse of discretion or clearly unwarranted exercise of discretion.

S.C. Code Ann. § 1-23-610(B).

For questions of law, including those on statutory interpretation, the Court has *de novo* review, owing no deference to the statutory constructions of the ALC or the Department, no matter how longstanding. *See Jack's Custom Cycles, Inc. v. S.C. Dep't of Revenue*, 439 S.C. 35, 48, 885 S.E.2d 433, 440 (Ct. App. 2023); *see also Colonial Pipeline Co. v. S.C. Dep't of Revenue*, 443 S.C. 448, 905 S.E.2d 129, 134 (Ct. App. 2024), *quoting Loper Bright Enters. v.*

Raimondo, 603 U.S. __, 144 S. Ct. 2244 (2024). When interpreting a tax imposition statute, like the statute at issue in this case, any ambiguity must be resolved in U.S. Bank's favor. *See Alltel Commc'ns, Inc. v. S.C. Dep't of Revenue*, 399 S.C. 313, 321, 731 S.E.2d 869, 873 (2012).

On questions of fact, the Court may not substitute its judgment for the judgment of the ALC's with regard to the weight of the evidence. *See* S.C. Code Ann. § 1-23-610(B). However, the Court must determine that the ALC's decisions are supported by substantial evidence. *See Original Blue Ribbon*, 380 S.C. at 605, 670 S.E.2d at 676. Substantial evidence is more than a scintilla of evidence and can only be found when reasonable minds would reach the same conclusion as the ALC based on the record as a whole. *See id*.

ARGUMENT

I. U.S. Bank Properly Sourced its Income to South Carolina

When a taxpayer conducts business partly within and partly without South Carolina, the taxpayer is generally required to apportion its net income to the State using a formula. *See* S.C. Code Ann. § 12-6-2210(B). The net income of a Bank Tax taxpayer must be apportioned to South Carolina using the following formula:

$$\frac{\text{Gross Receipts from Within South Carolina}}{\text{Total Gross Receipts Everywhere}}$$

S.C. Code Ann. § 12-6-2290. Under South Carolina law, gross receipts include, but are not limited to, the following items:

> (1) Receipts from the sale or rental of property maintained for sale or rental to customers in the ordinary course of the taxpayer's trade or business including inventory; **["Property Sourcing Statute"]**
>
> (2) Receipts from the sale of accounts receivable…;
>
> (3) Receipts from the use of intangible property in [South Carolina] including, but not limited to, royalties from patents, copyrights, trademarks, and trade names; **["Intangible Sourcing Statute"]**

(4) Net gain from the sale of property used in a trade or business. For purposes of this subsection, property used in the trade or business means property subject to the allowance for depreciation, real property used in the trade or business, and intangible property used in the trade or business which is:

(a) not property of a kind that properly would be includable in inventory of the business if on hand at the close of the taxable year; or

(b) held by the business primarily for sale to customers in the ordinary course of the trade or business;

["Net Gain Sourcing Statute"]

(5) Receipts from services if the entire income-producing activity is within [South Carolina]. If the income-producing activity is performed partly within and partly without [the State], sales are attributable to [South Carolina] to the extent the income-producing activity is performed within [the State].

["Service Sourcing Statute"]

S.C. Code Ann. § 12-6-2295(A). Many of the terms in the apportionment provisions are undefined, including "services" and "intangible property." *Id.* Proper interpretation of these terms – and proper application of the apportionment provisions to U.S. Bank's various income streams – is at the heart of this case.

The apportionment provisions require that each category of receipts earned by U.S. Bank be analyzed to determine its correct sourcing. *Id.* Ignoring this requirement, the ALC incorrectly determined that "mortgages must be classified as intangible property," and, as such, all categories of U.S. Bank's mortgage receipts must be lumped together as receipts from intangibles. R. p. 53. A similar lump determination was made for credit cards when the ALC incorrectly found that "[i]n extending credit to cardholders… U.S. Bank is creating accounts receivables that fall into the definition of intangible property." R. p. 63.

Where the Court finds ambiguity in the apportionment provisions, that ambiguity must be resolved in U.S. Bank's favor because Section 12-6-2295(A) is a tax imposition statute. *See*

Alltel, 399 S.C. at 318, 731 S.E.2d at 872 ("any substantial doubt in the application of a tax statute must be resolved in favor of the taxpayer").

II. U.S. Bank Properly Sourced its Income Related to Mortgage Servicing and Interchange Fees Under the Service Sourcing Statute

A. U.S. Bank's Mortgage Servicing and Interchange Fees Are Related to Services

The Service Sourcing Statute provides that receipts from services are sourced to South Carolina to the extent the income-producing activities occurred in the State. *See* S.C. Code Ann. § 12-6-2295(A)(5). U.S. Bank earns mortgage servicing fees by providing services to its customers – the GSEs. R. p. 342, line 24-p. 344, line 24; p. 379, line 23 – p. 380, line 1; p. 490, lines 4-22. U.S. Bank earns interchange fees by providing services to merchants. R. p. 379, lines 14-23; p. 408, lines 1-9. Thus, U.S. Bank sourced these fees in accordance with the Service Sourcing Statute.

To earn mortgage service fees, U.S. Bank performs services in Kentucky, including processing monthly payments, facilitating the payment of taxes and insurance and managing any necessary collections activities for the GSEs. R. p. 343, line 1-p. 344, line 24. To earn interchange fees, U.S. Bank performs the services of routing, processing and funding payments for each transaction. R. p. 376, line 19-p. 378, line 12; p. 406, line 3-p. 407, line 20.

Accordingly, U.S. Bank properly treated its receipts from its mortgage servicing and interchange fees as receipts from services, sourced to South Carolina to the extent U.S. Bank's income-producing activities occurred in the State. *See* S.C. Code Ann. § 12-6-2295(A)(5). Judge Kimpson agreed that U.S. Bank's interchange fee income is from the provision of services. R. p. 64.

i. The ALC Incorrectly Determined That U.S. Bank's Mortgage Service Fees Are From Intangibles

Judge Kimpson incorrectly determined that U.S. Bank's mortgage service fees are from intangibles. R. pp. 52-60. Under the Intangible Sourcing Statute, receipts from intangible property are only sourced to South Carolina if "from the use" of the intangible in the State. S.C. Code Ann. § 12-6-2295(A)(3). The ALC incorrectly determined that U.S. Bank's receipts from mortgage servicing are from intangibles that must be sourced under the Intangible Sourcing Statute. R. pp. 54, 81. The ALC's determination misinterprets South Carolina law and ignores the facts.

Specifically, Judge Kimpson incorrectly determined that U.S. Bank's "mortgages must be classified as intangible property" because of the general definition of intangible property provided in the definitions section of the Income Tax law. R. p. 53 (citing S.C. Code Ann. § 12-6-30 (defining "intangible property" as "all property other than tangible property")). However, Judge Kimpson's reliance on this definition is misplaced because South Carolina's apportionment law does not lump all receipts into one category. *See* S.C. Code Ann. § 12-6-2295(A).

Where a word is undefined in a statute, the Court should look to "the usual dictionary meaning to supply its meaning." *See Jack's Custom Cycles*, 439 S.C. at 43, 885 S.E.2d at 437 (internal citation omitted). Looking to the usual dictionary meanings of these terms, a service includes "useful labor that does not produce a tangible commodity." Merriam-Webster Dictionary, Service, *available at* https://www.merriam-webster.com/dictionary/service (last visited Feb. 5, 2025). By contrast, an intangible is "an asset (such as goodwill) that is not corporeal." Merriam-Webster Dictionary, Intangible, *available at* https://www.merriamwebster.com/dictionary/intangible (last visited Feb. 5, 2025).

The activities U.S. Bank performs to earn mortgage servicing fees do not involve the production of tangible commodities – fitting the definition of a service. U.S. Bank's activities also do not result in income from an asset akin to goodwill – not fitting the definition of an intangible. Thus, applying the usual meanings of the terms, U.S. Bank's mortgage servicing activities are related to services – not from intangibles.

The treatment of U.S. Bank's mortgage service activities as services rather than intangibles is also consistent with the Intangible Sourcing Statute, which provides guidance as to the interpretation of the term "intangible property" in the context of apportionment. *See* S.C. Code Ann. § 12-6-2295(A)(3). Specifically, it provides that intangible property includes "royalties from patents, copyrights, trademarks, and trade names." *Id*. These intangible property examples are consistent with the dictionary definition of the term intangible and provide further support for U.S. Bank's treatment of its activities that result in the income from its mortgage service fee income as from the provision of services.

In reviewing the examples provided by the Intangible Sourcing Statute, Judge Kimpson acknowledged that "the nature of the 'intangible property' specifically identified in [the Intangible Sourcing Statute]… seemingly contrasts with the nature of mortgages[.]" R. p. 56. Despite this acknowledgment, Judge Kimpson determined that intangible property can include receipts from mortgages because the examples provided are "non-exhaustive." *Id*.

Judge Kimpson's conclusion fails to give effect to the plain language of the statute, which provides examples of the types of receipts that should be treated as being from intangible property for sourcing purposes. While the Intangible Sourcing Statute is not limited to royalties, its examples provide context for the type of income to be addressed and suggest an intention to limit the type of property classified as intangibles. *See German Evangelical Lutheran Church of*

Charleston v. City of Charleston, 352 S.C. 600, 607, 576 S.E.2d 150, 153 (2003) (finding that "[e]xceptions strengthen the force of the general law and enumeration weakens it as to things not expressed"). Using Judge Kimpson's definition, any contract for the sale of tangible personal property would result in being treated as receipts from an intangible.

Moreover, Judge Kimpson's conclusion effectively resolves ambiguity in the term "intangible property" in favor of the Department, despite the clear mandate that any ambiguity be construed in U.S. Bank's favor.[4] *See Alltel*, 399 S.C. at 321, 731 S.E.2d at 872-873 (internal citation omitted).

Further, Judge Kimpson incorrectly determined that U.S. Bank's receipts from mortgage servicing fees are from intangibles that must be sourced to South Carolina to the extent the mortgage is used in the State. R. p. 54. However, to earn mortgage service fees, U.S. Bank provides services to third parties, it does not use an intangible. R. p. 343, lines 16-19; p. 344, lines 4-24; p. 345, lines 12-13. This was substantiated through the testimony of Frederick Bolstad, retail lending executive for mortgages with U.S. Bank. *Id*. (testifying that U.S. Bank earns mortgage servicing fees from the GSEs "for the servicing on their behalf"… including facilitating "payment every month, answering questions… collection activities [and] foreclosure activities").

In his Reconsideration Order, Judge Reibold upheld Judge Kimpson's determination despite finding that U.S. Bank continues to service the mortgages that it sells to the GSEs,

[4] In misclassifying U.S. Bank's mortgage related receipts as from intangibles, Judge Kimpson also misrelied on the Estate Tax law's definition of intangible personal property, which includes the term mortgages. R. p. 53. The Estate Tax law's definitions section expressly limits its application and provides that "[a]s used in this chapter" such definitions apply "unless the context clearly shows otherwise." S.C. Code Ann. § 12-16-20. The Estate Tax is in a different chapter than the Income Tax and involves a tax unrelated to the tax at issue. Thus, the context of this case demands that the ordinary definitions of the terms at issue apply.

pursuant to separate contracts for services and, as such, mortgage servicing fees "earned after a mortgage is sold are therefore a product of a service provided by U.S. Bank to the purchaser of the mortgage." R. p. 81. Judge Reibold's upholding of Judge Kimpson's incorrect conclusion undermines his own factual findings and the specific sourcing provision provided by the plain language of the law. *See* S.C. Code Ann. § 12-6-2295(A)(5). U.S. Bank earns mortgage servicing fees from the GSEs *after* it sells the mortgages to the GSEs. R. p. 343, lines 1-8. These fees are earned pursuant to agreements with the GSEs. R. p. 342, lines 13-20; p. 343, lines 3-8. Judge Reibold concluded that such fees earned after the sale of the mortgages are from services. R. p. 81. Thus, these fees must be sourced pursuant to the Service Sourcing Statute.

The evidence presented in this case shows that the ALC erred in treating U.S. Bank's mortgage fee income as from intangibles rather than from services.

B. U.S. Bank's Income-Producing Activities Occur Outside of South Carolina

As required under the Service Sourcing Statute, U.S. Bank determined its income-producing activities that generate its receipts from mortgage services and interchange fees, and the extent to which they occurred in the State. *See* S.C. Code Ann. § 12-6-2295(A)(5).

For mortgage servicing fees, U.S. Bank's income-producing activities are the services that it performs in Kentucky – including processing monthly payments, facilitating the payment of taxes and insurance and managing any necessary collections activities. R. p. 344, lines 6-24. For interchange fees, U.S. Bank's income-producing activities include the routing, processing and funding of transactions. R. p. 380, line 19-p. 381, line 3; p. 382, line 25-p. 383, line 7; p. 406, line 2-p. 408, line 20; p. 410, lines 5-13; p. 513, line 3-p. 515, line 8. These activities are not "in anticipation" of future profits. Rather, the activities described actually produce U.S. Bank's mortgage servicing and interchange fee income.

To substantiate its mortgage service fee income-producing activities, and the extent to which these activities occur in the State, U.S. Bank did not rely on proxies. *See DIRECTV, Inc. v. S.C. Dep't of Revenue*, 421 S.C. 59, 80, 804 S.E.2d 633, 644 (Ct. App. 2017). Instead, U.S. Bank provided the testimony of Mr. Bolstad, who explained in detail U.S. Bank's mortgage servicing fee income-producing activities, which occurred outside of South Carolina. R. p. 343, line 1-p. 345, line 13. In addition, U.S. Bank presented the testimony of Dr. Brian J. Cody, who was accepted as an expert in economics. R. p. 485, line 25-p. 486, line 5.

Dr. Cody explained that none of the fee income from providing mortgage services to the GSEs can be reasonably attributed to South Carolina because all of the activities performed by U.S. Bank occurred outside of the State and none of the GSEs were located in South Carolina. R. p. 503, line 15-p. 505, line 5. Thus, U.S. Bank properly sourced its mortgage servicing fees outside of the State.

The testimonies of Alexander Wylie, the head of card issuing risk management within the payment services division of U.S. Bank, John Owens, manager of U.S. Bank's partner credit card group, and Dr. Cody substantiated that U.S. Bank's interchange fee income-producing activities occurred outside the State. R. p. 380, line 19-p. 381, line 3; p. 382, line 25-p. 383, line 7; p. 406, line 2-p. 408, line 20; p. 410, lines 5-13; p. 513, line 3-p. 515, line 8. Moreover, each testified that if U.S. Bank did not perform the aforementioned activities, it would not earn interchange fee income. *Id.*

The substantial evidence presented by U.S. Bank established the income-producing activities that produce its mortgage servicing and interchange fee income and the extent to which these activities occurred in the State. Disregarding this evidence, the ALC incorrectly determined U.S. Bank's mortgage and interchange fee income-producing activities.

i. The ALC Erred in Finding That U.S. Bank's Interchange Fee Income-Producing Activities Are Based on the Merchant's Location

Judge Kimpson incorrectly found that the only income-producing activity that results in the interchange fee income is "U.S. Bank's delivery of the credit card approval/disapproval decision to the merchant location so that the merchant may either complete or terminate the sales transaction." R. p. 64. As a result, Judge Kimpson found that when the merchants are in South Carolina, the "primary" income-producing activity is in the State. *Id*.

Contrary to Judge Kimpson's conclusion, U.S. Bank does not send approval/disapproval decisions to the merchant's location. Rather, the decision is sent to the merchant processor – none of which are located in South Carolina. R. p. 376, line 19-p. 377, line 9; p. 406, lines 12-16; p. 513, lines 6-24. Moreover, the merchant is primarily paying to get funds from the transaction. R. p. 380, line 19-p. 381, line 3; p. 408, lines 2-20. If U.S. Bank approves the transaction, but it is never funded, then the merchant would pay no interchange fee. R. p. 408, lines 2-20. Thus, Judge Kimpson's conclusion is premised on a fundamental misunderstanding of the facts and of the activities that produce U.S. Bank's income. Furthermore, South Carolina law is clear that to source receipts from services, the income-producing activity *of the taxpayer* must be identified. *See* S.C. Code Ann. § 12-6-2295(A)(5). Judge Kimpson's determination ignores this mandate, solely looking to the merchant's activity.

Judge Kimpson also improperly disregarded the testimonies of Mr. Wylie and Mr. Owens, who each testified that U.S. Bank performs several income-producing activities that actually produce its interchange income. R. p. 380, line 19-p. 381, line 3; p. 406, line 2-p. 408, line 20. Both of these witnesses explained that none of the income-producing activities, including the actual approval/disapproval decision by U.S. Bank and transaction funding, occur in South Carolina. R. p. 382, line 25-p. 383, line 7; p. 410, lines 5-13.

Further disregarding the substantial evidence presented by U.S. Bank concerning its interchange fee income-producing activities, Judge Reibold chose "to draw the line between non-income-producing activities and income-producing activities based upon whether or not an activity can be performed without generating income." R. p. 89. Judge Reibold determined that the income-producing activities identified by U.S. Bank "can be performed without generating income," and thus, are not income-producing activities. *Id.*

Judge Reibold's new "test" for identifying income-producing activities finds no support in South Carolina law. Using the example relied upon by Judge Reibold, if a cardholder initiates a transaction at a merchant, and the transaction is approved but the credit card receipt goes unsigned, that particular transaction *may* result in non-funding of the transaction and thus, no interchange fee income being earned by U.S. Bank because of an interceding action by the cardholder. However, this interceding action is not an activity of U.S. Bank or even of the merchant. Thus, U.S. Bank's income-producing activities (*i.e.*, the routing, processing and funding of transactions) are still the income-producing activities.

Even applying this new "test" to Judge Kimpson's conclusion that "U.S. Bank's delivery of the credit card approval/disapproval decision" is its income-producing activity would cause Judge Kimpson's determination to fail because in all instances where a disapproval decision is delivered by U.S. Bank, no income would be generated.

Under the plain language of the statute, U.S. Bank properly identified its interchange fee income-producing activities. Moreover, the testimony presented substantiates that none of these activities occur in the State. Thus, U.S. Bank properly sourced its interchange fee income to outside of South Carolina.

ii. The ALC Erred in Determining That U.S. Bank's Only Mortgage Service Fee Income-Producing Activity is Loaning Money to a Borrower

Judge Kimpson rejected U.S. Bank's sourcing of its fees from mortgage services, finding that even if U.S. Bank's mortgage fee income is from services, U.S. Bank's primary income-producing activity is "loaning money to the borrower and that occurs where that borrower who received the loan is located." R. p. 60. Judge Kimpson's determination fails for many reasons.

First, Judge Kimpson's conclusion ignores the income-producing activities actually performed by U.S. Bank to produce the mortgage service income – *i.e.*, the processing of monthly payments, facilitating of the payment of taxes and managing any necessary collections activities. R. pp. 42-43; p. 344, lines 6-24. The third parties that own the mortgages pay U.S. Bank fees for these services. R. p. 343, lines 20-22. Contrary to Judge Kimpson's conclusion, U.S. Bank's loaning of money is not its income-producing activity. If anything, it is anticipatory.

In *DIRECTV*, this Court concluded that activities performed "in anticipation" of future profits are not income-producing for purposes of the Service Sourcing Statute. *DIRECTV*, 421 S.C. at 77-78, 804 S.E.2d at 643. As a result, DIRECTV's marketing, sales and content development activities were not income-producing because they were performed "'in anticipation'" of customers signing up for DIRECTV's services. *Id.* Likewise, U.S. Bank's loaning of money does not actually produce its income from its mortgage services. Rather, U.S. Bank earns mortgage service fees from those parties in exchange for performing the aforementioned services.

Second, Judge Kimpson ignored the unrefuted fact that U.S. Bank's mortgage service fee income-producing activities actually occurred outside of South Carolina as established by the testimonies of both Mr. Bolstad and Dr. Cody. R. p. 344, lines 4-24; p. 503, line 15-p. 505, line

5. Disregarding this testimony, Judge Kimpson improperly focused on the borrowers and their locations. *See* S.C. Code Ann. § 12-6-2295(A)(5).

Finally, neither the Service Sourcing Statute nor *DIRECTV* establish that only one income-producing activity per income stream may exist. *See id.*; *see also DIRECTV*, 421 S.C. at 78, 804 S.E.2d at 643. Rather, in *DIRECTV*, this Court analyzed DIRECTV's activities, which included developing television content, broadcast operations, marketing, and customer care, to determine which activities were income-producing under the Service Sourcing Statute. *See DIRECTV*, 421 S.C. at 63-65, 804 S.E.2d at 635-636. This Court found that the delivery of the signal to set-top boxes was the company's *primary*, not only, income-producing activity because the activity actually generated income for DIRECTV. *See id.*, 421 S.C. at 78, 804 S.E.2d at 643.

In his Reconsideration Order, Judge Reibold correctly determined that Mr. Bolstad's testimony established that to earn mortgage service fees from the GSEs, U.S. Bank's income-producing activities include facilitating monthly payments, answering borrowers questions, ensuring proper escrow amounts are held, paying taxes and mortgage insurance where applicable and managing collections and foreclosure activities. R. p. 82. However, Judge Reibold's ultimate conclusion – that U.S. Bank's mortgage service fee income should be sourced as the use of an intangible because "each of the income activities… has a nexus with South Carolina" if the borrower is located within the State – must be disregarded. R. p. 83. Such conclusion cannot be squared with the plain language of South Carolina law. *See* S.C. Code Ann. § 12-6-2295(A).

The Service Sourcing Statute involves a clear two-step process – (1) identify the income-producing activities of the taxpayer; and (2) determine the extent to which the activities occurred in South Carolina. *Id.* at (A)(5). Under step one, Judge Reibold correctly determined U.S. Bank's income-producing activities that actually produce the mortgage service fees from

the GSEs. R. p. 82. Despite this conclusion, Judge Reibold faltered on step two by finding that the fees should be sourced to the location of the borrower. R. p. 83. This conclusion ignores the clear requirement of step two – determine the extent to which the activities identified in step one occurred in South Carolina.

Judge Reibold's conclusion to look to the location of the borrower disregards the clear mandate of *DIRECTV* to analyze the activities of the taxpayer – not the location of the customer. *See DIRECTV*, 421 S.C. at 77-78, 804 S.E.2d at 642-643 (noting the "statutory policy [for the apportionment statutes] is designed to apportion to South Carolina a fraction of the taxpayer's total income *reasonably attributable* to *its* business activity in this State" (emphasis preserved and added) (internal quotations omitted)).

U.S. Bank established through substantial evidence that its mortgage service fee income-producing activities are the services that its servicing group performs in Kentucky. Accordingly, because these activities are performed outside of the State, U.S. Bank properly sourced this income to outside of South Carolina.

C. Even if U.S. Bank's Mortgage Service Fees Are From Intangibles, the ALC Erred When it Failed to Analyze Whether Such Receipts Are From the Use of Intangibles in South Carolina

Judge Kimpson improperly determined that U.S. Bank's receipts from mortgage service fees are from intangibles that must be sourced to South Carolina to the extent the borrower is located in the State. R. pp. 54-55. However, even if U.S. Bank's mortgage service fees are from intangibles, the ALC was required to analyze whether the receipts are "from the use" of intangible property in the State – not merely to rely on the location of the borrower. *See* S.C. Code Ann. § 12-6-2295(A)(3). Both Judge Kimpson and Judge Reibold disregarded the evidence presented by U.S. Bank, finding that the mortgage is "used" at the location of the real property that it secures and that the location of the borrower is a proxy for the location of the use.

R. pp. 54, 83-84. Neither provided any analysis to support this determination. R. pp. 52-55, 79-84.

The Judges' failure to conduct an analysis under the Intangible Sourcing Statute can also not be saved by relying on the Department's "longstanding administrative practice of sourcing income from loans to where the borrower is located." R. pp. 54, 84. No matter how arguably longstanding the Department's statutory construction, it is owed no deference when it contradicts the plain language of the law. *See Jack's Custom Cycles*, 439 S.C. at 48, 885 S.E.2d at 440; *see also Colonial Pipeline*, 443 S.C. 448, 905 S.E.2d at 134, *quoting Loper Bright*, 603 U.S. __, 144 S. Ct. 2244.

The foregoing demonstrates that even if U.S. Bank's receipts from mortgage fee activities are properly classified as from intangibles rather than services, the ALC failed to analyze whether the receipts are "from the use" of intangible property in the State. Without this analysis, the ALC's determination to simply source the receipts to the location of the borrower must be disregarded.

III. Receipts From U.S. Bank's Sale of Mortgages Are Sourced Under the Service Sourcing Statute

A. U.S. Bank's Income Related to the Sale of Mortgages is Income From Services

Under the Service Sourcing Statute, receipts from services are sourced to South Carolina to the extent the income-producing activities occurred in the State. S.C. Code Ann. § 12-6-2295(A)(5).

To earn income from the sale of mortgages that it sells to the GSEs, U.S. Bank performs multiple services, including working with the GSEs to price each loan and pooling the loans in either the form of mortgage-backed securities or bonds to be sold to the GSEs. R. p. 342, lines 5-23. Mr. Bolstad thoroughly explained these services and testified that U.S. Bank would not

earn income on its sale of the mortgages to the GSEs without performing these services. *Id*. Significantly, during the Years at Issue, U.S. Bank sold 95% of the mortgages that were originated in South Carolina. R. p. 341, lines 4-13.

Properly applying the Service Sourcing Statute, U.S. Bank treated the income from its sale of mortgages as receipts from services, which are only sourced to South Carolina to the extent U.S. Bank's income-producing activities occurred in the State. *See* S.C. Code Ann. § 12-6-2295(A)(5).

i. The ALC Erred in Determining That U.S. Bank's Income From its Sale of Mortgages is from Intangibles

Judge Kimpson improperly lumped together all of U.S. Bank's receipts related to mortgages – including U.S. Bank's receipts from its sale of mortgages – when he incorrectly determined that U.S. Bank's "mortgages must be classified as intangible property" sourced under the Intangible Sourcing Statute. R. pp. 53, 61. Judge Kimpson's conclusion is incorrect because South Carolina's apportionment law does not lump all receipts into one category. *See supra* discussion at 13; S.C. Code Ann. § 12-6-2295(A).

In addition, Judge Kimpson's conclusion continues to disregard the plain meaning of the terms at issue. Applying the previously discerned meaning of the terms "intangible property" and "service," the activities U.S. Bank performs to sell its mortgages do not involve the production of tangible commodities. *See supra* discussion at 13. The activities also do not result in income from an asset akin to goodwill. U.S. Bank performs several services to earn income on the sale of its mortgages to the GSEs. R. p. 342, lines 5-23. It follows that the sale of mortgages to the GSEs fits the definition of the provision of services, not intangibles.

Based on the above, the ALC erred when it determined that U.S. Bank's income from the sale of the mortgages to the GSEs is from intangibles rather than from services. U.S. Bank

established that this income is from services, which are only sourced to the State to the extent U.S. Bank's income-producing activities occurred in South Carolina.

B. U.S. Bank's Income-Producing Activities Occur Outside of South Carolina

In accordance with the Service Sourcing Statute, U.S. Bank properly determined that its income-producing activities related to its sale of the mortgages to the GSEs were outside of the State. *See* S.C. Code Ann. § 12-6-2295(A)(5). U.S. Bank's income-producing activities are the pooling and sale of the loans. R. p. 342, lines 7-20. These activities occur entirely outside of South Carolina. R. p. 338, lines 1-10; p. 489, lines 14-20. Further, these activities are not "in anticipation" of future profits – rather, they are the activities that U.S. Bank performs that actually produce the income. R. p. 342, lines 21-23.

Importantly, U.S. Bank did not rely on proxies to determine the extent to which these activities occurred in the State. *See DIRECTV*, 421 S.C. at 80, 804 S.E.2d at 644. Rather, Mr. Bolstad's testimony established that the income-producing activities related to the sale of the mortgages occur entirely outside of South Carolina. R. p. 338, lines 1-10. Thus, U.S. Bank properly sourced its income from the sale of mortgages to the GSEs outside of the State. R. p. 489, line 14-p. 490, line 3.

Relying on the determination that mortgages are intangibles, both Judge Kimpson and Judge Reibold overlooked Mr. Bolstad's testimony and failed to analyze U.S. Bank's income-producing activities that result in the income from the sale of the mortgages to the GSEs. However, because U.S. Bank provided substantial evidence regarding the income-producing activities that produced this income, and the extent to which those activities occurred in the State, U.S. Bank established that it properly sourced this income to outside of South Carolina.

C. Even if U.S. Bank's Income Related to its Sale of Mortgages is Not a Service, the Income is Not Sourced to South Carolina

Disregarding the plain meaning of the law and resting on his incorrect determination that a mortgage is an intangible, Judge Kimpson held that U.S. Bank's receipts from the sale of mortgages to the GSEs should be sourced pursuant to the Net Gain Sourcing Statute. R. p. 61. Under this provision, gross receipts include net gain from the sale of intangible property used in a trade or business. *See* S.C. Code Ann. § 12-6-2295(A)(4). Applying this provision, Judge Kimpson found that U.S. Bank's gain from its sale of mortgages to the GSEs must be sourced to the State because "U.S. Bank's South Carolina mortgages are tied to real estate in South Carolina." R. p. 61. Judge Kimpson's application of South Carolina law cannot be sustained.

Judge Kimpson's conclusion ignores the Property Sourcing Statute, which provides that South Carolina gross receipts include receipts from the sale of property maintained for sale in the ordinary course of the taxpayer's trade or business. *See* S.C. Code Ann. § 12-6-2295(A)(1). This provision does not differentiate between types of property – real, tangible or intangible. *See id*. Moreover, such receipts are sourced to the location of the customer purchasing the property, not to the location of the underlying borrower. *See id.*; R. p. 1094. As acknowledged by Judge Kimpson, all of the GSEs purchasing the mortgages are "located outside of South Carolina." R. p. 60.

Under Judge Kimpson's interpretation, net gain from the sale of all intangible property used in a trade or business must be sourced under the Net Gain Sourcing Statute. This interpretation renders the Property Sourcing Statute superfluous. *See Mead v. Beaufort Cnty. Assessor*, 419 S.C. 125, 135, 796 S.E.2d 165, 170 (Ct. App. 2016) (internal citations omitted) (noting that a statute should be read so that "'no word, clause, sentence, provision or part'" is "rendered surplusage, or superfluous"). To avoid this fatal error and to give separate value to

both sourcing provisions, the Property Sourcing Statute should be read as controlling how receipts from property are generally sourced. By contrast, the Net Gain Sourcing Statute should control the sourcing of net gain from intangible property used in a trade or business which is not held by the business primarily for sale in its ordinary course. The record here demonstrates that U.S. Bank did not use the mortgages, and therefore, its receipts related to the sale of the mortgages should be sourced pursuant to the Property Sourcing Statute.

Given that U.S. Bank sold 95% of its mortgages to the GSEs during the Years at Issue, U.S. Bank's sale of mortgages was done in the ordinary course of U.S. Bank's business. R. p. 341, lines 2-13. Thus, U.S. Bank's gain from the sale of the mortgages would only be sourced to the State if the customer purchasing the mortgage was located there. *See* S.C. Code Ann. § 12-6-2295(A)(1). The mortgages for South Carolina borrowers were sold to the GSEs, all of which are located outside of South Carolina. R. p. 60. Accordingly, these receipts are sourced outside of the State.

In his Reconsideration Order, Judge Reibold failed to analyze the application of the Property Sourcing Statute based on Judge Kimpson's conclusion that this code section "was not applicable because" the Net Gain Sourcing Statute "dealt more specifically with intangible property." R. p. 84. Judge Kimpson made no such conclusion – rather, Judge Kimpson failed to conduct any sourcing analysis under the Property Sourcing Statute. R. pp. 60-61.

Under the plain meaning of the law, U.S. Bank properly sourced its income from its sale of mortgages to the GSEs under the Service Sourcing Statute. *See* S.C. Code Ann. § 12-6-2295(A)(5). However, even if the Court finds that this income was properly classified as receipts from intangibles, such receipts should be sourced to the location of the purchasers

pursuant to the Property Sourcing Statute. *See* S.C. Code Ann. § 12-6-2295(A)(1). As none of the GSEs are in South Carolina, these receipts are not sourced to the State.

IV. U.S. Bank's Interest and Credit Card Fee Income is Properly Sourced Under the Service Sourcing Statute

A. U.S. Bank's Interest and Credit Card Fee Income is Related to the Provision of Services

The Service Sourcing Statute makes clear that receipts related to the provision of services are sourced to South Carolina to the extent the income-producing activities occurred within the State. S*ee* S.C. Code Ann. § 12-6-2295(A)(5). To earn mortgage interest income, U.S. Bank lends funds and performs ongoing financial services for its mortgage loans. R. p. 347, lines 5-17. These financial services include providing ongoing support to the borrower and adjusting payment allocations to account for changes in state tax rates. R. p. 344, lines 4-24; p. 345, line 25-p. 347, line 17; p. 496, line 3-p. 497, line 7.

To earn interest income on the credit cards that it issues to individuals and small business cardholders, U.S. Bank performs a number of financial services, including determining the credit worthiness of the cardholders and allowing them to make a purchase at a point of sale without using funds from their checking account. R. p. 380, lines 4-14. The interest income earned is the difference between the annual percentage rate charged and the cost of lending the funds to the customer. R. p. 379, lines 17-20.

With regard to credit card fees, U.S. Bank performs specific services for each fee type. For late fees, U.S. Bank's services include engaging in communication with the customers and other collections actions in order to assess delinquent customers. R. p. 381, lines 9-21. To earn annual fees, U.S. Bank operates rewards programs. R. p. 382, lines 1-13. Finally, U.S. Bank earns balance transfer fees in exchange for the service of transferring balances and for taking on the risk of the additional account balances. R. p. 382, lines 15-23.

Based on this uncontroverted evidence, U.S. Bank properly treated its interest and credit card fee income receipts as from the provision of services, sourced to South Carolina to the extent its income-producing activities occurred in the State. S*ee* S.C. Code Ann. § 12-6-2295(A)(5).

i. The ALC Misclassified U.S. Bank's Credit Card Fees as From Intangibles

Judge Kimpson incorrectly determined that U.S. Bank's credit card fees, as accounts receivables, are from the use of intangibles. R. p. 63. In reaching this determination, Judge Kimpson relied on the Black's Law Dictionary definition of "accounts receivable" as "a debt, owed to an enterprise, that arises in the normal course of business dealings and is not support [sic] by negotiable paper." *Id.* While it is appropriate to rely on the usual meaning of terms where they are undefined in a statute, Judge Kimpson's reliance on the definition of "accounts receivable" is misplaced for several reasons. *See Jack's Custom Cycles,* 439 S.C. at 43, 885 S.E.2d at 437 (internal citation omitted).

First, U.S. Bank earns credit card fees in exchange for services. R. p. 381, line 7-p. 382, line 24. This was substantiated through the testimony of Mr. Owens. *Id.* Moreover, there was previously no dispute between the parties with regard to the treatment of credit card receipts for sourcing purposes because the Department treated the receipts as from the provision of services. R. pp. 1160-1168. Judge Kimpson's sua sponte determination fails to address these uncontroverted facts.

Second, the broad definition of "accounts receivable" relied upon by Judge Kimpson could encompass any debts arising from U.S. Bank's dealings in the normal course of its business. Thus, this definition provides no clarity for the issues before the Court. Instead, the usual meaning of the terms "services" and "intangibles" should be relied upon. *See supra*

discussion at 13. Applying the usual meanings of these terms, U.S. Bank's credit card fees are from the provision of services, not from the use of intangibles.

Third, Judge Kimpson's reliance on the "accounts receivable" definition commits the fatal error of interpreting the language of a statute to lead to an absurd result. *See Kiriakides v. UA Commc'ns*, 312 S.C. 271, 275, 440 S.E.2d 364, 366 (1994). By applying the "accounts receivable" definition to classify intangibles for purposes of the Intangible Sourcing Statute, not only would U.S. Bank's credit card fees be classified as from intangibles, but so would all accounts receivables on the books of any business, such as payment due for the sale of tangible personal property. In addition, such a broad interpretation would render the Service Sourcing Statute superfluous, because any service business which "lends" its services for payment at a later date would be forced to classify the resulting accounts receivables as intangible property. *See Mead*, 419 S.C. at 135, 796 S.E.2d at 170 (internal citations omitted).

In his Reconsideration Order, Judge Reibold reviewed various definitions of the term "service" and the case law of other jurisdictions to uphold Judge Kimpson's classification of U.S. Bank's credit card fees as from intangibles. R. pp. 85-86. However, Judge Reibold's reliance on the case law from other jurisdictions is misplaced because the cases relied upon do

not involve laws substantially similar to the law at issue in this case.[5] *See Amazon Servs., LLC v. S.C. Dep't of Revenue*, 442 S.C. 313, 335, 898 S.E.2d 194, 205 (Ct. App. 2024).

Judge Reibold's conclusion that "the provision of a mere open line of credit" does not "fit within the common and ordinary meaning of the word service" also ignores the usual meaning of the term and the actual services that U.S. Bank provides to earn the credit card fees. R. p. 86. The provision of these services was substantiated by Mr. Owens, who testified that the services U.S. Bank performs include the making of credit decisions and allowing a customer to purchase at a point of sale without using their checking account funds. R. p. 378, line 1-p. 380, line 14; p. 381, line 7-p. 382, line 24.

In his Reconsideration Order, Judge Reibold opined that "to the extent that U.S. Bank generated receipts from services… to South Carolina credit card holders over and above the extension of credit… receipts from these services could potentially be sourced [under the Service Sourcing Statute]. Such services could for example include travel planning and ticket brokering." R. p. 87. However, Judge Reibold found that U.S. Bank provided no evidence of such services. *Id.* Judge Reibold's finding ignores the extensive record in this case including the

[5] Judge Reibold's reliance on the Minnesota Supreme Court's decision in *Boubelik v. Liberty State Bank* is misplaced because the case did not involve a law substantially similar to the one at issue in the case *and* because the case was superseded shortly after its publication by a change in the applicable law. R. p. 86; *see Boubelik*, 553 N.W.2d 393 (Minn. 1996), *superseded by* Act of May 16, 1997, ch. 157, § 60, 1997 Minn. Laws 965, 996. The California Court of Appeals case, *Hitz v. First Interstate Bank*, referenced by Judge Reibold involved a class action suit challenging a bank's late and overlimit fees and application of California's civil code definition of credit card agreements in relation to liquidated damages. R. p. 86; *see Hitz*, 38 Cal. App. 4th 274, 44 Cal. Rptr. 2d 890 (Cal. Ct. App. 1995). While not involving law substantially similar to that at issue in this case, the California Court of Appeals did determine that a credit card agreement is much more than the extension of credit, and is the provision of convenience services including reducing the need to carry cash and allowing the consumer to defer the payment for goods and services. *See id.*, 38 Cal. App. 4th at 286, 44 Cal. Rptr. 2d at 898. Judge Reibold rejected this aspect of the *Hitz* decision. R. p. 86.

services described by Mr. Owens which are "over and above" U.S. Bank's extension of credit to its customers. R. p. 381, line 7-p. 382, line 24. If U.S. Bank did not perform the services described, it would not earn the fees at issue. *Id*.

As the foregoing demonstrates, the ALC erred in determining that U.S. Bank's credit card fee income is from intangibles rather than from services.

ii. The ALC Erred in Determining U.S. Bank's Interest Income is From Intangibles

Relying on the incorrect determination that all mortgages and credit card receipts are from the use of intangibles, the ALC determined that U.S. Bank's mortgage and credit card interest income must be sourced under the Intangible Sourcing Statute. S.C. Code Ann. § 12-6-2295(A)(3). However, these determinations must fail because they ignore the facts and result in a misapplication of South Carolina law.

First, Judge Kimpson's determinations that because mortgages are intangibles, "interest income from loans to debtors in South Carolina for use in [the] State must be sourced to South Carolina" and such sourcing is "consistent with the Department's longstanding administrative practice of sourcing income from loans to where the borrower is located" are erroneous. R. p. 54. These determinations find no support in the plain language of the law, which does not classify interest as either from a service or from an intangible. *See generally* S.C. Code Ann. §§ 12-6-30, 12-6-2220, 12-6-2295(A). Moreover, no matter how purportedly longstanding the statutory construction of the Department, it is owed no deference, especially where it contradicts the plain language of the law. *See Jack's Custom Cycles*, 439 S.C. at 48, 885 S.E.2d at 440.

Instead, just as it was necessary to discern the meaning of "services" and "intangible property" for purposes of the apportionment provisions, it is necessary to discern the usual

meaning of the relevant terms to determine how interest income should be sourced. *See id.*, 439 S.C. at 43, 885 S.E.2d at 437 (internal citation omitted).

Here, a mortgage is a type of loan. *See* Merriam-Webster Dictionary, Mortgage, *available at* https://www.merriam-webster.com/dictionary/mortgage (last visited Feb. 5, 2025). A loan is "money lent at interest." *Id.*, Loan, *available at* https://www.merriam-webster.com/dictionary/loan (last visited Feb. 5, 2025). Interest is a "charge for borrowed money generally a percentage of the amount borrowed." *Id.*, Interest, *available at* https://www.merriam-webster.com/dictionary/interest (last visited Feb. 5, 2025).

Applying these meanings, and the ordinary definitions of the terms "service" and "intangible," it becomes clear here that the interest that U.S. Bank charges for the loaning of money and the provision of its financial services is more analogous to arising from a service than from a non-corporeal asset. As explained by both Mr. Bolstad and Dr. Cody, U.S. Bank lends money to its customers. R. p. 336, lines 16-19; p. 496, line 3-p. 497, line 7. Those customers use those funds to purchase a home. R. p. 322, lines 10-13; p. 496, line 3-p. 501, line 5. In exchange for the continued use of the borrowed funds, and for U.S. Bank's ongoing mortgage services, customers pay U.S. Bank interest. R. p. 345, line 25-p. 347, line 20; p. 496, line 3-p. 501, line 5. U.S. Bank is providing ongoing services for which it is receiving payment in the form of interest.

Next, Judge Kimpson's determination that in "extending credit to cardholders… U.S. Bank is creating accounts receivables that fall into the definition of intangible property for purposes of South Carolina's [Income Tax]" is also erroneous. R. p. 63. Once again, Judge Kimpson's reliance on the definition of "accounts receivable" is misplaced. *See supra* discussion at 29-30. Moreover, this conclusion disregards the testimony of Mr. Owens, who

testified that the services U.S. Bank performs to earn credit card interest income include the making of credit decisions and allowing a customer to purchase at a point of sale without the use of funds from their checking account. R. p. 380, lines 4-14.

As the foregoing demonstrates, the ALC erred in treating U.S. Bank's mortgage and credit card interest as from intangibles rather than services. Based on the substantial evidence it presented, U.S. Bank established that its interest income is from services, which are only sourced to the State to the extent U.S. Bank's income-producing activities occurred in South Carolina.

B. U.S. Bank's Interest and Credit Card Fee Income-Producing Activities Occur Largely Outside of South Carolina

As the Service Sourcing Statute instructs, U.S. Bank determined its interest and credit card fee income-producing activities and the extent to which they occurred within the State. *See* S.C. Code Ann. § 12-6-2295(A)(5). U.S. Bank's mortgage interest income-producing activities include the lending of money and the servicing of the loans. R. p. 345, line 25-p. 347, line 17; p. 496, line 3-p. 497, line 7. To earn credit card interest income, U.S. Bank's income-producing activities include not only the extension of credit, but the servicing of the credit card loans each month. R. p. 380, lines 4-14; p. 505, line 6-p. 508, line 2. For credit card fees, U.S. Bank's income-producing activities include the extension of credit *and* the collections, rewards program and balance transfer activities. R. p. 381, line 7-p. 382, line 24. If U.S. Bank did not perform these activities, it would earn neither mortgage nor credit card interest nor credit card fee income. R. p. 345, line 25-p. 347, line 17; p. 380, lines 4-14; p. 496, line 3-p. 497, line 7; p. 505, line 6-p. 513, line 2. Thus, these activities are not anticipatory.

To substantiate these income-producing activities, Mr. Bolstad and Mr. Owens testified that U.S. Bank performs the income-producing activities largely outside of the State. R. p. 347, lines 3-23; p. 380, lines 4-18; p. 381, line 7-p. 383, line 3. In addition, Dr. Cody established that

a reasonable sourcing method for U.S. Bank's interest and credit card fee income would be to source it two-thirds to where U.S. Bank performs its related services, and one-third to the cardholder/borrower location. R. p. 500, lines 7-25; p. 505, line 6-p. 513, line 2.

Accordingly, U.S. Bank sourced its interest and credit card fee income to South Carolina by applying this reasonable sourcing methodology.

i. The ALC Improperly Rejected U.S. Bank's Sourcing of its Interest and Credit Card Fee Income

Judge Kimpson erroneously rejected U.S. Bank's interest income sourcing under the Service Sourcing Statute. Improperly narrowing *DIRECTV*, Judge Kimpson found that even if U.S. Bank's mortgage interest income is from services, the "borrower pays U.S. Bank to use or hold money [and the] debtor using the borrowed money creates U.S. Bank's income from mortgage lending." R. p. 60. However, just as Judge Kimpson's sourcing determination failed with regard to U.S. Bank's mortgage servicing fees, Judge Kimpson's mortgage interest determination must also fail. *See supra* discussion at 12-16.

Judge Kimpson's mortgage interest determination also incorrectly applies an all-or-nothing standard not found in the Service Sourcing Statute. *See* S.C. Code Ann. § 12-6-2295(A)(5). The Service Sourcing Statute is clear that receipts from services are attributable to South Carolina "*to the extent* the income-producing activity is performed within [the] State." *Id*. (emphasis added.) Judge Kimpson's application ignores this language by sourcing all mortgage interest income to the State if the borrower is located in the State.

With regard to credit card interest and fee income, Judge Kimpson improperly found that even if U.S. Bank's receipts "are treated as a service" the activities identified by U.S. Bank are anticipatory. R. p. 63. Further, Judge Kimpson determined that the only income-producing

activity is the loan itself, and for South Carolina credit cardholders "that income-producing activity occurs in South Carolina." R. p. 64.

Based on the substantial evidence it presented, U.S. Bank established its interest and fee income-producing activities and the overwhelming extent to which they occur outside of the State. Thus, U.S. Bank properly sourced its interest and credit card fee income to South Carolina only to the extent these activities reasonably occurred in the State.

C. Even if U.S. Bank's Interest Income and Credit Card Fees Are From Intangibles, the ALC's Continued Reliance on Proxies is Incorrect

Misapplying the plain language of the law, Judge Kimpson determined that U.S. Bank's receipts from interest and credit card fees are from intangibles sourced to South Carolina if the borrower/cardholder is located in the State. R. pp. 54-55, 63. Under the Intangible Sourcing Statute, receipts from intangible property are only sourced to South Carolina if "from the use" of the intangible in the State. S.C. Code Ann. § 12-6-2295(A)(3). Thus, even if U.S. Bank's interest and credit card fees are from intangibles, the Intangible Sourcing Statute clearly requires an analysis of the "use" of the intangible in the State. *Id.* Neither Judge Kimpson nor Judge Reibold performed this analysis. R. pp. 50-64, 79-88.

Instead, relying on his broad conclusions that mortgages are intangibles and credit cards create accounts receivables that are intangibles, Judge Kimpson found that U.S. Bank's interest and credit card fee income must be sourced to South Carolina when the borrower/cardholder is located in the State. R. pp. 54-55, 63. This result relies on proxies for the use of the intangibles – despite this being inconsistent with the plain language of the Intangible Sourcing Statute. S.C. Code Ann. § 12-6-2295(A)(3). Importantly, Judge Reibold acknowledged that the plain language of this statute "does not specifically mention using the location of the borrower[/cardholder] as a proxy." R. p. 87. Notwithstanding this acknowledgment, Judge

Reibold looked to the laws and administrative guidance of other jurisdictions, including Colorado, Connecticut and Indiana, to justify use of proxy locations. *Id*.

However, this case is about application of South Carolina law, not the laws of Colorado, Connecticut, Indiana or any other state. Thus, how these States have chosen to exercise their sovereign power of taxation is irrelevant here. Moreover, the tax laws relied upon by Judge Reibold do not involve statutes substantially similar to the apportionment provisions. *See Amazon Servs.*, 442 S.C. at 335, 898 S.E.2d at 205.

Likewise, the Department's allegedly "longstanding administrative practice of sourcing income from loans to where the borrower is located" cannot remedy the ALC's failure to conduct the required analysis under the Intangible Sourcing Statute. R. pp. 54, 84. No deference is owed to the Department's longstanding statutory construction when it contradicts the plain language of the law. *See Jack's Custom Cycles*, 439 S.C. at 48, 885 S.E.2d at 440; *see also Colonial Pipeline*, 443 S.C. 448, 905 S.E.2d at 134, *quoting Loper Bright*, 603 U.S. __, 144 S. Ct. 2244.

As shown, even if U.S. Bank's receipts from interest and credit card fee activities are properly classified as from intangibles rather than services, the ALC failed to analyze whether the receipts are "from the use" of intangible property in the State. With no such analysis, the ALC's determination to source this income to the location of the borrowers/cardholders by proxy must be disregarded.

V. The ALC Erred in Upholding the Substantial Understatement Penalties

The Department imposed substantial understatement penalties on U.S. Bank on the basis that the asserted deficiency for the Years at Issue is greater than 25% of the tax shown on the returns for those years. R. pp. 1160-1168. Substantial understatement penalties *must* be reduced by portions attributable to the tax treatment of an item:

(i) by the taxpayer if there is or was substantial authority for that treatment; or

(ii) with respect to which the relevant facts affecting the item's tax treatment are adequately disclosed… and there is a reasonable basis for the tax treatment of the item by the taxpayer.

See S.C. Code Ann. § 12-54-155(B)(2)(b). Substantial authority for a position may exist if supported "by a well-reasoned construction of the applicable statutory provision." Treasury Reg. 1.6662-4. Moreover, substantial understatement penalties *must not* be imposed if it is shown "that there was a reasonable cause for the [understatement] and that the taxpayer acted in good faith with respect to the [understatement]." S.C. Code Ann. § 12-54-155(D)(1).

i. The Department's Purported Long-Standing Administrative Practice is Untenable

To support its imposition of substantial understatement penalties, the Department relied on what it refers to as its "long[-]standing administrative practice" of sourcing receipts from intangibles to the borrower's location. R. pp. 1160-1168. The Department's support for this so-called "long-standing administrative practice" is two documents – both of which related to statutes not at issue here and were published before the General Assembly even enacted the apportionment provisions at issue.

The first is the 1987 stipulation of facts in *Lockwood Greene Engineers, Inc. v. S. C. Tax Comm'n*. R. pp. 1672-1681. This stipulation was not available on the Department's website and is not otherwise referred to by the Department in its sourcing guidance. R. p. 423, line 10-p. 425, line 6. Moreover, at issue in *Lockwood* was the meaning of the phrase "gross receipts from within this State," under the prior version of Section 12-6-2290. *See Lockwood*, 293 S.C. 447, 448, 361 S.E.2d 346, 347 (Ct. App. 1987). Because *Lockwood* deals with South Carolina law not at issue here, the stipulation is irrelevant to this case.

The second piece of support is South Carolina Tax Commission Information Letter #94-35 ("IL #94-35"), dated December 20, 1994. R. p. 423, line 10-p. 424, line 12. IL #94-35 provides that "[f]or returns filed for years ending before 1997, the Department will accept multistate bank tax returns which are based upon the proportion of the bank's entire net income that reasonably represents the proportion of the bank's trade or business carried on within this State in the same manner as required of those corporations subject to the corporate income tax of Chapter 7[.]" R. p. 50. The Department's reliance on IL #94-35 is misplaced because South Carolina law significantly changed after its issuance.

Moreover, in the 2005 South Carolina Corporate Income Taxes Policy, the Department states that receipts from intangible property "are assigned to the state where the income-producing activity is." R. p. 775. Further, the apportionment provisions at issue here were enacted in 2007 – 13 years after the publication of IL #94-35. *See* 2007 S.C. Acts 110, 2007 S.C. S.B. 91. Thus, the Department's so-called "long-standing policy" does not relate to the statute at issue here.

Inexplicably, despite similarly deciding that the Department's "long-standing policy about gross proceeds from the use of intangible property" did not encompass U.S. Bank's receipts from its sale of mortgages to the GSEs, the ALC upheld penalties related to such receipts. R. p. 71. These penalties continue to be upheld even after the ALC reversed course in its Reconsideration Order by finding that U.S. Bank's receipts from mortgages sold to the GSEs are in fact receipts from services, not intangibles, as originally determined. R. p. 81.

U.S. Bank should not be penalized for the Department's lack of guidance, especially where there is a change of law in the midst of the Department's "long-standing administrative practice." Moreover, this Court owes no deference to the Department's statutory constructions

or administrative practices, no matter how longstanding. *See Jack's Custom Cycles*, 439 S.C. at 48, 885 S.E.2d at 437; *see also Colonial Pipeline*, 443 S.C. 448, 905 S.E.2d at 134, *quoting Loper Bright*, 603 U.S. __, 144 S. Ct. 2244.

ii. U.S. Bank's Tax Treatment is Based on Substantial Authority and is Well-Reasoned

In upholding the substantial understatement penalties on U.S. Bank's income streams, including income from sales to the GSEs, mortgage servicing fees, mortgage interest and credit card interest and fees, the ALC disregarded U.S. Bank's well-reasoned construction of the apportionment provisions. Specifically, Judge Kimpson determined that U.S. Bank's construction of the statute cannot be well-reasoned in light of the Department's long-standing administrative practice and because he determined that these receipts are from intangibles rather than services. R. pp. 67-72. Judge Kimpson reached this conclusion despite finding that U.S. Bank acted in good faith in sourcing its income. R. p. 72.

U.S. Bank's tax treatment is based on substantial authority and is well-reasoned. To support its tax treatment, U.S. Bank presented testimony and substantial evidence showing that its receipts should be sourced in accordance with the Service Sourcing Statute and that its income-producing activities occur largely outside of South Carolina. Moreover, U.S. Bank's statutory construction of the law comports with its plain language – unlike the ALC's.

To ascertain and effectuate the intent of the legislature, U.S. Bank relied on the usual meanings of the terms in the statute. *See* S.C. Code Ann. § 12-6-2295(A); *see also DIRECTV*, 421 S.C. at 70, 804 S.E.2d at 638-639. By contrast, Judge Reibold acknowledged repeatedly that the plain language of the Intangible Sourcing Statute does not support Judge Kimpson's finding that U.S. Bank's receipts from intangibles should be sourced to the location of the borrower/cardholder. R. pp. 80, 84, 87. Thus, it is U.S. Bank whose position is based on

substantial authority – *i.e.*, the plain language of the law. Further, and as discussed in detail, U.S. Bank's treatment of its income-producing activities is consistent with this Court's approach in *DIRECTV*.

In the absence of recent, published guidance of the Department's interpretation of the apportionment provisions, because the ALC determined that U.S. Bank acted in good faith and because the ALC's interpretation of the law contradicts its plain language, the ALC's conclusions should have resulted in the full abatement of the substantial understatement penalties assessed by the Department.

CONCLUSION

For the reasons stated, U.S. Bank respectfully requests that this Court reverse the Order and Reconsideration Order. Both orders conflict with the plain language of the law at issue and ignore material facts. Thus, these decisions warrant reversal by this Court.

Respectfully submitted,

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