

THE STATE OF SOUTH CAROLINA
In The Supreme Court

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APPEAL FROM THE ADMINISTRATIVE LAW COURT
S.C. Supreme Court

Carolyn C. Matthews, Administrative Law Judge

Case No. 09-ALJ-17-0160-CC
Appellate Case No. 2012-212203

CarMax Auto Superstores West Coast, Inc. Respondent/Petitioner

v.

South Carolina Department of Revenue Petitioner/Respondent

**BRIEF OF RESPONDENT/ PETITIONER CARMAX AUTOSUPERSTORES
WEST COAST, INC. IN RESPONSE TO BRIEF OF
PETITIONER/RESPONDENT
SOUTH CAROLINA DEPARTMENT OF REVENUE**

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INTRODUCTION

Pursuant to Rule 242(i) of the South Carolina Appellate Court Rules, Respondent/Petitioner CarMax Auto Superstores West Coast, Inc. ("CarMax West") submits this Brief in response to the brief filed by the South Carolina Department of Revenue ("SCDOR"), which asked this Court to review the final decision of the Court of Appeals captioned CarMax Auto Superstores West Coast, Inc. v. South Carolina Department of Revenue, 2012 WL 832985, Op. No. 4953 (Ct. App. March 14, 2012). (Appendix ("App.") pp. 1168-1172).

COUNTER QUESTION PRESENTED FOR REVIEW

- I. Did the Court of Appeals Correctly Conclude that the Burden of Proof was on SCDOR to Show that (1) the Standard Apportionment Method Did Not Fairly Reflect the Business Activities of the Taxpayer in South Carolina and (2) SCDOR's Alternative Method Did?

- II. Is the Court of Appeals' decision in the instant case appealable in light of this Court's decisions in Charlotte-Mecklenberg Hosp. Auth. v. S.C. Dep't of Health & Env'tl Ctrl., 387 S.C. 365, 692 S.E.2d 894 (2013) and Bone v. U.S. Food Serv., 404 S.C. 67, 744 S.E.2d 552 (2013)?

COUNTER STATEMENT OF THE CASE

PROCEDURAL HISTORY

A. CarMax West's Protest of SCDOR Assessment

This case involves a protest by CarMax West of an assessment of corporate income taxes and penalties imposed by SCDOR for the income tax years ending in 2002-2007. In the tax returns at issue, CarMax West filed using the standard statutory apportionment method for multi-state taxpayers. Specifically, CarMax West followed the tax return instructions and the guidance in the returns themselves, which dictate that the starting point for determining taxable income is a taxpayer's federal taxable income.

App. p. 85, lines 20-25; p. 89, lines 4-9; p. 90, lines 14-25; and p. 91, lines 16-21.¹

CarMax West then made the following statutorily dictated calculation to determine the amount of taxes due to South Carolina:

$$\begin{array}{r} \text{Federal taxable income} \\ +/ - \text{ South Carolina adjustments } \\ \text{Apportionable net income} \\ \times \text{ Apportionment formula (South Carolina receipts/total receipts) } \\ \text{South Carolina taxable income} \\ \times \text{ South Carolina tax rate } \\ \text{Income tax due to South Carolina} \end{array}$$

See S.C. Code Ann. §12-6-2290 (Supp. 2007).

SCDOR rejected CarMax West's use of the standard statutory method claiming that it did not fairly reflect CarMax West's activity in this State and instead applied an alternative method. App. p. 96, lines 4-9. This alternative method does not use federal taxable income as a starting point (see App. pp. 477-485, SCDOR Report of Field Audit), but rather separates and taxes only CarMax West's royalty receipts and thus is an attempt at separate accounting. App. p. 96, lines 4-9 and p. 96, line 20 - p. 97, line 10.

CarMax West then filed a request for contested case hearing with the Administrative Law Court ("ALC") and asserted several claims regarding the corporate income taxes assessed by SCDOR. The relevant claim for purposes of this brief is CarMax West's claim that the standard statutory apportionment method was the appropriate method as it fairly reflected CarMax West's activity in this State and SCDOR's alternative method did not.

¹ See also App. p. 549, Sample SCDOR Corporate Tax Return Instructions (Basis of Return section) and pp. 503-543, CarMax West Amended Tax Returns 2002-2007 (page 1, line 1 of each return).

B. The ALC's Decision

On April 22, 2010, the ALC upheld SCDOR's application of an alternative apportionment method. See App. pp. 4–21, Order. In its ruling, the ALC held, despite universal authority to the contrary, that the burden of proof was on CarMax West to prove that the standard apportionment method reasonably reflected its business activities in this State and that the method chosen by SCDOR did not. The ALC upheld SCDOR's imposition of a separate accounting method based on its finding that CarMax West failed to meet this burden. Id. at 10-15.

C. The Appeal of the ALC's Decision

CarMax West appealed the ALC's decision to the Court of Appeals and argued, *inter alia*, that the ALC should not have placed the burden of proof on CarMax West but instead should have placed the burden of proof on SCDOR, as the proponent of an alternate method, to show that the standard apportionment method did not reasonably reflect CarMax West's business activities in this State and that the method chosen by SCDOR did. The Court of Appeals agreed with CarMax West and held that the ALC should have placed the burden of proof on SCDOR. See CarMax Auto Superstores West Coast, Inc. v. South Carolina Department of Revenue, 2012 WL 832985, Op. No. 4953, *5 (S.C. Ct. App. March 14, 2012), App. p. 1172. Accordingly, it reversed the ALC and remanded the case to the ALC for reconsideration in light of its holding as to the proper party to bear the burden of proof. Id.

D. Petitions for Writ of Certiorari to this Court

CarMax West and SCDOR then each filed a petition for writ of certiorari to this Court on June 6, 2012. App. pp. 1254-1277 and 1278-1294.² In SCDOR's petition, it did not continue to assert, as it did before the ALC and the Court of Appeals, that the burden of proof should be on CarMax West, but instead it *agreed* that SCDOR should bear the burden of proof. See SCDOR's Brief at pp. 9-10. However, SCDOR found fault with a statement by the Court of Appeals that "based on Media General, the Department, as the proponent of an alternative apportionment method, must establish that its alternative method is not only appropriate, but more appropriate than any competing methods." Id. at pp. 6-7. SCDOR sought a writ of certiorari to have this Court review that issue, among others.

On August 29, 2013, this Court granted in part and denied in part both parties' Petitions. As to SCDOR's petition, the Court granted certiorari as to the following questions:

- I. Did the Court of Appeals err by ignoring the plain language of S.C. Code Ann. § 12-6-2320 (Supp. 2009) by finding that the Department of Revenue (Department or Petitioner) has the burden of proof to show an alternative accounting method is "more appropriate than the competing methods?"
- II. Did the Court of Appeals err in interpreting Media General Communications, Inc. and Media General Holdings, Inc. v. South Carolina Department of Revenue, 388 S.C. 138, 694 S.E.2d 525 (2010), to require the Department to show that its alternative method of apportionment for taxes, pursuant to § 12-6-2320, is "more appropriate than any competing methods?"

² Please see CarMax West's Petition for Certiorari as to all grounds upon which CarMax West sought review by this Court. App. pp. 1254-1277.

Id. The Court also requested that both parties brief the following question: Is the Court of Appeals' decision in the instant case appealable in light of this Court's decisions in Charlotte-Mecklenberg Hosp. Auth. v. S.C. Dep't of Health & Env'tl Ctrl., 387 S.C. 365, 692 S.E.2d 894 (2013) and Bone v. U.S. Food Serv., 404 S.C. 67, 744 S.E.2d 552 (2013)? App. at 1398.

STATEMENT OF FACTS

Please see Car Max West's Brief at pp. 5-12 for a full statement of the facts in this matter. However, for purposes of this brief, the Procedural History section set forth above contains the facts necessary to rule upon SCDOR's appeal.

SUMMARY OF ARGUMENT

In its ruling, the Court of Appeals correctly concluded that the ALC should not have placed the burden of proof on CarMax West but instead should have placed the burden of proof on SCDOR to show that pursuant to S.C. Code Ann. § 12-6-2320, the standard apportionment method did not reasonably reflect CarMax West's business activities in this State and the method chosen by SCDOR did. SCDOR now agrees with this ruling and has not appealed it. See SCDOR's Brief at p. 9. Instead, in its brief, SCDOR complains about the Court of Appeals statement that "based on Media General, the Department, as the proponent of an alternative apportionment method, must establish that its alternative method is not only appropriate, but more appropriate than any competing methods." However, this reference to "any competing methods" simply refers to whatever competing methods have been asserted in the case. In this case, the standard statutory method advocated by CarMax West was the only competing

method. To the extent the Court of Appeals' language could be interpreted, as SCDOR suggests it could, to require that it to prove that its method was more appropriate than any other method, such a statement would be harmless error as to this case and dicta as to future cases as that issue was not before the Court and should not be before the ALC on remand. The only two methods at issue are the standard statutory method and the SCDOR's alternative separate accounting method. Thus, as the Court of Appeal's opinion held, the ALC will be applying the burden of proof to SCDOR to show that the standard statutory method does not reasonably reflect CarMax West's business activities in this State and that SCDOR's alternative method does. Accordingly, the Court should deny the relief requested by SCDOR in this appeal as the Court of Appeals has properly instructed the ALC as to the appropriate burden of proof to be applied on remand.

ARGUMENT

I. The Court of Appeals Correctly Found that SCDOR Bore the Burden of Proving that (1) the Standard Apportionment Method Did Not Fairly Reflect the Business Activities of the Taxpayer in South Carolina, and (2) SCDOR's Method Did.

A. The Only Competing Method in this Case is the Standard Statutory Apportionment Method Proposed by CarMax West, and the Court of Appeal's Discussion of a Competing Method is a Reference to this Standard Method.

The Court of Appeals correctly found that SCDOR bore the burden of proof in this matter as to the issue of the proper apportionment method for CarMax West. The apportionment statute provides as follows:

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:

- (1) separate accounting;
- (2) the exclusion of one or more of the factors;
- (3) the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in the State; or
- (4) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

S.C. Code Ann. § 12-6-2320(A) (Supp. 2009).

CarMax West relied on the standard statutory method set forth in S.C. Code Ann. §12-6-2290 to determine the amount of taxes owed in the corporate income tax return at issue. SCDOR opposed this method and proposed an alternative separate accounting method. The Court of Appeals correctly held that SCDOR, as the proponent of an alternative method, had the burden of proving that the standard apportionment formula did not fairly represent the taxpayer's business activity in this state and that the method chosen by SCDOR did. App. at 1172. Which party bore the burden of proof in order to deviate from the standard statutory method and replace it with a reasonable alternative method was the only burden of proof question before the Court of Appeals.

SCDOR has not appealed this ruling and, in fact, now agrees with it. See SCDOR's Brief at pp. 9-10. Rather, SCDOR finds fault with a statement by the Court of Appeals that "based on Media General, the Department, as the proponent of an alternative apportionment method, must establish that its alternative method is not only

appropriate, but more appropriate than any competing methods." *Id.* at pp. 6-7. SCDOR is apparently concerned that this statement could be construed to mean that SCDOR must exhaustively consider and rule out all other possible competing methods in the universe. However, this is an illogical interpretation of the Court of Appeals' statement. A more logical reading is that the Court of Appeals is referring to the competing method or methods at issue in a particular case.

The only competing method to SCDOR's alternative method in this case is the standard statutory apportionment method. CarMax West's position is and always has been that the standard statutory apportionment method fairly represents its business activity in South Carolina. CarMax West has not proposed any other competing method, and it is not required by the statute to do so. See S.C. Code Ann. § 12-6-2320(A) (Supp. 2009). Thus, the Court of Appeals' language is simply stating that SCDOR had the burden of showing that its alternative method was more appropriate than the statutory method, which it had rejected. The Court correctly recites this burden both before and after the statement about which SCDOR complains. See e.g. App. at 1172 (stating that "[i]t is only logical that a party seeking to override the legislatively determined apportionment method bears the burden of proving that method is not appropriate and an alternative method more accurately reflects the taxpayer's business activity within the state"). Accordingly, the Court should affirm the Court of Appeals' decision.

B. There is No Requirement that CarMax West Propose an Alternative Apportionment Method if it Relies on the Standard Statutory Method.

SCDOR's argument related to its misinterpretation of the Court of Appeals' "any competing methods" language could be read to suggest that CarMax West had a duty to propose a third formula as though South Carolina law requires the following sequence of events: (1) the taxpayer files using the standard formula; (2) SCDOR objects and proposes an alternative method; (3) the taxpayer must come forward with a third competing method. First, under the plain language of the relevant statutes and SCDOR's own forms, a taxpayer has the initial and obvious right to rely on the standard apportionment method provided by the Legislature. See S.C. Code Ann. §12-6-2290 (Supp. 2007); S.C. Code Ann. §12-6-2320(A) (Supp. 2009); App. p. 549, Sample SCDOR Corporate Tax Return Instructions (Basis of Return section) and pp. 503–543, CarMax West Amended Tax Returns 2002-2007 (page 1, line 1 of each return).

Furthermore, the apportionment statute only allows a taxpayer to request an alternative method if the standard statutory method does not fairly represent its business activities in this State. S.C. Code Ann. § 12-6-2320(A) (Supp. 2009) (stating that "[i]f 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 . . . [an alternative method] if reasonable. . ."). Because CarMax West asserts that the standard statutory method fairly reflects its in-state activities, it could not have petitioned for an alternative method under the statute. Id.

Additionally, a review of the facts in Media General makes it clear that SCDOR is misreading the Court of Appeals' language regarding "any competing methods." As

SCDOR points out in its brief, both the taxpayer and SCDOR *agreed* in Media General that the standard apportionment formula did not fairly represent the extent of the taxpayer's business activities in South Carolina. The parties further agreed that the method proposed by the taxpayer (the combined method) fairly represented those activities. Because SCDOR did not propose another (or third) method of calculation in that case, the Court in Media General adopted the taxpayer's method as that was the only method proposed by either party. In this case, had both parties agreed (as they did in Media General) that the standard statutory method was not appropriate, then CarMax West would have had the option of proposing a third competing method. However, CarMax West did not agree with SCDOR and continues to submit that the standard statutory method fairly represents its activities in South Carolina. Thus, it need not and, in fact, was not permitted to propose a third competing method.

C. Even if SCDOR's Interpretation of the Court of Appeals' Reference to "Any Competing Methods" Language is Correct, Such Language May be Disregarded by this Court as it Would be Harmless Error as to this Case and Non-Binding Dicta as to Future Cases.

Even if SCDOR is correct in its interpretation of the Court of Appeals' reference to "any competing methods," this Court may properly disregard this language as it is harmless error as to this case and non-binding dicta as to future cases. First, where a court makes a technical error that does not affect the merits of the case, an appellate court may properly disregard that error as harmless. See Lewis v. Lewis, 400 S.C. 354, 371, 734 S.E.2d 322, 331 (Ct. App. 2012) (finding error by trial court harmless where no indication that Court considered it and where other evidence presented was just as damaging); August Wright Co. v. Hodges, 87 S.C. 560, 70 S.E.2d 316, 318 (1911)

(affirming judgment where court determined that technical error did not affect merits of the case); McCall v. Finley, 294 S.C. 1, 362 S.E.2d 26 (Ct. App. 1987) (recognizing "overriding rule of civil procedure which says: whatever doesn't make any difference, doesn't matter").

In this case, to the extent that the Court of Appeals' language could be interpreted as requiring that SCDOR prove that its method was more appropriate than *any* other method in the universe, such a ruling was a technical error that will not affect the merits of this case and thus is harmless error. On remand, this technical error will have no impact on the merits of this case as the Court of Appeals correctly set forth the burden of proof on a number of occasions both before and after the alleged misstatement. See e.g. App. at 1172 (stating that "[i]t is only logical that a party seeking to override the legislatively determined apportionment method bears the burden of proving that method is not appropriate and an alternative method more accurately reflects the taxpayer's business activity within the state"). On remand, the ALC will simply apply this burden of proof in considering the only competing method at issue in this case, i.e. the standard statutory method. Thus, the alleged misstatement by the Court of Appeals is merely a technical error, which constitutes harmless error, and this Court should disregard it.

Additionally, to the extent that SCDOR is concerned that this statement could be used against it in future cases, this concern is not merited as the statement would be non-binding dicta because that issue was not before the Court of Appeals. Nash v. Tindall Corp., 375 S.C. 36, 40-41, 650 S.E.2d 81, 83 (Ct. App. 2007), quoting 21 C.J.S. Courts § 227 (2006) (stating that "dicta or, as it is also known, dictum 'is a statement

on a matter not necessarily involved in the case, and is not binding as authority. Dictum is an opinion expressed by a court, but which, not being necessarily involved in the case, is not the court's decision.""); Dennis v. South Carolina Nat. Bank, 299 S.C. 34, 382 S.E.2d 237 (Ct. App. 1988) (construing language in opinion as "dictum, which is an expression or statement by the court on a matter not necessarily involved in the case nor necessary to a decision thereof"); Hampton v. Richland County Council, 296 S.C. 72, 72, 370 S.E.2d 714, 714 (1988) (stating that discussion of a legal doctrine in a Court of Appeals' opinion was dicta where it was "clearly unnecessary to a resolution of the issue before the court"). As previously stated, the only issue before the Court of Appeals was whether SCDOR bore the burden of proving that the standard apportionment method did not reasonably reflect CarMax West's business activities in this State and that the method chosen by SCDOR did. Therefore, to the extent the Court of Appeals' statement could be read to require SCDOR to establish that its method is more appropriate than any other possible method, that issue was not before the court and thus is non-binding dicta, which cannot be used as precedent in future cases.

Accordingly, even if SCDOR's interpretation of the Court of Appeals' "any competing methods" language is correct, this Court may properly disregard it as the statement is harmless error as to this case and non-binding dicta as to future cases.

II. The Court of Appeals' Decision in the Instant Case is Appealable in Light of this Court's Decisions in Charlotte-Mecklenberg Hosp. Auth. v. S.C. Dep't of Health & Envtl Ctrl., 387 S.C. 365, 692 S.E.2d 894 (2013) and Bone v. U.S. Food Serv., 404 S.C. 67, 744 S.E.2d 552 (2013).

Please see CarMax West's Brief at pp. 27-32 as to its position that this case is appealable.

CONCLUSION

While SCDOR contended before the ALC and the Court of Appeals that CarMax West bore the burden of proof in this case as to the apportionment issue, SCDOR now agrees with the Court of Appeals' ruling that it bears this burden and must show that the standard statutory method does not fairly reflect the taxpayer's business activities in this State and that SCDOR's alternative method does. See SCDOR's Brief at p. 9. Thus, that holding is agreed upon by the parties and has not been appealed.

The only issue raised in SCDOR's appeal is its argument that the Court of Appeals erred in stating that SCDOR must prove that its method was more appropriate than "any competing methods." This argument is meritless. That language was simply a reference to the standard statutory method, which was the only competing method in this case. To the extent the Court of Appeals' language could be interpreted to require that SCDOR prove that its method was more appropriate than any other conceivable method, such a statement would be harmless error as to this case and dicta as to future cases. The only two methods that were before the Court and that will be reviewed by the ALC on remand are the standard statutory method and SCDOR's alternative method.

Accordingly, this Court should deny the relief requested by SCDOR because the Court of Appeals has properly instructed the ALC as to the appropriate burden of proof

to be applied on remand. In the alternative, CarMax West respectfully requests that the Court simply supplement these instructions to make clear that SCDOR need not show that its method is more appropriate than any other conceivable method but rather must only establish that the standard statutory method does not fairly reflect the taxpayer's business activities in this State and that SCDOR's alternative method does.

Finally, CarMax West requests that this Court grant it all relief requested in its Brief filed on October 30, 2013.

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v.

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PROOF OF SERVICE

I, the undersigned Administrative Assistant of the law offices of Nelson Mullins Riley & Scarborough LLP, attorneys for Respondent/Petitioner, do hereby certify that I have served all counsel in this action with a copy of the pleading(s) hereinbelow specified by mailing a copy of the same by United States Mail, postage prepaid, to the following address(es):

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December 2, 2013