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SC Court of Appeals

THE STATE OF SOUTH CAROLINA
In The Court of Appeals

APPEAL FROM THE ADMINISTRATIVE LAW COURT

Ralph King Anderson, III, Chief Administrative Law Judge

Appellate Case No. 2024-000013
Administrative Law Court Case No. 19-ALJ-17-0416-CC

Tractor Supply Company,	Appellant,
v.	
South Carolina Department of Revenue,	Respondent.

**RECORD ON APPEAL
VOLUME III**

NELSON MULLINS RILEY &
SCARBOROUGH, LLP
C. Mitchell Brown
Bryson M. Geer
John C. von Lehe, Jr.
Robert T. Streisel
151 Meeting Street, Suite 600
Charleston, SC 29401-2239
Telephone: (843) 853-5200
mitch.brown@nelsonmullins.com
bryson.geer@nelsonmullins.com
john.vonlehe@nelsonmullins.com
bobby.streisel@nelsonmullins.com

*Counsel for Appellant Tractor Supply
Company*

SOUTH CAROLINA DEPARTMENT OF
REVENUE
Marcus D. Antley
W. Allen Myrick
Jason P. Luther
300A Outlet Pointe Blvd.
Columbia, SC 29210
(843) 898-5623
marcus.antley@dor.sc.gov
allen.myrick@dor.sc.gov
jason.luther@dor.sc.gov
courtorders@dor.sc.gov

*Counsel for Respondent South Carolina
Department of Revenue*

TABLE OF CONTENTS

VOLUME I

ORDERS

Final Order dated August 8, 2023.....	1
Order Rescinding Final Order dated August 21, 2023	65
Amended Final Order dated December 4, 2023	66
Order on Motion for Reconsideration dated December 4, 2023.....	138
Order Denying Second Motion for Reconsideration dated January 3, 2024	146

PLEADINGS

Tractor Supply Company’s (“TSC”) Request for Contested Case Hearing	154
TSC’s Pre-Hearing Statement	181
South Carolina Department of Revenue’s (“Department”) Pre-Hearing Statement	189
TSC’s Amended Pre-Hearing Statement	197
Department’s Amended Pre-Hearing Statement	208

PRE-TRIAL MOTIONS

TSC’s Motion in Limine to Limit Testimony of David DeRamus dated January 6, 2023.....	216
TSC’s Motion in Limine to Exclude Economic Substance or Other Similar Claim and Certain Expert Testimony Regarding the Same dated January 6, 2023.....	337
Department’s Response to Petitioner’s Motion in Limine to Limit Testimony of David DeRamus dated January 17, 2023.....	355
Department’s Response to Petitioner’s Motion in Limine to Exclude Economic Substance or Other Similar Claim and Certain Expert Testimony Regarding the Same dated January 17, 2023	379

TRANSCRIPTS

Hearing Transcript dated January 23-27, 2023.....	391
---	-----

VOLUME II

Testimony of Marjorie McKeown	
Direct Examination by Ms. Wooten, Counsel for Department	437
Cross Examination by Ms. Geer, Counsel for TSC	525
Redirect Examination by Ms. Wooten, Counsel for Department	529
Recross Examination by Ms. Geer, Counsel for TSC	530
Further Redirect Examination by Ms. Wooten, Counsel for Department	532
Testimony of Orville Sharpe	
Direct Examination by Mr. Luther, Counsel for Department	552
Cross Examination by Ms. Geer, Counsel for TSC	575
Testimony of Steven Riggs	
Direct Examination by Ms. Wooten, Counsel for Department	603
Cross Examination by Ms. Geer, Counsel for TSC	677
Redirect Examination by Ms. Wooten, Counsel for Department	713
Testimony of Akash Sehgal	
Direct Examination by Ms. Wooten, Counsel for Department	722
Cross Examination by Mr. Streisel, Counsel for TSC	783
Redirect Examination by Ms. Wooten, Counsel for Department	820
Recross Examination by Mr. Streisel, Counsel for TSC	822
Further Redirect Examination by Ms. Wooten, Counsel for Department	825

VOLUME III

Testimony of David W. DeRamus, Ph.D.	
Direct Examination by Ms. Wooten, Counsel for Department	827
Cross Examination by Ms. Geer, Counsel for TSC	1049
Redirect Examination by Ms. Wooten, Counsel for Department	1216
Recross Examination by Ms. Geer, Counsel for TSC	1227
Testimony of Marjorie McKeown	
Direct Examination by Ms. Geer, Counsel for TSC	1237

VOLUME IV

Testimony of Marjorie McKeown continued	
Cross Examination by Ms. Wooten, Counsel for Department	1300
Redirect Examination by Ms. Geer, Counsel for TSC	1335
Recross Examination by Ms. Wooten, Counsel for Department	1342
Testimony of John J. Small	
Direct Examination by Mr. Streisel, Counsel for TSC	1347

Cross Examination by Mr. Antley, Counsel for Department	1396
Redirect Examination by Mr. Streisel, Counsel for TSC	1418
Testimony of Professor Richard Pomp	
Direct Examination by Mr. von Lehe, Counsel for TSC	1425
Cross Examination by Mr. Luther, Counsel for Department	1493
Redirect Examination by Mr. von Lehe, Counsel for TSC	1540
Testimony of Dr. David Andrade	
Direct Examination by Mr. Streisel, Counsel for TSC	1546
Cross Examination by Ms. Wooten, Counsel for Department	1644
Redirect Examination by Mr. Streisel, Counsel for TSC	1703
Testimony of Akash Sehgal	
Direct Examination by Ms. Wooten, Counsel for Department	1726
Cross Examination by Mr. Streisel, Counsel for TSC	1733
<u>VOLUME V</u>	
Testimony of Bruce Fort	
Direct Examination by Mr. Luther, Counsel for Department	1748
Cross Examination by Mr. von Lehe, Counsel for TSC	1825
Testimony of David W. DeRamus, Ph.D.	
Direct Examination by Ms. Wooten, Counsel for Department	1869
Cross Examination by Ms. Geer, Counsel for TSC	1930
30(b)(6) Deposition of Department	2011
Testimony of Robert A. King, Jr.	
Direct Examination by Ms. Geer, Counsel for TSC	2015
Cross Examination by Ms. Wooten, Counsel for Department	2123
Redirect Examination by Ms. Geer, Counsel for TSC.....	2127
Testimony of Orville Sharpe	
Direct Examination by Ms. Geer, Counsel for TSC	2130
<u>VOLUME VI</u>	
Exhibit 1, Notice of 30(b)(6) Deposition	2210
Exhibit 2, S.C. Code Ann. §12-6-2320	2217
Exhibit 3, <i>Media General Communications v. SCDOR</i>	2220
Exhibit 4, SC Revenue Ruling 15-5	2228
Exhibit 5, Department Determination	2241
Exhibit 6, Explanation of Audit Assessments and Adjustments	2268

POST-TRIAL SUBMISSIONS AND MOTIONS

TSC's Proposed Final Order	2275
Department's Proposed Final Order	2337
TSC's Response to Department's Proposed Final Order	2399
Department's Response to TSC's Proposed Final Order	2456
TSC's Motion to Reconsider dated August 18, 2023	2531
Department's Response to TSC's Motion to Reconsider dated September 5, 2023	2696

VOLUME VII

TSC's Motion to Reconsider Amended Final Order and Order on Motion for Reconsideration dated December 14, 2023	2708
Department's Response to TSC's Motion to Reconsider Amended Final Order and Order on Motion for Reconsideration dated December 27, 2023	2875

TRIAL EXHIBITS

Joint Exhibit # 1 — 2014 TSC Annual Report	2888
Joint Exhibit # 2 — 2015 TSC Annual Report	2962
Joint Exhibit # 3 — 2016 TSC Annual Report	3039
Joint Exhibit # 4 — FY2016 TSC Organizational Structure	3124
Joint Exhibit # 5 — TSC & Subsidiaries Officer Listing 2014-2016	3129

VOLUME VIII

Joint Exhibit # 6 — FY2014 TSC & Subsidiaries Federal Tax Return	3133
Joint Exhibit # 7 — FY2015 TSC & Subsidiaries Federal Tax Return	3287
Joint Exhibit # 8 — FY2016 TSC & Subsidiaries Federal Tax Return	3439

VOLUME IX

Joint Exhibit # 9 — FY2014 – TSC SC Tax Return	3631
--	------

Joint Exhibit # 10 — FY2015 – TSC SC Tax Return.....	3650
Joint Exhibit # 11 — FY2016 – TSC SC Tax Return.....	3675
Joint Exhibit # 12 — Audit Appointment Letter	3699
Joint Exhibit # 13 — 2014-2016 Corporate Working Papers.....	3700
Joint Exhibit # 14 — 05/03/2018 Explanation of Audit Assessment and Adjustments	3715
Joint Exhibit # 15 — 08/20/2018 Proposed Assessment.....	3718
Joint Exhibit # 16 — Emails re: IDR #2 Responses.....	3722
Joint Exhibit # 17 — SC Revenue Ruling #15-5.....	3724
Joint Exhibit # 18 — 11/13/2018 TSC Protest	3737
Joint Exhibit # 19 — 11/12/2019 Department Determination.....	3744
Joint Exhibit # 20 — 07/11/2014 PwC Transfer Pricing Planning – TSC Texas Inventory Markup Analysis.....	3762
Joint Exhibit # 21 — TSC Memos re: § 482 Study for 2014-2016	3823
Joint Exhibit # 22 — Inventory Procurement Agreement (between TSC and TSC of Texas).....	3826
Joint Exhibit # 23 — Inventory Procurement Agreement (between TSC and TSC of Texas).....	3835
Joint Exhibit # 24 — Akash Sehgal CV	3851
Joint Exhibit # 25 — David DeRamus CV	3852
Joint Exhibit # 26 — Bruce Fort CV	3861
Joint Exhibit # 27 — Jack Small CV	3865
Joint Exhibit # 28 — David Andrade CV	3866
Joint Exhibit # 29 — Rick Pomp CV.....	3868
Joint Exhibit # 30 — 2010 TRAC Commission Report	3903

Joint Exhibit # 31 — Global Trading Preliminary Memo	3952
Joint Exhibit # 32 — Distribution Preliminary Memo	3971
Joint Exhibit # 33 — TSC Apportionment Calculations for SC	
2014	4010
2015	4012
2016	4014
Joint Exhibit # 34 — Trial Balances 2014-16	4016
Joint Exhibit # 35 — 3 Company Entities 2014-2016.....	4016
Joint Exhibit # 36 — TAS Report.....	4016
Joint Exhibit # 37 — National SKU Data 2014-2016	4016
Joint Exhibit # 38 — TSC of Texas Financials	4016
Joint Exhibit # 39 — TSC Product Line Specific Comps	4016
Joint Exhibit # 40 — TSC Summary of Product Line Specific Analysis.....	4016
Joint Exhibit # 41 — TSC Retail P&L for 2014-16	4016
Joint Exhibit # 42 — TSC Farm Retail Comps	4016
Joint Exhibit # 43 — DeRamus Retailer Set	4016
Joint Exhibit # 44 — DeRamus Global Trading Set.....	4016
Joint Exhibit # 45 — DeRamus Revised Global Trading Set.....	4016
Joint Exhibit # 46 — DeRamus Distributors Set.....	4016
Joint Exhibit # 47 — DeRamus Revised Distributors Set	4016
Joint Exhibit # 48 — DeRamus PwC Distribution Set.....	4016
Joint Exhibit # 49 — Vendor Payment Records.....	4016
Joint Exhibit # 50 — Employees by Location	4016
Joint Exhibit # 51 — Gross Profit — Store Directory.....	4016

Joint Exhibit # 52 — Procurement TB 2015	4016
Joint Exhibit # 53 — TSC-HQ Employees by Legal Entity	4016
Petitioner’s Exhibit #1 — Andrade Analysis	4017

VOLUME X

Respondent's Exhibit # 1 — 2000 TSC Annual Report and 10-K.....	4018
Respondent's Exhibit # 2 — 2001 TSC Annual Report and 10-K.....	4178
Respondent's Exhibit # 3 — 2002 TSC Annual Report and 10-K.....	4289
Respondent's Exhibit # 7 — Master Shared Services Agreement dated 09/30/01	4423
Respondent's Exhibit # 8 — Administrative Services Agreement dated 09/30/01	4432
Respondent’s Exhibit #9 — Licensing Agreement between TSC of Texas and TSC dated 09/30/01	4441
Respondent's Exhibit # 10 — AON Allianz Marine Cargo Policy.....	4453
Respondent's Exhibit # 12 — Minutes of Board of Directors Meeting dated 06/26/01	4456
Respondent's Exhibit # 17 — Email chain 08/14/18 with Steven Riggs.....	4468
Respondent's Exhibit # 18 — Audit Data Sheet	4470
Respondent's Exhibit # 22 — TSC & Subs — SC Audit Years 2014-2016.....	4509
Respondent's Exhibit # 29 — 2014-2016 Administrative Service Charge.....	4511
Respondent's Exhibit # 30 — TSC Average Store Profit by State	4511

VOLUME XI

Respondent's Exhibit # 31 — Riggs Demonstrative.....	4512
Respondent's Exhibit # 32 — Sehgal Demonstrative	4523
Respondent's Exhibit # 33 — DeRamus Demonstrative	4538

CERTIFICATE

Certificate of Counsel	4607
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1 **MS. WOOTEN:** The Department calls Dr. David DeRamus.

2 **THE COURT:** Okay.

3 **COURT REPORTER:** If you'll raise your right hand?

4 **DR. DERAMUS:** (Witness complies.)

5 **COURT REPORTER:** Do you swear to tell the truth, the
6 whole truth and nothing but the truth, so help
7 you God?

8 **DR. DERAMUS:** I do.

9 **COURT REPORTER:** Thank you.

10 **DR. DAVID DERAMUS,** having been duly sworn, testifies
11 as follows:

12 **DR. DERAMUS - DIRECT EXAMINATION BY MS. WOOTEN:**

13 Q: Dr. DeRamus, can you please state your full
14 name for the record?

15 A: David Watlington DeRamus.

16 Q: And, Dr. DeRamus, what do you do for a living?

17 A: I am an economist and partner with the economic
18 consulting firm of Bates White, LLC.

19 Q: All right. And where is Bates White located?

20 A: Our headquarters is in Washington D.C.

21 Q: Okay. The Department of Revenue hired you as
22 an expert witness in the dispute with Tractor
23 Supply, is that correct?

24 A: That's correct.

25 Q: Okay. And what were you asked to do?



1 A: I was asked to review the information that's
2 been produced in this case and to conduct my
3 own research, and to provide my opinion on
4 three broad issues. The first one is, what --
5 my opinion as to whether the transfer pricing
6 policies implemented by Tractor Supply are
7 reasonable and reliable, and also whether the
8 PricewaterhouseCooper study, which those
9 policies are based, was also reasonable and
10 reliable.

11 The second area that I was asked to
12 provide my opinion on was, whether the
13 Company's implementation of separate entity
14 reporting, and specifically, it's use of the
15 transfer pricing policies as part of that
16 reporting method, results in income to South
17 Carolina, that -- from an ec- -- economic
18 perspective, reasonably reflects it's economic
19 activity in the State.

20 And then, third -- the third area, was to
21 evaluate whether a combined entity
22 apportionment method would more reasonably
23 reflect the income earned by the Company in the
24 State of South Carolina, as compared with the
25 separate entity -- or reporting method used by



1 the taxpayer given the way it's implemented in
2 it's transfer pricing. And also, I -- well, I
3 was asked, as part of that, to evaluate whether
4 a combined entity apportionment method would
5 more reasonably approximate -- or more closely
6 approximate the result that you would obtain if
7 the transfer pricing policies were implemented
8 more reasonably.

9 Q: All right. Before we get into your opinions,
10 let's review your qualifications.

11 **MS. WOOTEN:** Ms. Buckner, can you switch it over,
12 please?

13 **MS. BUCKNER:** Uh-huh.

14 **MS. WOOTEN:** Thank you.

15 Q: And if you could, if you could start with your
16 educational background and describe that for
17 the Court, please.

18 A: Sure. I did my undergraduate degree at Duke
19 University. I obtained my Master's in
20 economics from the University of Massachusetts
21 at Amherst. And I received my Ph.D. from the
22 University of Massachusetts at Amherst, as
23 well.

24 Q: And what are your specialized areas within your
25 education?



1 A: So, within the field of economics, my areas of
2 specialization were industrial organization,
3 which is effectively the applied theory of
4 price, it's where economists analyze the impact
5 of alternative market structures on price
6 formation. It's often off -- where the study
7 of antitrust and competition appears. It's
8 also the area where transfer pricing appears.
9 And I've also -- my other area of
10 specialization was international economics.

11 Q: And if you could, if you could describe your
12 work experience for the Court, please.

13 A: Certainly. So, at this point, I have worked in
14 the area of transfer pricing for nearly 30
15 years. I was at KPMG, then KPMG Peat Marwick,
16 for approximately five years. I was at an
17 economic consulting firm called A.T. Kearney
18 for approximately a year, or maybe a year and
19 a half. And then, I was one of the founders of
20 Bates White back in 1999, where I've been since
21 it's inception.

22 Q: All right. And in the, the 30 years that
23 you've done transfer pricing work, could you
24 summarize your work experience for the Court in
25 that particular area?



1 A: Certainly. So I've worked, pretty much, across
2 the gamut of transfer pricing cases. I've
3 worked on documentation studies. I've worked
4 on something called advanced pricing
5 agreements, agreements that are negotiated
6 between tax authorities and taxpayers. I've
7 worked on a fair number of controversies at
8 this point. I've also worked on audit and tax
9 planning studies. Some of my work has also
10 involved restructuring, as well.

11 Q: Have you been qualified to testify on economic
12 and transfer pricing issues in court
13 proceedings?

14 A: Yes, I have.

15 Q: Okay. And are you familiar with the IRS
16 Section §482 Regulations?

17 A: Yes, I am. I confer them a reasona- --
18 frequently, as part of my work. They are the,
19 probably, the touchstone that economists use
20 when doing transfer pricing analysis in the
21 United States. I also frequently consult the
22 OECD, Transfer Pricing Guidelines, Organization
23 of Economic Cooperation and Development. So
24 they are a mirror, to some extent, of the §482
25 Regulations in concept. Although, the



1 implementation is different, and they differ
2 depending on the international tax
3 jurisdiction.

4 Q: And what is transfer pricing?

5 A: So, transfer pricing is, effectively, the way
6 in which companies set and administratively
7 determine prices with all of their intercompany
8 transactions -- or, I should say, with those
9 intercompany transactions, they either cross
10 legal jurisdictions, but most often, they cross
11 geographic boundaries. They are adminis- --
12 administratively determined prices, as compared
13 to market prices that are -- where there is a,
14 kind of, that third party negotiation that,
15 that determines those prices.

16 Q: And in your experience, why are taxing
17 authorities concerned about transfer pricing?

18 A: Well, generally, tax authorities are concerned
19 that companies have an incentive to use
20 transfer pricing to shift income artificially
21 from one jurisdiction to another in order to,
22 effectively, push income into low tax
23 jurisdictions and reduce their tax liabilities
24 in higher tax jurisdictions.

25 Q: Can a company use transfer prices for



1 administrative functions for a similar purpose?

2 A: Certainly. So, I think a lot of the -- I
3 think that, kind of, the easy example of tran-
4 -- using transfer pricing to shift income is
5 often with regard to tangible goods
6 transactions. So ---

7 **THE COURT:** What, what type of ---

8 A: With a tangible good ---

9 **THE COURT:** Oh, tangible. Okay.

10 A: --- transaction. So, for example, the
11 manufacturer of a finished product migh- -- in
12 -- located in the United States, may be selling
13 that finished product to an overseas subsidiary
14 that then distributes that product. And so, it
15 may have an incentive to, either charge a very
16 high price or a very low price for that
17 particular finished product in order to then
18 move income either out or into the United
19 States.

20 Well -- and with regard to administrative
21 functions, the tax authorities have long been
22 concerned that companies are able to use -- or,
23 or have an incentive to charge inappropriately
24 high prices for certain administrative
25 functions, such as purchasing, in ways that



1 would then shift income out of a particular tax
2 jurisdiction, or into a tax jurisdiction.

3 Q: And can a company engage in restructuring for
4 a similar purpose? Is -- did you just refer to
5 that? I'm sorry.

6 A: I think I referred earlier that I ---

7 Q: Okay.

8 A: I've been involved in certain restructurings.
9 A company can either attempt to implement
10 transfer pricing policies within the structure
11 that it has, or it could -- companies can often
12 attempt to restructure their, their operations
13 in order to, to accomplish the same result,
14 i.e., where you may've -- originally have had
15 an integrated business, a single entity
16 operating, the company may decide to slice up
17 the company into different pieces, create
18 intercompany transactions between those
19 different organizations, and thereby create
20 opportunities to use transfer pricing between
21 those new entities to artificially shift income
22 from one jurisdiction to another.

23 Q: And on your CV you have a couple of cases that
24 you've been, that you've been involved in as
25 part of your transfer pricing work. Is part of



1 your -- what you just described with the
2 restructuring, was that part of your testimony
3 on -- in Federal Court on behalf of the
4 Department of Justice in the *Perrigo* Case?

5 A: Yes, it was.

6 Q: Okay. And what were you asked to do -- or what
7 was your op- -- opinion that you were asked to
8 be a pr- -- asked to provide in that particular
9 case?

10 A: So I was asked to provide whether the -- in
11 that, that regard, it was an asset, an asset
12 transfer. It was a -- there was a creation of
13 new entities, and there was a transfer in asset
14 from one entity to another after that new
15 entity was created, and I was asked to provide
16 my opinion as to whether that, that creation of
17 a new entity and if that transfer had any
18 commercial effect on the business, on the
19 operations of the business, did it have any
20 operational effect on that business. And I was
21 asked to assess the economic substance of the
22 transaction, and to provide my opinion as to
23 the appropriate transfer prices to be charged
24 in that related party transaction, as well as
25 to calculate a proposed income adjustment, if



1 any, should the Court adopt the opinions that
2 I was providing in the case.

3 Q: Okay. And with respect to those -- of all the
4 opinions that you are providing in this case,
5 obviously one was transfer pricing, but ha- --
6 what do the others have to do with transfer
7 pricing?

8 A: Well, with regard to whether a restructuring
9 had a commercial effect on -- or an operational
10 effect on the business, that has an important
11 implication for whether you would expect the
12 income of a taxpayer to change pre and post
13 that transaction. So, there was a certain
14 transact- -- if there was a transaction at a
15 time period, effectively, T-minus one, before
16 the restructuring takes place, there's income
17 being earned by a, by a taxpayer. And then, if
18 the taxpayer implements a restructuring and as
19 a result of that restructuring nothing has
20 really changed, operationally, but the income
21 of the taxpayer has changed significantly, that
22 has important implications for the transfer
23 pricing that should've been charged, that would
24 be more consistent with the arm's length
25 principles. With regard to the economic



1 substance of the transaction, I think that's --
2 part and parcel of the §482 Guidelines, is that
3 an economist needs to analyze, not simply the
4 legal form of the transaction, because as a
5 related party transaction, a company can
6 effectively structure it and write down the
7 term -- the contractual terms however it wants
8 to, but ultimately what should govern the
9 actual pricing of that related party
10 transaction is the economic substance of that
11 transaction. So, I needed to analyze and
12 provide my opinion as to what the economic
13 substance of the transaction was in order to
14 properly price it.

15 Q: Okay. And what do you consider your expertise,
16 as it's relevant to this to this dispute with
17 Tractor Supply?

18 A: Well, I would say, it's primarily with regard
19 to the economics of transfer pricing, and what
20 they actually implement -- actual
21 implementation of transfer pricing methods and
22 analysis, from the perspective of an economist.
23 But I would say, in kind of my broader training
24 and expertise as a -- what I consider to be a
25 -- I consider myself to be an applied micro-



1 economist, I think that broader training and
2 experience is relevant to other issues in this
3 case, as well. I -- in addition to my work on
4 transfer pricing, I work on issues relating to
5 competition analysis, for example. I've
6 studied a wide range of industries in a wide
7 range of different kinds of disputes. And I
8 think assessing the underlying economic
9 characteristics of a market, assessing consumer
10 demand has been part and parcel of that work,
11 and I think that is also relevant here in
12 assessing the extent to which the income that
13 the Taxpayer is reporting in South Carolina
14 reasonably reflects it's economic activity in
15 the State.

16 Q: And as part of your work in the area of
17 transfer pricing, do you generally analyze the
18 extent which -- of which activities performed
19 by different related parties contribute to the
20 firms overall profitability?

21 A: Yes. I, I think that's pretty much the first
22 step in the analysis, is to examine which
23 entities are involved in related party
24 transactions and what is the respective value-
25 add of each of these different entities.



1 Q: And have you done that analysis in this case?

2 A: Yes, I have.

3 Q: Okay. And as part of your work in the area of
4 transfer pricing, do you routinely analyze a
5 taxpayers tax returns?

6 A: Yes, I do. I, I am not -- as an economist, I
7 am not responsible for preparing tax returns.
8 My analysis is typically at the companies -- is
9 dealing with the companies financial
10 statements, and often at the operating income
11 level, determining what's -- what operating
12 income should have been reported. But often
13 times, I will need to compare a transfer
14 pricing study with the way a taxpayer exactly
15 implemented it's transfer prices, which would
16 then be reflected in it's tax return. And I'm
17 also often asked, particularly, in, in dispute
18 proceedings in either Federal Court or Tax
19 Court to actually calculate a proposed income
20 adjustment based on my analysis of the actual
21 -- of the more appropriate transfer prices.

22 Q: And did you analyze Tractor Supply's tax
23 returns in this case?

24 A: Yes, I did.

25 Q: Okay. And also, in the, in the area of your



1 work of transfer pricing, do you routinely
2 analyze the allocation or apportionment of
3 costs or income among related parties?

4 A: Yes. And often times it may be in a slightly
5 different context -- or a somewhat different
6 context than, kind of, the apportionment income
7 that occurs in a -- as I understand, occurs in
8 certain states and under certain conditions.
9 But the allocation of costs is something that
10 comes up routinely as a matter of transfer
11 pricing, particularly, if you have centralized
12 costs that need to be allocated out to
13 different related parties. And also with
14 regard -- even to the apportionment of income,
15 there are certain methods that are applied that
16 effectively result in that apportionment of
17 income, either directly, such as, for example,
18 with something called the res- -- the prob- --
19 profit split methods, or indirectly as a result
20 of the other types of analytical techniques
21 that the analyst might apply.

22 Q: And is your review of the documents and
23 information in this case, are you familiar with
24 how the Department has implemented its
25 alternative combined unitary apportionment

1 method in this case?

2 A: Yes, I am.

3 Q: Okay. And have you previously analyzed the
4 extent to which companies operations across
5 different related parties were interdependent?

6 A: Yes, I have.

7 Q: Okay. And do your opinions regarding the
8 reliability of a taxpayer's transfer pricing
9 policies have implications for your opinion as
10 to whether TSC's use of separate entity
11 reporting reflects, from an economic
12 perspective, the activity of that company in
13 South Carolina?

14 A: Yes.

15 Q: All right. You said earlier that you've
16 previously analyzed the extent to which
17 activities performed by different related
18 parties contribute to a firms overall
19 profitability, have you done that in this case?

20 A: Yes, I have.

21 Q: And does that analysis have any implications
22 for your opinion as to whether Tractor Supply
23 Company's use of separate entity reporting
24 reflects, again, from an economic perspective,
25 the activity in South Carolina?



1 A: Yes, it does.

2 Q: Okay. Has the Department asked you to redo the
3 taxpayer's transfer pricing analysis and
4 calculate a precise proposed income adjustment
5 based on that analysis?

6 A: No, it has not.

7 Q: Okay. And do you have an opinion of the result
8 that you would obtain, to a reasonable degree
9 of certainty, or approximation, if you were to
10 redo the taxpayer's transfer pricing analysis
11 and calculate an income adjustment on that
12 basis?

13 A: Yes, I do.

14 Q: Okay. And are you able to compare the
15 approximate result that the taxpayer has
16 actually implemented through the use of
17 separate entity reporting?

18 A: Yes. I have the ability to compare the result
19 that I believe the taxpayer would've obtained,
20 had it applied a reasonable set of transfer
21 pricing policies to its separate entities. And
22 I'm able to compare that to what I expect --
23 what the taxpayer would've reported if it had
24 used the combined entity apportionment method.

25 Q: All right. Displayed for the Court is Joint



1 Exhibit 25. I believe it's your CV.

2 **(Joint Exhibit Number 25 was introduced into the**
3 **record at this time.)**

4 A: Yes.

5 Q: Is this your current CV?

6 A: Yes, it is. I have recently been deposed in
7 one additional matter that does not appear on
8 that, but it's not related to transfer pricing.

9 Q: All right. Let's ---

10 A: I'm sorry. I, I should've said -- I should've
11 clarified that. It is related to an investor
12 dispute where there are some transfer pricing
13 issues, but I did not see those issues as being
14 central to this case.

15 Q: All right. Let's talk about the process that
16 you used to formulate your opinion in this
17 matter.

18 To start with, did the Department tell you
19 what your opinion should be?

20 A: No.

21 Q: Okay. Did anyone in the Department limit your
22 ability to research or analyze the matters at
23 issue in this case?

24 A: No.

25 Q: And are you being compensated for this -- your



1 work today?

2 A: Yes.

3 Q: All right. So, let's talk about your summary
4 of opinions, and -- what were you asked to do
5 in this matter?

6 A: Well, again, going back to the, the three
7 different areas, just to kind of say it in a
8 way to be more succeedingly.

9 So, first, I was asked to provide that
10 opinion -- or I was asked to provide my opinion
11 with regard to the reliability of the company's
12 transfer prices.

13 Q: Okay.

14 A: And second, I was asked to review the -- or to
15 assess the reasonableness of -- from an
16 economic perspective, of the company's use of
17 separate entity reporting, as to whether that
18 reasonably reflected the economic activity of
19 the Company in the State of South Carolina.

20 And then, the third area was to assess
21 whether combined entity apportionment method
22 would more reasonably reflect the company's
23 economic activity in the State of South
24 Carolina, as compared to its separate entity
25 reporting, and whether combined entity



1 apportionment method would more closely
2 approximate the result one would get from a
3 properly performed transfer pricing analysis.

4 Q: Okay. All right. And could you briefly
5 summarize for the Court the information or
6 documents you reviewed to arrive at the conc-
7 -- the opinions that you just described?

8 A: Certainly. It was a very broad range of
9 documents. So, I reviewed an extensive number
10 of documents produced by the Taxpayer in
11 discovery, including not only documents from
12 Tractor Supply, but also from Pricewaters- --
13 waterhouseCoopers. I reviewed the analysis
14 performed by their expert Dr. Andrade. I --
15 and the various documents that he provided in
16 support of his analysis. I did my own
17 extensive research of the -- not only the
18 Company's 10-Ks, but also using commercially
19 available databases to analyze things like
20 company profitability, other metrics of
21 comparable companies. I reviewed analyst
22 reports, company earnings calls with analysts,
23 and various materials of that nature.

24 Q: All right.

25 OFFER AS EXPERT:



1 **MS. WOOTEN:** At this time, Your Honor, the
2 Department would move to recognize Dr. DeRamus
3 as an expert witness in the area of transfer
4 pricing analysis, including economic
5 principles.

6 **THE COURT:** Expert in transfer pricing analysis,
7 including economic principles.

8 **OBJECTION:**

9 **MS. GEER:** Yes, Your Honor. I'll go back to our
10 discussion from the other day. So we don't
11 have any issue with him being an expert in
12 transfer pricing analysis and the economic
13 principles with in the §482 Regs, as we
14 discussed the other day. I -- it sounds like
15 they're, maybe, limiting it to that, so it --
16 if that's the case, then I think we're good
17 there. On the opinions, our other ---

18 **THE COURT:** Well, you can object to the opinions
19 when we get to them.

20 **MS. GEER:** Well, if you recall ---

21 **THE COURT:** This, this is a qualification.

22 **MS. GEER:** Ye- -- okay. Well, she ---

23 **THE COURT:** That's not ---

24 **MS. GEER:** --- kind of put both of them in there, so
25 I'll -- that's fine. I can wait until ---

1 **THE COURT:** All right.

2 **MS. GEER:** I mean, she discussed the qualifications
3 and the opinions just now.

4 **THE COURT:** In developing the testament.

5 **MS. GEER:** That's fine.

6 **MS. WOOTEN:** That's in developing his
7 qualifications.

8 **THE COURT:** Yeah.

9 **MS. WOOTEN:** I -- we haven't gone into his opinions.

10 **MS. GEER:** Okay. So, I -- we agree -- consent to
11 him being an expert in transfer pricing and
12 economic principles under 482.

13 **THE COURT:** Well, she added something. Under 482.

14 **MS. WOOTEN:** I think what I have designated him as
15 encompasses that. I don't think it's a
16 limitation. I mean, he is a transfer pricing
17 expert, and his analysis is based on, as he
18 stated, the guidelines and principles of 482.

19 **THE COURT:** I'm gonna qualify him, generally ---

20 **MS. GEER:** That's fine, Your Honor.

21 **THE COURT:** --- as she just stated.

22 **MS. WOOTEN:** Thank you, Your Honor.

23 **THE COURT:** All right.

24 **Q:** All right. So, let's start with your first
25 opinion. What is your overall opinion



1 regarding the reliability of the trans- -- of
2 the taxpayer's transfer pricing study, i.e.,
3 PricewaterhouseCoopers, PwC's Transfer Pricing
4 Memo for Tractor Supply dated July 11th, 2014?
5 And I believe that is Joint Exhibit 19.

6 A: I consider the PricewaterhouseCoopers Transfer
7 Pricing Study to be unreliable and inconsistent
8 with the arm's length standard and the guidance
9 provided in Section 482. And I, similarly,
10 consider the taxpayer's implementation of its
11 actual transfer prices to be inconsistent with
12 the arm's length principles, and unreliable.

13 Q: All right. And I stand corrected. It was
14 Joint Exhibit 20.

15 **(Joint Exhibit Number 20 was referenced at this**
16 **time.)**

17 Q: All right. Turning back to your opinion. Can
18 you please summarize why you conclude the PwC
19 transfer pricing study is unreliable?

20 A: Certainly. The -- first, I think that the --
21 that PwC has incorrectly characterized the
22 functions, assets and risks of the related
23 parties. That's basically from a -- that's
24 transfer pricing lingo for, the first step that
25 you need to do. So, I think they missed the

1 step, even in performing that first step.
2 Second, I think they have inappropriately
3 characterized tran- -- Tractor Supply of Texas
4 as a wholesale distributor, or at least, they
5 have tried to benchmark Tractor Supply
6 Corporation of Texas -- I'm sorry, I'll refer
7 to it as TSCT, or Texas, if I might, that they
8 have tried to benchmark TSCT against a group of
9 wholesale distributors, which I consider to be
10 an unreliable way of benchmarking that
11 procurement function.

12 I considered unreliable the re- -- the
13 analysis to be unreliable because PwC did not
14 evaluate alternative, what are called profit
15 level indicators, i.e., financial ratios for
16 the comparable companies, and for the tested
17 party, Texas. I consider it unreliable with
18 regard to its approach to benchmarking the, the
19 profitability of the retail function -- or what
20 it asserts to be the retail function of Tra- --
21 of TSC the parent company. And I consider it
22 unreliable, with respect to the analysis it
23 performed regarding the royalty rate. So,
24 pretty much, all three of the different
25 analyses that it provides in there, I consider

1 to be unreliable.

2 Q: As part of your analysis, did you consider
3 whether Tractor Supply Texas and Tractor Supply
4 Company were interdependent businesses?

5 A: Yes, I did.

6 Q: Okay. And what was your conclusion regarding
7 that?

8 A: I consider the -- TSC and Texas to be highly
9 interdependent. Actually, TSC, TSCT and
10 Michigan are highly interdependent. As a
11 retailer, you can't sell things if you, if you
12 don't buy things first. So the procurement
13 function is integral to the company's operation
14 as a retailer. Likewise, Texas can't procure
15 anything without having customers to sell them
16 to. So there's not an independent procurement,
17 or an independent wholesaling function, or an
18 independent distribution that Texas performs
19 separate and apart from the core retailing
20 business of the company.

21 **THE COURT:** You said they can't procure anything
22 without someone -- they could not stay in
23 business without procuring things if they don't
24 have something ---

25 A: Correct.



1 **THE COURT:** --- someone to sell to, but they could
2 procure it ---

3 A: So, so tech- ---

4 **THE COURT:** --- initially, couldn't they?

5 A: So, so you're correct that they could
6 physically order a part, if they had the
7 capital to do so, independent of the capital of
8 the company. It's still -- the ca- -- all the
9 capital of the company is effectively from one
10 joint pot of money. These are legal entities,
11 but it's still within, kind of, a single
12 corporate framework. It has a central cash
13 management function, so, frankly, I don't think
14 -- it can't even pay -- TSCT can't even cut a
15 check to somebody else without the parent
16 company, since it relies on the treasury
17 functions of the parent company.

18 **THE COURT:** So the Texas company relies on the
19 parent company ---

20 A: Yes.

21 **THE COURT:** --- to write the checks?

22 A: Yes. And I would say, the best way to think of
23 it is, we've -- we talk about these companies
24 as if they are distinct, they are distinct
25 legal entities, but they are not distinct



1 operating entities the way, I think, a common
2 sense understanding of that term would imply,
3 i.e., it's -- there's just one corporate staff
4 in -- located in Tennessee, the vast majority
5 of those employees are employees of TSC,
6 there's a small number of -- a relatively small
7 proportion of, of employees that are nominally
8 employees of Texas, even though they sit in
9 Tennessee. The on- -- the only people in Texas
10 itself, in the geography of Texas, are going to
11 be the store employees and the -- and prod- --
12 the man- -- including not only the, the shop
13 level employees but the managers, and there may
14 even be some regional managers in the state, as
15 well.

16 **THE COURT:** I interrupted you. Do you know where
17 you were?

18 **A:** I do. And I would say also, in terms of the
19 question of, could the company -- could TSCT
20 perform that function, the procurement
21 function, absent the retail store, it certainly
22 could not procure inventory at the prices it's
23 able to procure because it wouldn't have the
24 five or six billion dollars of sales with which
25 -- to, to promise the, the vendors, that it can

1 then move a substantial amount of their, of
2 their production.

3 The other thin- -- so, so the -- in terms
4 of the, the issue of that interdependence,
5 there are -- there are just the in- -- there's
6 the interdependence of that structure where --
7 also, I should say -- I didn't -- we didn't
8 talk about Michigan. So, Michigan is entirely
9 dependent on employees who are nominally
10 employees of the parent company, but they --
11 even though they sit in Michigan -- so there's
12 a dependence on that, you can't have -- you
13 can't make a retail sale in the State of
14 Michigan without rely- -- without having
15 employees on the shop floor to ring that sale
16 up. Those, those employees are nominally
17 employees of the parent company. And here, we
18 have -- I think there is a, from my analysis --
19 the documents and my review of the functions
20 performed even by the procurement individuals
21 themselves, who are nominally part of te- -- of
22 Texas, they are a part of an integrated
23 headquarters operation. So, a -- the
24 procurement function is part of this broader
25 merchandising function for a retailer, which is



1 integrated with pricing and a wide range of
2 other administrative functions that is
3 supervised by executives who are part of TSC.
4 So it is not a stand-alone kind of, of function
5 that is being performed outside in some other
6 jurisdiction the way I've seen in some of my
7 international transfer pricing work, for
8 example.

9 Q: All right. Did you, as part of your review in
10 this case, did you analyze the 2001
11 restructuring that created TSC Texas and the
12 trade flows at issue?

13 A: Yes, I did.

14 Q: Okay. And can you describe your conclusions
15 about that restructuring, as it effects the
16 transfer pricing analysis?

17 A: Certainly. So, I concluded that it had no
18 operational effects, or no commercial effects
19 on the company. That the -- I've reviewed some
20 of the assertions that the company has made
21 about other reasons for those -- for their
22 restructuring, and I have not found any
23 economic evidence to support those other
24 assertions, other than with regard to the tax
25 savings that the reorganization provided.



1 I also considered that the restructuring
2 resulted in a change in the, in the way in
3 which the -- and the amount of income that TSC
4 was earning, as a re- -- particularly, as a
5 result of the inventory agreement, that is
6 inconsistent with the company's available
7 alternatives at the time. I -- and it's --
8 which is a bit of a defying term in the
9 transfer pricing world. And often, when you
10 look at a restructuring the question is -- you
11 have, again, the situation that T-minus one,
12 before the restructuring and the situation
13 after the restructuring, and the question is,
14 if somebody has a valuable asset or a valuable
15 activity, would they consent at arm's length to
16 transferring that valuable asset -- or to
17 relinquishing that responsibility in return for
18 either A, no compensation, or B; in return for
19 giving up a substantial portion of the income
20 that it otherwise would continue to earn absent
21 that restructuring.

22 Q: And based on your review of the documents, does
23 Tractor Supply operate it's -- operate it's
24 U.S. stores' distribution centers and
25 headquarters as a single integrated enterprise,

1 or as separate enterprises, obviously, not
2 withstanding the separation of some of these
3 functions into distinct legal entities?

4 A: Yes. Again, I think it ---

5 **OBJECTION:**

6 **MS. GEER:** Objection. Leading, Your Honor.

7 A: As I ---

8 **THE COURT:** Whoa, whoa. Just ---

9 A: Oh, apologies.

10 **THE COURT:** Response?

11 **MS. WOOTEN:** I'm happy to restate it. I didn't
12 think it was leading, but if Your Honor
13 sustains it, I'll rephrase.

14 **THE COURT:** Well, I don't -- it wasn't that bad, but
15 it did suggest an answer, so. If you will on
16 that one.

17 **MS. WOOTEN:** All right.

18 **MS. GEER:** Thank you, Your Honor.

19 Q: All right. Based on your review of the
20 documents, how does Tractor Supply operate ---

21 **THE COURT:** There you go.

22 Q: --- it's U.S. stores' distributions and
23 headquarters as a single integrate --
24 integrated enterprise versus separate
25 enterprises?



1 A: It op- -- based on my review of the documents
2 and my analysis of the overall business, and
3 also consistent with my experience in dealing
4 with other retailers, it operates its business
5 as a single enterprise. The company operates
6 distribution centers around the United States,
7 and as I understand, the way it uses its
8 information systems it endeavors to ship supply
9 from the location where it is to the location
10 where it's needed based on, kind of, the
11 efficiency in the cost of that overall
12 integrated system, not based on a legal entity
13 by a legal entity basis.

14 It's my understanding that, that customers
15 can return products that they purchase in one
16 jurisdiction -- or in -- for example, if they
17 purchase something in Texas they could make a
18 return in, in Mississippi, which would be part
19 of TSC the parent company, without any
20 consideration of it being a different legal
21 entity. So, yes, that's why I think the
22 entirety of it operates as a single entity.
23 And, similarly, on the operational side of the
24 headquarters where these are all, effectively,
25 cheek by jowl headquarters oper- -- functions,



1 where purchasing and advertising, and pricing,
2 and inventory management, and IT are all
3 integrated at the same location.

4 Q: And could you please summarize your opinion,
5 from an economic perspective, as to whether the
6 combined entity apportionment would reasonably
7 reflect Tractor Supply's economic activity in
8 the State of South Carolina?

9 **OBJECTION:**

10 **MS. GEER:** Your Honor, we would object to that
11 opinion. I think we're at the right stage now.

12 **THE COURT:** Okay.

13 **MS. GEER:** Just based on, he is a transfer pricing
14 expert, we're not questioning that, but he's
15 not talking about the -- he's now trying to
16 talk about what the combined reporting statute
17 does and what the separate entity reporting
18 statute was, and I can't remember which one you
19 just said. One's opinion two, one's opinion
20 three. So whichever one we just -- I think
21 he's got to combined just now. He has no
22 expertise with the alternative apportionment
23 statute or combined reporting and separate
24 entity reporting. I know you mentioned
25 something about tax returns earlier, but I



1 don't think he has any real expertise in tax
2 returns, so that's the basis of our objection
3 to that opinion.

4 **MS. WOOTEN:** Sure. And I think we've gone through
5 the -- in his qualifications, as part of his
6 work in the transfer pricing area he routinely
7 relies on and reviews tax returns as part of
8 his analysis. He described the allocation and
9 apportionment of costs of income from the
10 transfer pricing side of it. I didn't ask him
11 an opinion on combined entity reporting under
12 the statute, I'm asking it from his
13 perspective, from an econom- -- for an
14 economist and how that relates to transfer
15 pricing.

16 **THE COURT:** All right.

17 **MS. WOOTEN:** And ---

18 **THE COURT:** I'll overrule the objection on this one.

19 **MS. GEER:** Okay. Thank you, Your Honor.

20 **MS. WOOTEN:** Thank you, Your Honor.

21 Q: Would you like for me to restate a question, or
22 do you remember it?

23 A: Yes, please. Restate the question.

24 Q: Okay.

25 A: Thank you.



1 Q: Could you summarize your opinion, again, from
2 an economic perspective, as to whether combined
3 entity apportionment would reasonably reflect
4 Tractor Supply's economic activity in the State
5 of South Carolina?

6 A: So, you wanna -- you're asking me whether a
7 combined entity apportionment would, would
8 reasonably reflect it, or whether a separate
9 entity reporting ---

10 Q: Let's start with combined ---

11 A: Combined ---

12 Q: --- entity.

13 A: --- entity, yes.

14 Q: And then we'll go to separate entity.

15 A: Cer- -- certainly. Yes, based on my analysis
16 of the company's operations and its transfer
17 pricing policies, I think the combin- -- a
18 combined entity apportionment method would
19 reasonably reflect the company's economic
20 activity in the State of South Carolina.

21 Q: All right. Now, let's go back to the separate
22 entity, and I'm going to restate that question
23 for you.

24 Can you summarize your opinion whether the
25 company's returns, based on separate entity



1 reporting, again, from your economic
2 perspective and background, reflect the
3 economic activity of Tractor Supply in South
4 Carolina?

5 **OBJECTION:**

6 **MS. GEER:** Your Honor, just for the record
7 preservation purposes, I'm gonna object to this
8 one, as well.

9 **THE COURT:** And, and I'll ---

10 **MS. GEER:** Same reasons.

11 **THE COURT:** I don't have a problem with that at all.

12 **MS. GEER:** Okay.

13 **THE COURT:** I'll overrule it.

14 **MS. GEER:** Thank you.

15 **THE COURT:** She's asking from an economic ...

16 A: So, again, from an economic perspective, I
17 consider the, the company's use of separate
18 entity reporting, and particularly the way in
19 which it has used and implemented its transfer
20 prices among the separate entities, I consider
21 that to -- not to reasonably reflect the
22 economic activity of the company in the State
23 of South Carolina.

24 Q: And what is your basis for that conclusion with
25 regard to the separate entity reporting?



1 A: Well, I would say, there's a hi- -- a high
2 level and then a more detailed basis. So, at
3 a high level, this goes to the question of what
4 determines profitability in this industry. Why
5 is -- does Tractor Supply as a Company earn the
6 levels of profitability that we observe on a
7 consolidated basis? And my -- it's my opinion
8 that there are effectiv- -- as an economist, I
9 see there to be two broad reasons. One, it
10 reflects the strength of customer demand in
11 South Carolina for the specific products that
12 the company sells in those particular
13 locations. These are brick and mortar
14 locations. This is not an internet-type
15 business. It has a small e-commerce business,
16 but it's by and large the vast majority of its
17 business is a brick and mortar business. So,
18 it -- the profitability that it earns reflects
19 the strength of that local customer demand at
20 that location where those brick and mortar
21 stores are for a specific brick and mortar
22 retail product, or I should say, for a product
23 sold through a brick and mortar outlet.

24 I would also say it reflects the relative
25 degree of competition, or lack thereof, of



1 competition from other competing retailers in
2 those local -- those same locations with a
3 similar, either format for the shopping
4 experience -- so the -- that lack of
5 competition is what allows the company to earn
6 relatively healthy margins. And I should say,
7 the relative lack of competition, I'm not
8 saying an absence of competition. But those
9 are the two basic things that economists look
10 to when assessing what drives profitability for
11 a type of -- a given business.

12 Q: All right. So let's dive into profitability
13 and how you determine profitability.

14 **MS. WOOTEN:** Ms. Buckner, do you mind switching
15 over? Thank you, very much.

16 Q: All right. As part of your assignment, have
17 you analyzed Tractor Supply's overall
18 consolidated level of profitability?

19 A: Yes, I have.

20 Q: All right. All right. If you will look to ---

21 **MS. GEER:** Nikki? Do you have any copies of those?

22 **MS. WOOTEN:** Yes.

23 Q: I'm handing Tractor Supply's counsel what's
24 been marked as Respondent's Exhibit 33. It's
25 being shown on the screen.



1 Do you need a copy or can you view it up
2 there? Dr. DeRamus?

3 A: Oh, I'm sorry. Do I need a -- I'm, I'm looking
4 at the screen.

5 Q: Okay.

6 A: Yes.

7 **(Respondent's Exhibit Number 33 was introduced into**
8 **the record at this time.)**

9 Q: You can look at the screen?

10 A: Yes.

11 Q: Okay.

12 **MS. WOOTEN:** Would the Court like a copy?

13 **THE COURT:** No, I'm good.

14 **MS. WOOTEN:** Okay.

15 **THE COURT:** We're -- I stand -- with what Dr.
16 DeRamus said.

17 **MS. WOOTEN:** Oh, you can look at it on the screen?
18 Oh, you're ...

19 **MS. BUCKNER:** Oh.

20 **MS. WOOTEN:** Thank you.

21 Q: All right. Could you please describe for the
22 Court what is on screen one -- or slide one.

23 A: Certainly. This is the company's taxable
24 income on a consolidated basis for 2014 to
25 2016. Which shows it earned somewhere in the



1 range of 550 million dollars, to just shy of
2 600 million dollars, during the years at issue,
3 on an annual basis.

4 Q: 500 -- I'm sorry. Did you say 550 million or
5 billion?

6 A: Million.

7 Q: Million. Okay. All right.

8 **MS. WOOTEN:** (To Ms. Gamble) You can go to the next
9 slide.

10 Q: All right. And if you will please describe for
11 the Court what is being shown on -- well, what
12 is being shown on slide two.

13 A: Certainly. So these are certain profitability
14 ratios for the company, so in -- for the years
15 at issue. There are a -- two of them, I think
16 are, are probably self-evident. The operating
17 margin is the operating profits divided by
18 sales. Markup on total costs is operating
19 profit divided by total costs. The return on
20 assets is operating profit divided by operating
21 assets. And operating assets are generally
22 considered things like, accounts receivable,
23 inventory, and in particular are property
24 planning equipment. In this case, this will be
25 a lot of their real estate that's owned by, by



1 the company. So these are alternative ways, or
2 alternative economic views, or alternative
3 financial views of the financial performance of
4 the company during this time period.

5 Q: And why would you focus on one of these ways,
6 or means, over another way?

7 A: Well, in transfer pricing analysis, it often
8 can matter dep- -- once you get into the
9 related party transaction, which of these
10 measures you look at. They're the fun- --
11 they're often referred to as PLIs, Profit Level
12 Indicators, in the §482 Regulations. There are
13 certain types of businesses that are more
14 conducive to being analyzed reliably -- or
15 benchmarked reliably with one or another of
16 these measures. I think there are -- and there
17 are others as well. There's something called
18 the Berry Ratio, which is the measure of gross
19 profit divided by operating expenses. So, each
20 of these op- -- an operating margin will often
21 be what you will gravitate to in analyzing the
22 profitability of a retailer, for example, or a
23 distributor. A return on assets is often what
24 you analyze in reviewing the performance of a
25 company that has a lot of tangible assets, for



1 example, a manufacturing company. But it's
2 also an important one to analyze even in the
3 context of a retail or a distribution activity,
4 particularly when there are related party
5 transactions that may distort some of the other
6 financial measures, depending how the company
7 measures the individual costs -- or, profit
8 elements in those measures.

9 Q: And as an economist, do you consider Tractor
10 Supply's consolidated profitability to be
11 particularly high?

12 A: I consider them to be hi- -- the, the --
13 particularly, the operating margin, to be
14 reasonably high for a, a retailer. A -- I have
15 seen in -- other retailers with higher ones,
16 but it is definitely on the higher si- -- the
17 higher end of that range. I should also say,
18 it's a company that persistently earns
19 relatively high profit margins year in and year
20 out. Other types of retailers are a little bit
21 more cyclical and, and others have suffered
22 more of the brunt of competition from Amazon,
23 for example, think of bookstores. So, at an
24 all in all basis, I consider it to be a highly
25 profitable company.

1 Q: And have you compared Tractor Supply's
2 profitability to other retailers?

3 A: Yes, I have.

4 Q: Okay. And can you describe what is being shown
5 on slide three?

6 A: So, slide three, and then, I believe the
7 following slide as well, shows the -- a, kind
8 of, a broad range of different kind of
9 retailers. And if you, kind of, eyeball them,
10 you'll -- particularly, if you look at the
11 period average, you can see the extent to which
12 profitability in the retail sectre -- sector
13 can vary quite significantly, both from
14 company-to-company, but also across sectors.
15 I think the easiest way to get a sense of that
16 is, maybe, starting at the bottom. Food
17 retailers generally earn smaller margins than
18 other types of retailers, they're selling in
19 much higher volumes. They are often selling in
20 quite close proximity to each other, so there's
21 competition to reduce those margins.

22 Then, as you go up, you'll see department
23 stores in, kind of, a range. In this, this
24 particular set of department stores, between
25 seven and 8.8 percent, for example -- I'm



1 sorry, it's between 6.7 and eight percent, so
2 what I would consider, kind of, a medium-level
3 of profitability for a retailer, given the
4 products that they sell. And then, as you get
5 into more specialty-type areas, you see
6 significantly higher profit margins, again,
7 depending on a specialty and depending on the
8 company.

9 So, for example, in automotive retailing
10 you see some quite substantial levels of
11 profitability as we observe for both O'Reilly
12 and AutoZone, for example. Then as you get up
13 into apparel retail, there's gonna be greater
14 variability depending on the extent to which a
15 given retailer has a particular niche in, for
16 example, running shoes for ex- -- or, or like
17 Foot Locker, for example, that specialize in
18 running apparel versus more general apparel
19 retailers such as -- for example, the Men's
20 Warehouse where you see considerably lower
21 levels of profitability.

22 As you go to the next slide, you'll see,
23 kind of, a similar, kind of, variability
24 depending on other sectors. General
25 merchandise stores, surprisingly, you see very



1 high levels of margins in companies that sur-
2 -- that provide very low unit value products,
3 like the dollar stores, the Dollar Tree, Dollar
4 General Corporation, as compared to other
5 companies that are more general retailers, even
6 as compared to Walmart, for example. And then,
7 similarly, in, in home improvement, you'll see
8 some variability across that, but still,
9 roughly, healthy margins in particularly the
10 larger ones, such as home- -- The Home Depot
11 and Lowe's, as compared to the smaller
12 companies.

13 Q: And have you lea- -- analyze the factors that
14 have lead to Tractor Supply's high level of
15 profitability?

16 A: Yes, I have.

17 Q: Okay. And is that routinely part of that -- an
18 analysis of a companies transfer prices?

19 A: Yes, it is.

20 Q: Okay. And based on your research and
21 experience, what do you consider is the reason
22 for Tractor Supply's high level of
23 profitability?

24 A: Well, I would say, kind of, back to my initial
25 framework of -- well, as an economist of



1 analyzing the profitability of a company, the
2 strength of customer demand for this specific
3 mix of products that the customer -- that
4 Tractor Supply sells in the location that it
5 sells them. So these are predominantly, either
6 rural or, what are often called an exurban,
7 i.e., kind of, just beyond suburban-type
8 locations where there is relatively less
9 competition from, kind of, the larger format
10 stores, at least, in the specific location
11 where the company has placed it's retail
12 locations.

13 A lot of the, the mix that it's selling is
14 centered around, what they call the hobbyist
15 farmer. So there is a large fraction of the
16 company's sales that it count -- that is
17 attributable to things like animal feed, for
18 example. So, a customer who's located in a
19 rural environment, who goes in to get their
20 animal feed or their pet food, goes into a
21 store and also has an opportunity to buy
22 additional products such as, clothing, work
23 clothing or yard implements, things that would
24 blend in more towards a hardware, kind of,
25 store offering.



1 And one of the reasons why I think it's
2 been very successful, is the fact that the
3 competition that it faces, particularly, in
4 that animal feed segment of the market, is
5 really for more small -- smaller mom-and-pop-
6 type feed stores. I just don't see the type
7 of, kind of, mass merchandising that you
8 observe, for example, in Walmart, in that, in
9 that feed store. So it's able to bring
10 customers in with that particular offering,
11 sell them a broader range of offerings, and
12 it's also appealing to customers who are for --
13 or, are -- who often use cash. And so, that
14 combination of big bulky items like animal
15 feed, and a cash transaction, means that you
16 are more protected from competition from the
17 likes of Amazon. And I think e- -- the
18 competition from e-commerce is probably the
19 biggest story in retailing today. And so, a
20 company's ability to maintain those high levels
21 of profitability really depend on the extent to
22 which it's protected from competition from,
23 from Amazon, because of the nature of the
24 product and the nature of the customer demand
25 in that location for the particular products

1 they sell.

2 Q: And your review of the documents, is -- are
3 economies of scale important to Tractor
4 Supply's business?

5 A: Yes, they are. They're very important.

6 Q: Okay. And how are they important?

7 A: Well, as I described before, the competition
8 that they primarily face is the smaller mom-
9 and-pop feed stores in that location, in these
10 rural environments -- or exurban environments
11 that cannot buy in the quantities that Tractor
12 Supply can. So, as it is able to sell -- buy
13 in bulk, in larger volumes, and it has a
14 national footprint, it's able to buy greater
15 volumes at a cheaper price and therefore
16 attract customers into the store, kind of, the
17 same way that Walmart was able to do so, as
18 compared to the smaller local department stores
19 that use to populate a lot of rural America.

20 **MS. WOOTEN:** (To Ms. Gamble) Advance the next slide.

21 Q: And, I think -- we're going back to the
22 operating margins we were talking about
23 earlier. We, we got off track on -- talking
24 about economies of scale and some other things.
25 If -- could you describe what's on slide



1 five, finishing up your thoughts on the
2 operating margin for Tractor Supply compared to
3 other retailers?

4 A: Certainly. So this just simply summarizes
5 Tractor Supply's operating margin, what we saw
6 early on, in terms of their -- is their
7 operating profits divided by sales, as compared
8 to the operating margins for these oth- -- this
9 broader range of retailers. And this is how --
10 this helps inform my deci- -- my opinion that
11 they're on the high side of that. They're not
12 on the extraordinarily high side -- they're not
13 extraordinarily high, i.e., they're not above
14 the 75th percentile of operating margins I
15 observe across this broader range of retailers,
16 but they're certainly on that higher side. I
17 would also say, this applies to -- if you use
18 a different kind of measure of profitability,
19 the markup on costs is gonna be very similar to
20 the conclusions you come to of -- in terms of
21 the operating margin.

22 The, the next slide is the return on
23 operating assets. Their, their return on
24 assets is significantly higher than the 75th
25 percentile for the comparables. A lot of that



1 is a reflection of the fact that Tractor Supply
2 leases a lot -- or has operating leases for a
3 lot of its retail stores, so they don't -- back
4 -- at -- during this time period, they did not
5 show up at their full value, or their
6 capitalized value on the balance sheets. So,
7 later on in, I believe, 2019 there was a change
8 in the accounting rules, and so those
9 capitalized leases come on the balance sheet,
10 which in turn, increases the size of its
11 property planning equipment and then lowers
12 this, our way -- this return on assets
13 somewhat. But, by any measure, it's still a
14 high level of profitability.

15 *(Whispering.)*

16 Q: And as part of your review of the documents and
17 your experience in the -- in transfer pricing,
18 have you formed an opinion with regard to the
19 profits of Tractor Supply versus the number of
20 stores and economy of scale?

21 A: Yes.

22 Q: Okay.

23 A: So the Demonstrative that's on the screen right
24 now shows how the company has progressed over
25 time, between 2000 and 2017, with the, the



1 orange bar being the number of stores. You
2 read the number of stores off the left-hand
3 axis, and the operating profits on the -- or
4 operating income on the right-hand axis. And
5 you can see that the company's expanded
6 considerably from, approximately, 300 stores
7 nationally in 2000, to well over, it looks
8 like, 1800 stores as of 2017. And its
9 operating profits have increased substantially
10 in keeping with that incre- -- the way it's
11 opened new stores in new physical brick and
12 mortar locations.

13 Q: So if you'll notice at the bottom of the
14 screen, there's a source, it's called
15 CapitalIQ. Can you describe CapitalIQ for the
16 Court?

17 A: Certainly. So CapitalIQ is one of the
18 commercial database vendors. It compiles
19 public information from, from public
20 financials, primarily. Often it will compile
21 additional types of information. They are --
22 it -- CapitalIQ is probably the largest such
23 provider. It's kind of like Bloombergs. You
24 might be more familiar with Bloombergs. But
25 for purposes of financial statement allow- --



1 analysis and, particularly, in transfer pricing
2 analysis, I would say, CapitalIQ has become --
3 I wou- -- don't wanna say the defacto standard,
4 but it's, it's widely used.

5 Q: Okay. And is that something professionals,
6 such as yourself, routinely rely upon in their
7 practice with transfer pricing analysis?

8 A: Yes. And often times, the -- or, again, almost
9 always, the financial information they are
10 pulling is the financial information from the
11 company's 10-Ks.

12 Q: All right. And just for the record, is the
13 information on -- or the analysis on the screen
14 your analysis, or CaptialIQ's analysis?

15 A: So the underlying data is from CapitalIQ, but
16 the analysis is the analysis I have performed.

17 Q: Okay. All right.

18 **OBJECTION:**

19 **MS. GEER:** Your Honor, I don't -- I have not seen
20 this before. But, I would object to this. I
21 mean, this is the first time I've seen it,
22 today. We asked for the expert's file. We
23 asked for all documents that support their
24 case, and this appears to be a document that
25 they are using to support their case that was



1 -- I mean, it's different th- -- to me, this is
2 different than trial, trial presentation, where
3 you're pulling documents that have already been
4 in evidence, already been provided to the other
5 side.

6 **THE COURT:** Response?

7 **MS. WOOTEN:** Sure. And I'm happy to have Dr.
8 DeRamus explain that more. But if you'll
9 notice it says, Operating Profits and then --
10 and number of stores, the previous six slides
11 -- or four slides, were discussing Tractor
12 Supply's operating profits, the analysis that
13 he's done, he presented -- all of this
14 information -- it may be in a different format
15 than what Ms. Geer is seeing right now, but Dr.
16 DeRamus' opinions, the support for his
17 opinions, and the data he relied upon was all
18 discussed during his deposition.

19 **THE COURT:** So this graph is simply a reflection of
20 the data that he has testified to earlier?

21 **MS. WOOTEN:** Yeah. And I'm happy to ask that to him
22 -- ask that information to ---

23 **MS. GEER:** I mean, this, this does not have a Bates
24 number on it. So, it definitely ---

25 **THE COURT:** Well, it's a Demonstrative Exhibit.



1 **MS. GEER:** Right.

2 **THE COURT:** So.

3 **MS. GEER:** So, I, I would -- if they can show me
4 where he discussed this -- these numbers and
5 this graph in the deposition, I'll certainly
6 consider -- I, I just don't think they have.

7 **THE COURT:** (To Ms. Wooten) Go ahead.

8 **MS. WOOTEN:** Sure. Again, I don't believe the
9 actual document that you're seeing is up there,
10 but the data behind it in his opinions are in
11 the deposition.

12 **THE COURT:** Well, go ahead.

13 **Q:** Dr. DeRamus, is there any other information
14 that you can provide for the Court regarding
15 slide number eight, and the data and your
16 analysis behind it?

17 **A:** Certainly. And I -- I'm trying to recall which
18 analyses I've done at different points in time.
19 So, I was deposed in August of 2022, and I
20 received Dr. Andrade's report in Novem- -- I'm
21 -- or was it -- it may have been December. And
22 there was additional information provided by
23 Dr. Andrade at that point. So I have continued
24 my analysis, both from the time leading up to
25 my deposition, after my deposition, and



1 particularly after receiving Dr. Andrade's
2 report and additional information. So, my
3 analysis has been ongoing.

4 I'm trying to recall the spe- -- I know in
5 my deposition we discussed at length, the issue
6 of -- I believe, we discussed at length, the
7 issue of economies of scale, but again, I'm
8 doing this from memory. But, economies of
9 scale are an important issue in, I think, in
10 this case. And it's also referenced in the
11 documents that the, that the, the company's
12 documentation, the PwC Report, talks about
13 economies of scale, and it plays a critical
14 role in its analysis. I believe the operating
15 income level, I think, I can visualize the, the
16 spreadsheet that contains that, that was
17 probably produced as part of my work papers at
18 the time. I just don't recall whether I ever
19 drew a graph relative to the number of stores
20 at that point in time, but it would've been --
21 the number of stores is information that's in
22 the 10-Ks, which I had been reviewing at the
23 time. So I had been looking at the number of
24 stores.

25 Again, I just don't know -- I -- exactly

1 the point in time when I would've had -- well,
2 pulled all the data for all the stores from
3 that same, that same Cap IQ database.

4 Q: Okay. All right. Could ---

5 **THE COURT:** (To Ms. Geer) I'll hear from you again
6 when she offers this.

7 **MS. GEER:** Okay.

8 **THE COURT:** Regarding this particular exhibit.

9 **MS. GEER:** Your Honor, I have a, have a suspicion,
10 based on what I'm flipping through, that there
11 will be others. Do you want -- can I wait --
12 can I have an objection ---

13 **THE COURT:** I think just ---

14 **MS. GEER:** --- that gets -- on every -- or you want
15 me to object ---

16 **THE COURT:** --- object whenever it's offered.

17 **MS. GEER:** --- to each one? Okay.

18 **THE COURT:** Okay.

19 **MS. WOOTEN:** Yeah. And they're highlighted in red,
20 for the ---

21 **MS. GEER:** Okay.

22 **MS. WOOTEN:** So, to lea- -- just leave those.

23 Q: All right. Going back to slide eight. What is
24 -- based on the information that you've
25 received, have you reached a finding or



1 conclusion or basis for your opinion, regarding
2 the increase sales in the store locations with
3 regard to their profit over time?

4 A: Yes. And it's, I think, it's also reflected in
5 a lot of the analysts statements, that the
6 expectation is that the company is a --
7 particularly, those analysts who considered a
8 good investment opportunity, focus quite
9 extensively on its growth potential, its
10 ability to increase earnings and earnings --
11 ultimate earnings per share by opening new
12 store locations, new physical brick and mortar
13 locations, and that that is expected to have a
14 in- -- an impact on the company's
15 profitability. And I've also -- the next
16 slide, the one you see up, right now, shows
17 that it's not simply -- that opening new stores
18 didn't simply lead to greater profits per s- --
19 alone, but it also lead to increased profit
20 margins. And so, you see that on the --
21 whether you look at the gross margin level,
22 which it rose from about 27 percent in 2000,
23 all the way up to, just shy of 35 percent in
24 2017, or -- you see the same thing at the
25 operating profit -- or operating margin level,



1 which rose from approximately five percent in
2 2000 up to -- close to 10 percent, which is
3 what we had seen in that earlier slide by the
4 -- during the tax years at issue and through
5 2017.

6 Q: Okay.

7 A: And I should say, this is -- I believe, all of
8 these data that are here, are similarly
9 reflected in the -- in that original
10 spreadsheet that I recall -- that I believe,
11 was part of the work papers provided in advance
12 of my deposition.

13 Q: And from a transfer pricing perspective, can a
14 company's purchasing arm claim the benefit from
15 economies of scale to itself?

16 A: Well, it can attempt to do so, but it's not --
17 but I -- that's probably one of the -- frankly,
18 some of the older attempts to unreasonably
19 shift income from one jurisdiction to another
20 that I've seen, in an international context.
21 So, for exam- -- the classic example would be,
22 a large company purchases in large volumes from
23 various vendors, it obtains volume discounts.
24 And it then says, okay, I'm going to buy at the
25 discounted price that, that the company is able

1 to earn, but then I'm going to resell to my
2 related parties at a higher price, namely, the
3 undiscounted price, as if the related parties
4 were not able to enjoy the benefit of those
5 economies of scale.

6 This is often -- economies of scale, and
7 particularly economies of scale in purchasing,
8 are often referred to as a passive association
9 benefit in the transfer pricing world. It's
10 the, it's the benefit that a -- an entity
11 receives simply because it's part of that
12 larger organization, it's not something that
13 the purchasing arm earns, per se, because of
14 the specific nature of that -- of the function
15 it performs.

16 Q: And in your research, did you review statements
17 by the company regarding reasons for Tractor
18 Supply's high level of profitability?

19 A: Yes, I did.

20 Q: Okay. If you will look in front of you, there
21 are a stack of documents. And one is entitled
22 Respondent's Exhibit 5.

23 A: I know there's a pending question, but, do you
24 mind if we take a one minute break? Just
25 because I seem to have spilled a little bit of



1 water and ---

2 Q: Sure.

3 A: --- I don't want to get the documents wet.

4 Q: Sure.

5 **THE COURT:** It's a good time to take one anyway.

6 **MS. WOOTEN:** Okay. Thank you.

7 (Off the record from 2:32 p.m. until 2:43 p.m.)

8 **THE COURT:** Okay.

9 Q: Before we broke, I asked if you could pick up
10 Respondent's Exhibit 5, and review that.

11 A: In -- I'm sorry. In the binder?

12 Q: No, there should be a separate document
13 entitled Respondent's Exhibit 5. Right here.
14 It's just down in here. And go ahead and grab
15 6, too, right there (indicating).

16 Do you recognize what's been identified as
17 Respondent's Exhibit 5?

18 A: Yes, I do.

19 (Respondent's Exhibit Number 5 was referenced at this
20 time.)

21 Q: Okay. And what is this?

22 A: So Exhib- -- Respondent Exhibit 5, is a -- an
23 Earnings Call Transcript dated February 1st,
24 2017. It's where certain company executives
25 provide information in verbal -- in a earnings



1 call with analysts.

2 Q: Okay. And did you obtain this information?

3 A: Yes, I did.

4 Q: Okay. And when did you obtain it?

5 A: I believe, I obtained it before my deposition.
6 I -- as part of, kind of, my broader research
7 into some of the analysts reports and the 10-
8 Ks, and the statements that the company's ma-
9 -- the company made.

10 Q: And, part of producing your file to Tractor
11 Supply Company prior to your deposition, was
12 this document included in that file?

13 A: I believe so, yes.

14 Q: Okay. And is this the type of information
15 that's routinely relied upon by professionals,
16 such as yourself?

17 A: Yes, it is.

18 Q: Okay. And why?

19 A: Because it -- in conjunction with analysts
20 reports and the 10-Ks, it provides helpful
21 insight into what the company describes as the
22 various factors that contribute to its
23 profitability and to its near-term outlook, or
24 even longer term outlook. Often times a
25 company executive will, will outline the



1 strategy that they intend to pursue, so that
2 can give you a sense, as an analyst, of the
3 relative importance of factor A versus factor
4 B in evaluating what is really driving a
5 company's profitability and long-term growth.

6 Q: Okay. And, in your profession and your
7 experience, do you consider earning call
8 transcripts to be reliable?

9 A: Yes, I do.

10 Q: Okay.

11 MS. WOOTEN: Your Honor, at this time, the
12 Department would offer Respondent's Exhibit 5
13 into evidence.

14 MS. GEER: Do I have a copy of that? I didn't ...

15 MS. WOOTEN: I did, yeah -- I provided ---

16 MS. GEER: Okay.

17 MS. WOOTEN: --- it with Marjorie. I asked her
18 questions on the first day and I gave it to you
19 that day. It was -- that was the Earnings Call
20 where I had to take out ---

21 MS. GEER: Yeah.

22 MS. WOOTEN: --- portions.

23 MS. GEER: Yeah.

24 MS. WOOTEN: I don't know if I have another copy.

25 MS. GEER: Or could you just put it up on the



1 screen?

2 **MS. WOOTEN:** I can. I'm gonna have to switch from -

3 --

4 **MS. GEER:** Oh, okay. So, on- ---

5 **MS. WOOTEN:** If you hang on a second, I'll see if I
6 have another copy.

7 **MS. GEER:** (To Mr. Streisel) Do we have 5? Okay.
8 So, what you have on the screen is -- this is
9 definitely ---

10 **MS. WOOTEN:** I have not sho- -- I have not shown ---

11 **MS. GEER:** --- totally separate ---

12 **MS. WOOTEN:** Yeah. I have ---

13 **MS. GEER:** Okay.

14 **MS. WOOTEN:** --- not shown what's ---

15 **MS. GEER:** This was the last one. You're moving on
16 to the next one?

17 **MS. WOOTEN:** I'm moving on to the next one, but ---

18 **MS. GEER:** Okay.

19 **MS. WOOTEN:** --- I'm getting this in the record
20 before we talk about it.

21 **OBJECTION:**

22 **MS. GEER:** I understand. Your Honor, our objections
23 to this ...

24 Nikki, was, was this, 4763, was that
25 produced like a week, a week ago?



1 **MS. WOOTEN:** No. 4763 was produced at the time of -
2 - before his deposition.

3 **MS. GEER:** Okay. Then our objection to this one was
4 simply that it was not authenticated.

5 **THE COURT:** Okay.

6 **MS. WOOTEN:** Your Honor ---

7 **THE COURT:** He said he relied upon it, no?

8 **MS. GEER:** I mean, an expert can rely on many things
9 that don't come into the record if they aren't
10 authenticated, is ---

11 **THE COURT:** Yeah.

12 **MS. GEER:** --- my understanding. So, he can rely
13 upon it, but it can't -- doesn't come in as
14 substantive evidence, right?

15 **THE COURT:** An expert can rely upon many things that
16 don't come into the record.

17 **MS. GEER:** Right.

18 **THE COURT:** I ---

19 **MS. GEER:** She's now trying to put it in the record,
20 though.

21 **THE COURT:** I understand.

22 **MS. GEER:** And I'm saying it's not authenticated.

23 **THE COURT:** Oh, okay.

24 **MS. WOOTEN:** Your Honor, on the first day I went
25 through this specific document and I asked --



1 and I apologize, I'm gonna call her Marjorie
2 again.

3 **THE COURT:** Yeah.

4 **MS. WOOTEN:** I asked her specifically if we went
5 through the website and looked, that Tractor
6 Supply Company publishes earning calls on their
7 website, she confirmed that they do. We went
8 through this particular document and we talked
9 about the specific company executives that have
10 made statements in the document, she confirmed
11 that those were Tractor Supply executives.

12 **THE COURT:** Okay.

13 **MS. GEER:** They were -- these were not on the
14 website. They do post some on their website,
15 but they don't have ones from this time period
16 on their website. So, this is from another
17 website.

18 **THE COURT:** Give me the Rule, if you're about to.

19 **MS. WOOTEN:** Sure. (Reviews Document.)

20 So, with regard to the actual document, we
21 believe that it is authenticated, it doesn't
22 need to be -- Ms. Marjorie authenticates that
23 specific document. She authenticated that
24 there are transcripts, earning transcripts, on
25 the website. She identified everyone -- or,



1 the particular Tractor Supply individuals and
2 executives that made the statement. And Dr.
3 DeRamus routinely relies on that information
4 and it's considered reliable in his profession.

5 **THE COURT:** Where did this come from (indicating)?

6 **MS. WOOTEN:** Dr. DeRamus got it from ---

7 Q: Dr. DeRamus, where did you obtain the Earnings
8 Call?

9 A: We would've pulled it from our general research
10 capabilities. So it would've been from one of
11 our -- probably our vendors -- our, our data
12 vendors that consolidates this information and
13 retains historical earnings calls like this.

14 **THE COURT:** So, you didn't go specifically to their
15 website to get it, you got it from a vendor?

16 A: I, I was told that -- this -- I -- this is
17 something that I asked my staff to do, so I
18 don't recall asking him specifically whether he
19 went to the website. My expectation is that he
20 would've obtained it as part of, kind of, a
21 broader data dump from the -- from our, our
22 general research web services, since -- just
23 like with our -- the financial information, you
24 go to one place, like, like a Bloomberg's. So,
25 so that's why I can't say with certainty,



1 whether he got it from the website or whether
2 he got it from the -- from our, our gen- -- our
3 database ---

4 **MS. GEER:** Well, we went ---

5 **DR. DERAMUS:** --- provider.

6 **MS. GEER:** --- to the website, it's not on the
7 website.

8 **THE COURT:** Well ... (To Ms. Geer) Well, you're not
9 under oath either, now.

10 **MS. GEER:** I'm, what?

11 **THE COURT:** You're not under oath to testify about
12 that either.

13 **MS. GEER:** No, I mean, while, while we ---

14 **MS. WOOTEN:** That -- during -- we were ---

15 **MS. GEER:** We went in his file.

16 **MS. WOOTEN:** We were gonna ---

17 **THE COURT:** Oh, y'all ---

18 **MS. WOOTEN:** We did ---

19 **MS. GEER:** Yeah.

20 **MS. WOOTEN:** We did go before, and Tractor Supply's
21 only archived them through 2018. So earning
22 call transcripts are on the website through
23 2018.

24 **THE COURT:** And that's a 20?

25 **MS. WOOTEN:** And this is a 2016, or '15?



1 MS. GEER: I think this is ---

2 DR. DERAMUS: 2017.

3 MS. GEER: --- '17.

4 MS. WOOTEN: '17?

5 MS. GEER: '17.

6 THE COURT: Yeah.

7 MS. WOOTEN: So it's an earning calls transcript
8 from '17.

9 THE COURT: Oh ---

10 MS. GEER: '17 is also outside the audit period, but
11 that's just another issue.

12 MS. WOOTEN: Can I hold that for just a second?

13 MS. GEER: Oh, yeah. That -- that's not -- I'm not
14 objecting on that basis.

15 MS. WOOTEN: It's also for fiscal quarter 4/20/16,
16 which is part of the audit period. The
17 transcript -- I mean, the call occurred in
18 2017.

19 THE COURT: Well, I'm ...

20 MS. GEER: I think he can rely on it upon it, Your
21 Honor.

22 THE COURT: I do -- yeah, I ---

23 MS. GEER: I think that's ---

24 THE COURT: That's what I was gonna say ---

25 MS. GEER: Yeah.



1 **THE COURT:** --- he can rely upon it ---

2 **MS. GEER:** Yeah. It just shouldn't ---

3 **THE COURT:** --- but it's not gonna ---

4 **MS. GEER:** --- come in as substantive evidence.

5 **THE COURT:** I honestly think I'm doing an improper
6 ruling because I really think that's probably
7 authentic. But just following the Rules of
8 Evidence and what he just testified to, I'm
9 gonna sustain the objection.

10 **MS. WOOTEN:** Okay. Thank you, Your Honor.

11 **MS. GEER:** Thank you, Your Honor.

12 **MS. WOOTEN:** All right. (To Ms. Gamble) If you'll
13 advance to slide 10.

14 **Q:** Okay. Before that dialogue, we talked a little
15 bit about -- or -- excuse me, you confirmed
16 that you reviewed statements by the company
17 regarding their high level of profitability, is
18 that correct?

19 **A:** Correct. I did.

20 **Q:** Okay. If you could please describe what's on
21 slide 10.

22 **A:** So, on slide 10 it -- these are -- these
23 reflects -- these reflect statements from the
24 company's 10-K regarding its current and long-
25 term growth strategy. So it, effectively,



1 reflects statements similar to the, the
2 conclusions I summarized before, in terms of
3 what's really driving the long-term growth and
4 profitability of the Company. And they focus
5 on the things that you would expect for a
6 retailer. They focus on the importance of
7 opening new retail stores, again, the new
8 retail brick and mortar locations. They, they
9 talk about trying to achieve comparable sales
10 store growth, i.e., not simply expand the
11 number of stores, but increase the sales that
12 they're giving -- they're earning in the stores
13 that they already have. And doing it through
14 a combination of, of efforts, both on, what
15 they call targeted merchandising and marketing
16 programs, it's also this, this val- -- everyday
17 value price philosophy, so that customers go in
18 and they can see prices that they would expect
19 to be reasonably competitive, and very
20 competitive relative to, particularly, the
21 smaller retailers that they might otherwise
22 shop at.

23 It talks about a broad range of other, of
24 other factors that they are doing to enhance
25 their product margins, such as strategic



1 product sourcing, inventory markdown
2 management, the things you would expect, also,
3 a retailer to focus on, which is constantly
4 ensure the efficiency and improvements to the
5 efficiency of those retail operations. That's
6 why they, they talk about continuous
7 improvement in the elimination of waste in all
8 their processes. They do talk about the e-
9 commerce and internet-supported sales as a --
10 one particular part of their long-term growth
11 strategy that I, I can come back to in a little
12 bit, but they also talk about acquisitions, as
13 well.

14 **MS. WOOTEN:** (To Ms. Gamble) If you'll advance to
15 the next slide.

16 **Q:** Does the 10-K -- the company's 10-K also talk
17 about its retail employees?

18 **A:** Yes. It has a fairly extensive discussion
19 about the employee -- about their employees and
20 the importance of their retail employees. I
21 think it's important to contrast a -- the way
22 different retailers use in-store employees to
23 differentiate themselves relative to one
24 another. The company, as I understand it, emp-
25 -- tries to employee people with a farming

1 background, or at least some kind of knowledge
2 of the products that they sell, because one
3 thing that they try and pride themselves on is,
4 when a customer comes into the store, there's
5 someone there who can provide them with
6 specific recommendations of the products they
7 sell, rather than, maybe, the classic big-box
8 experience that many of us have had, where you
9 walk into a very large store and you have no
10 idea what yo- -- you know, where you can find
11 the thing you're looking for and you don't have
12 a knowledgeable sales person, simply because --
13 that's one of the reasons they're keeping their
14 ver- -- their margins very sm- -- very tight,
15 is to have low prices in that, kind of, broader
16 big-box format.

17 So, their stores -- they do extensive
18 amounts of sa- -- of store training on their
19 employees, as well. And even down below,
20 you'll see that -- the very last line is Vendor
21 Product Presentations, as I -- I've read
22 through their 10-Ks, there are discussions
23 about their vendor partners where their part-
24 -- their vendors will provide information on
25 their products to the retail store employees so

1 the store employees can better sale those
2 products.

3 *(Whispering.)*

4 Q: All right. We're skipping 12. That was the
5 slide that talks about the analyst reports. Do
6 you recall the information, with respect to
7 those earnings calls?

8 A: Well -- yeah, I'm trying to remember which one
9 said which. So, with regard to their analyst
10 reports, and then there's the earnings calls.
11 So, analyst reports will be something that --
12 like, a J.P. Morgan analyst will write about
13 the company because it's a publicly traded
14 company. And then, there are the earnings
15 calls, where the executives of the company will
16 be on the phone and talking about the things
17 that drive the profitability. I would say
18 there are -- the things that they ar- -- the
19 analysts talk, are very similar in nature to
20 the thing -- the things that the executives
21 talk about. The analysts focus on things like
22 the product assortment that the company has as
23 being important. The fact that it has fee- --
24 that feed accounts for and these, what's called
25 CUE products, Consumable, Useable and Edible



1 products, and those account for a large
2 fraction of the, of the store sales because
3 that's what pulls people into the store, but
4 then, they have the opportunity to buy these
5 broader array of either, clothing products or,
6 or hardware products, or lawn care, or even
7 seasonal-type products, and that seems to be a
8 format that works very well in these rural
9 locations that helps drive sales in those
10 locations. And they also talk about -- at
11 least, some of them talk about this protection
12 from Amazon, that this is the type of business
13 that ha- -- particularly, because of the large
14 cash customers -- or the large fraction of
15 customers that are cash-paying, and the fact
16 that you have these bulk purchases as being,
17 kind of, a big driver of what they're doing,
18 that it drives those customers to keep coming
19 back to that brick and mortar Tractor Supply
20 location rather than simply sitting in their
21 home and clicking a button and ordering the
22 product for delivery through Amazon.

23 Q: All right. The next couple of slides, I think,
24 13 through the next -- they're more quotes from
25 10-Ks. Without reading them, if you could just



1 briefly talk about why those statements in the
2 10-K are relevant to your opinion and analysis.
3 A: Certainly. I -- the, the company and the --
4 and PwC, and Dr. Andrade talk extensively about
5 the procurement function and the importance of
6 the procurement function, to the profitability
7 of the company. In the 10-K, I think it's
8 important to review, kind of, the broader range
9 of activities that the company itself
10 highlights. And those -- many of those
11 activities are performed, either at the local
12 store level by retail store employees, by -- or
13 by local management, or they're bro- -- they're
14 performed by other staff at the headquarters
15 that are part of TSC the, the taxpayer.

16 So, for example, advertising. Advertising
17 and marketing is a function that's part of the,
18 the -- TSC the parent company. It's performed
19 by the individuals sitting in the same
20 Tennessee headquarters as the procurement
21 folks, and it is part and parcel of their,
22 their strategy to increase sales to figure out
23 how to target the product offerings, and to
24 inform customers about their product offering,
25 as well as things like, this Neighbor's Club

1 Program, which is similar to many customer
2 loyalty programs. These are ways to engage
3 with a customer, to -- if you sign up with
4 their Neighbor's Club Program you'll get e-
5 mails every day talking about the things that
6 you've recently purchased and whether they're
7 on sale, and -- as a way of getting customers
8 into the, into the store. Those actions drive
9 profitability. Those actions are -- the --
10 with regard to the design of those programs,
11 the administration of those programs, those are
12 done by the headquarters part of TSC, not part
13 of the procurement function. They're actually
14 implemented at the store level, when the cash
15 registers -- at the cash register, the person
16 says, would you like to sign up for our, our
17 customer rewards-type program?

18 With regard to the, the other statements
19 that are in there, we know there are statements
20 about the importance of their customer returns
21 program, or their -- I'm sorry, the special
22 order function. So there's a larger array of
23 products that a customer can buy from Tractor
24 Supply than what's on its shelf. So it has a
25 fairly extensive staff in the TSC headquarters,



1 again, not part of Texas, but part of the Cal-
2 -- the South Carolina taxpayer that manage that
3 process. And, interestingly, a lot of those
4 orders actually happen through -- or appear to
5 happen through the store level. So the
6 customer walks into the brick and mortar store,
7 places the order that way with -- as a special
8 order, and sometimes with the assistance of
9 the, of the folks in the Tennessee
10 headquarters, perhaps other times, simply as a
11 result of a key entry, by the person at the
12 store itself.

13 The -- there's a discussion about internet
14 sa- -- their internet sales. One thing I found
15 surprising is, there wasn't a greater expansion
16 of the volume of sales for a retailer like
17 Tractor Supply through the -- through internet
18 sales, given the extent to which so many
19 individuals have migrated a lot of their
20 shopping to internet purchasing. And it turns
21 out that, particularly, for the segment that
22 they're going after it appears that the
23 internet, primarily, is -- it's very -- they
24 have to have an internet presence, but often
25 times it's used as, almost like a store --

1 simply a store locator. So if I'm a customer,
2 I wanna find out where the, the nearest Tractor
3 Supply store is, I go to the internet, find
4 that and then walk into the brick and mortar
5 store to buy my purchase. Again, something
6 that helps to inform my opinion as an Economist
7 and that importance -- and that critical
8 importance of that brick and mortar presence,
9 that is not simply about product availability
10 in general, it's not about the product
11 assortment, it's about that availability at
12 that local store.

13 The slide you have up there is also -- I
14 did look to see the statements that the custom-
15 -- that the company had in its 10-K about the
16 importance of its vendor relationships. And
17 similar to statements I've seen with other
18 retailers or even other manufacturers, it
19 states it's not dependent on a, on a particular
20 vendor. It uses a lot of vendors, hundreds of
21 vendors. And, particularly, that last sor- --
22 the, the last two lines that are highlighted on
23 the screen, that it has adequate source of
24 supply at substantially similar costs for
25 nearly all of our products, i.e., there's no



1 one special sauce that the company has with
2 regard to, kind of, a privileged position with
3 one supplier that is able to provide it with
4 the kind of competitive advantage that it seems
5 to be asserting in the company's other
6 documents, or in the documents -- the -- such
7 as the PwC document or Dr. Andrade's analysis.
8 And also, that they have no long-term
9 contractual commitments.

10 So my inference from this, and based on my
11 other work, not only for a retailer -- or in
12 the retail sector, but also from manufacturing,
13 these comp- -- the, the vendors from whom
14 they're purchasing, I expect would also be
15 selling at similar prices to other retailers,
16 or other purchasers, assuming those other
17 purchasers are buying at similar volumes as
18 Tractor Supply.

19 Q: And who within Tractor Supply manages these
20 vendor relationships?

21 A: So, the, the procurement function itself,
22 again, is part of Texas even though it's
23 sitting in Tennessee, so it's at that
24 headquarters function. So -- and, I've
25 reviewed the employment records or, at least,

1 databases that have the employees and their,
2 and their typ- -- both their names and their
3 titles, and where they sit, i.e., which legal
4 entity they belong to. So, the -- it, it
5 appears that the vast majority, but not all of
6 those in the -- in dealing with purchasing, are
7 in Texas. The person in charge of it appears
8 to actually be a person who -- the -- at the
9 executive level, is Mr. -- I believe, it's
10 Barbarick, and he is a -- at the -- as an
11 executive, he's an employee of TSC the parent
12 company, and thus an employee of the South
13 Carolina taxpayer. So he, himself, at the --
14 sitting on top of that function, is not part of
15 Texas.

16 Q: And in your research, did you view -- or review
17 any financial analyst reports assessing your
18 reasons, again, for Tractor Supply's high level
19 of profitability?

20 A: Yes, I did.

21 Q: Okay. And can you explain to the Court the
22 conclusions that you drew from those analyst
23 reports?

24 A: Yes. And, I'm sorry, I probably answered that
25 in your previous question, when you were asking



1 me about both the, the analyst calls and the
2 inven- -- the, what I understood you to be
3 asking about, the analyst -- the, the analyst
4 reports, that it's similar to the things I
5 talked about here. That it's -- they're
6 looking at having an expansion of new brick and
7 mortar locations, and that the Company has an
8 opportunity to further expand, quite
9 substantially, those brick and mortar
10 locations. And if it does so, then it will --
11 able to simply increase its overall level of
12 profits, but it's at profit margins. The, the
13 analysts seem to think that there's the
14 opportunity to increase the density within a
15 given geographic location, i.e., back to this
16 issue of, what is the nature of localized
17 competition that Tractor Supply faces in these
18 various communities. Apparently, there are
19 more areas in which that localized competition
20 for these particular products is not
21 sufficiently strong to prevent them from in- --
22 from opening new stores and earning similar
23 levels of profits in these new locations.

24 Q: And if you'll look on the screen. I wanna look
25 at slide 17. This is another excerpt from the,



1 the 10-K. How does the product category in the
2 percent of net sales, how does that relate to
3 your opinion in this matter?

4 A: So, again, it helps to inform my opinion as
5 what's driving that customer demand. What's
6 driving customers to go into the store. And a
7 lot of it is because of the importance of this
8 livestock and pet category. You'll see it
9 comprises about 44 to 46 percent of the
10 company's sales. These are not the highest
11 margin sales that the company makes. The
12 company makes more money per unit it sells, on
13 -- or, per dollar of sales on some of the other
14 products. That's what gets a customer in
15 there, the customer comes back to buy those
16 things and then, often times, it's buying
17 things as a matter of more -- or, what I would
18 think of as, as impulse -- either impulse
19 purchases or things that might be -- it's a
20 more efficient way to do your shopping. If you
21 go in and you're buying your horse feed and,
22 and you need a pair of boots, why not buy the
23 boots that are right there next to the horse
24 feed rather than going out to another store.

25 Economists often talk about this as --



1 effectively, it's -- the term is monopolistic
2 competition, that fir- -- even though they
3 sound like they're oxymorons, it's a way in
4 which companies in reasonably competitive
5 industries try and differentiate themselves
6 from one another in almost, kind of, a spacial
7 sense, so that customers are more likely to buy
8 their set of products, and in ways that the
9 customer -- that the company can earn higher
10 profit margins than you would otherwise expect
11 based on, simply the basic -- the pure product
12 charaster -- characteristics. Customers find
13 it convenient to buy things at the same time,
14 and therefore they're willing to pay a little
15 bit more for the things that they do buy.

16 **MS. WOOTEN:** (To Ms. Gamble) All right. Go ahead to
17 the next slide.

18 Q: Have you analyzed the company's balance sheets?

19 A: I have.

20 Q: Okay. And what did you find?

21 A: Again, as I would expect with this company as
22 a retailer, that on the assets that the company
23 relies on to help generate the sales,
24 inventories play a significant role. As to --
25 so when a customer goes in to a, to a Tractor

1 Supply store the extent to which it's going --
2 the customer's going to come back, really
3 depends on the extent to which the product the
4 customer's looking for is right there on the
5 shelf, and when the customer leaves they feel
6 like, oh, the cu- -- this store, Tractor
7 Supply, has the type of products that I want,
8 and therefore it generates the type of goodwill
9 that keeps the customer coming back for repeat
10 purchases. So inventories accounts for the
11 majority of the company's assets. Accounts
12 receivable, not so much, because these are
13 customers who are paying on cash or credit
14 cards, so unlike industrial customers, you'll
15 see more accounts receivable. The property
16 planting equipment net, which is also circled
17 in red here, is actually -- while it's
18 substantial in dollar amounts, just shy of a
19 billion dollars, it's actually relatively low,
20 given the number of stores it has, simply
21 because of the fact that the company has a lot
22 of its stores under capital -- under, under
23 long-term leases, so once that accounting rule
24 changed, that number pops up a lot.

25 It has -- the -- I think it's also



1 important to look at the company's liabilities,
2 and particularly, its accounts payable. So
3 this is the monies it owes its vendors. And
4 so, some other companies I've seen in the
5 retail sector, are actually able to hold off
6 paying their, their vendors until they sell a
7 significant amount of their inventory they
8 purchase. In this case, there, you see, kind
9 of, a disproportionate -- the, the amount of
10 inventories is far higher than the accounts
11 payable, which suggests the company is
12 deploying capital, an important amount of
13 capital, putting that in inventory on its
14 shelf, and in advance it has to pay the in- --
15 the, the vendors before it actually sells all
16 that inventory. So, that helps -- and also, in
17 terms of thinking about, what are, kind of,
18 reasonable ways in which different entities
19 should be compensated, from a transfer pricing
20 structure, the importance of inventory is --
21 kind of, goes into that depart -- that
22 determination.

23 Q: Okay. And with regard to inventory ---

24 **MS. WOOTEN:** (To Ms. Gamble) If you'll advance to
25 the next slide.

1 Q: Did you also look at the amount of inventory
2 per store as part of your analysis?

3 A: Yes. And so, this slide shows that you have
4 anywhere between seven -- approximately,
5 700,000 and \$800,000 a store. Some of that
6 reflects the fact that these stores -- it's,
7 it's significant in any, kind of, reasonable
8 measure of the term, companies have to have
9 that store -- well, the, the -- I'm sorry.
10 Tractor Supply needs to have those stores well
11 stocked in order to -- and with a lot of
12 inventory sitting on the shelves, you -- not
13 that -- so the customers come in and they don't
14 simply see empty shelves and are not able to
15 find the things they need, it's not, I would
16 say, kind of, the level I would expect from a
17 big box format. So this, kind of, reflects
18 their -- kind of, a -- what I'd call more of a
19 medium box retail format. So, it's still
20 significant, and -- it's amount of inventory
21 they have to have year in and year out, but
22 it's not at the level that you would expect on
23 a -- for a bigger format store. But, still,
24 much bigger than a -- the smaller mom-and-pop
25 feed store that you would typically encounter



1 in these areas.

2 Q: And so, with regard to the inventory held by
3 Tractor Supply Company, which, in this case, is
4 the South Carolina taxpayer, which legal entity
5 holds that?

6 A: So, for the TSC store, so the retail stores in
7 every state except for Texas and Michigan, that
8 inventory is almost entirely held by TSC
9 itself. So, TSC can hold that store -- that,
10 that inventory in one of two places, either
11 it's on the shelves in the retail stores, so
12 you walk into a store in South Carolina and
13 that inventory is sitting on a shelf or it's
14 being held in distribution centers, and the
15 vast majority of the inventory held in
16 distribution centers, that's being held
17 ultimately for sale through the retail stores,
18 in this TSC footprint, i.e., excluding Texas
19 and Michigan, these are -- that inventory is
20 being held in TSC distribution centers.
21 There's a small amount of inventory in
22 Tennessee -- I'm sorry, in Texas, the Waco
23 Distribution Center that goes out to a couple
24 of states in close proximity, namely, Oklahoma
25 and Louisiana, those are the big ones, but it's



1 a very modest -- or a very small fraction of
2 the overall inventory that TSC relies on. And
3 TSC itself is also providing inv- -- holding
4 the inventory -- or some of the inventory for
5 Michigan, to the extent that Michigan appears
6 to be relying on TSC distribution centers and
7 not Texas -- the Texas Distribution Center.

8 **MS. WOOTEN:** (To Ms. Gamble) If you'll advance to
9 the next slide.

10 Q: All right. As part of your review of documents
11 in this matter, do you recall seeing the
12 document dis- -- displayed on the screen?

13 A: Yes, I do.

14 Q: Okay. And do you recall how you received this
15 particular document?

16 A: So, I believe this was in -- as part of the
17 discovery materials provided in conjunction
18 with -- I think, it was Dr. Andrade's -- either
19 his analysis or around that time, I just don't
20 recall exactly when it was produced, but it was
21 a Grant Thornton document.

22 Q: Okay. And is this document consistent with
23 your understanding of Tractor Supply's
24 corporate structure?

25 A: On the terms of the legal ownership, I think



1 it, it is a helpful visual to see, you know,
2 the -- like I said, the, kind of, the ownership
3 percentages and their relationships among them,
4 but I don't think it accurately reflects the
5 full extent of the activities performed by the
6 various entities. So, for example, when the --
7 next to TSC, including South Carolina, this is
8 the headquarters/retail/distribution company
9 that covers most of the United States except
10 Michigan and Texas. So according to this
11 slide, it's simply identifying TSC as retailers
12 and lessor of employees. Well, TSC also has
13 it's distribution centers, the DCs that the
14 Company's 30(b)(6) witness referred to. And
15 those form an important part of the, the chain
16 of distribution for the products that come from
17 vendors and then go into the retail stores. So
18 distribution is important -- as impor- -- an
19 important function performed by TSC. And
20 probably, most importantly -- or the biggest
21 gap here is that T- -- it doesn't include the
22 other significant headquarters function that
23 TSC performs. They -- not just the accounting
24 and the HR type stuff, but also advertising,
25 planning, you name it, there's a, kind of, a

1 broader range of things other than procurement
2 that TSC is performing.

3 Q: All right. So turning back to Tractor Supply
4 Company and the retail stores. What fraction
5 of the company's retail stores does TSC account
6 for?

7 A: So, TSC the parent company, accounts for
8 approximately 81 percent of the company's
9 retail sales. Texas, being a relatively large
10 state, accounts for 13 percent of the sales and
11 Michigan accounts for about 5.6 percent.

12 Q: Okay. And how does that fraction correspond to
13 the Tractor Supply inventory by legal entity?

14 A: So it tracks pretty closes as you would expect,
15 simply because TSC accounts for 80 percent of
16 the sales. TSC actually appears to account for
17 80 percent of the, of the inventory held by the
18 company. And again, this is drawn, I believe,
19 from the company's trial balances.

20 Q: Okay. And, approximately, what amount of
21 inventory is held by Tractor Supply Company, in
22 terms of dollars?

23 A: So, it's about a billion dollars, I believe, in
24 terms of -- so, the -- that 80 percent is a --
25 it's a lot of dollars, so I believe it's about



1 a billion.

2 Q: Okay. And have you analyzed the relative sales
3 and profitabilities of Tractor Supply's retail
4 stores versus those in Texas and Michigan?

5 A: Yes, I have.

6 Q: Okay. And what have you concluded based on
7 that analysis?

8 A: So this is based on -- well, the figures in
9 this slide and in the next slide are from
10 documents that -- or spreadsheets prepared by
11 the company. So that -- so the company appears
12 to analyze the profitability of these stores in
13 its ordinary course of business. I've also
14 looked at other calculations that I've done
15 separate from those spreadsheets that confirm
16 the general direction of those. And so, it
17 does appear that Texas -- the Texas stores have
18 slightly greater -- or, not just slightly, but
19 somewhat greater retail sales on a per store
20 basis, so about four million dollars of annual
21 sales per store for TSC across all the states
22 of the TS- -- in which TSC operates, whereas
23 Texas stores have about five million dollars in
24 sales and Michigan has a -- somewhere between
25 four and five.



1 Q: And how do the profit margins for the Texas and
2 Michigan stores compare to those of the Tractor
3 Supply Retail stores?

4 A: So, they're actually -- despite that difference
5 in the sales volumes, they're actually very
6 similar, you know. I don't think that they are
7 distinguishable in any statistical sense. So
8 this is data from, again, from an analysis that
9 Tractor Supply seems to have -- the data that
10 they seem to collect on a regular basis. This
11 is before the transfer pricing, so this is
12 before any kind of inventory charge. This is
13 also before allocation of headquarters
14 expenses, that's why you'll see, as an
15 operating margin, the operating margins here
16 are a lot higher than what we saw before. So
17 these are in the, you know, the -- call it 17
18 to 18 percent range, as opposed to the
19 operating margin on a consolidated basis, is
20 more like 10 percent.

21 So before you look at those -- the
22 allocation of the, of the 9.7 percent inventory
23 markup and, particularly, before you allocate
24 out the headquarters expenses, they are almost
25 dead even across the sto- -- across the types



1 of stores. Despite that larger format in --
2 or, perhaps -- I don't know if the larger store
3 size in Texas or if it's simply, kind of, a
4 greater volume of product moving through tho--
5 -- each individual store, you see, kind of, the
6 green -- I'm sorry, the orange bars are
7 actually below the profit margin that's being
8 earned by South Carolina in 2015, and they're
9 pretty much dead even in 2016. And if you
10 average across those years, they're pretty much
11 dead even across the three states. I would say
12 -- I've done this analysis also on a gross
13 margin basis, just to make sure that there's
14 nothing in there about the operating margin
15 analysis that would skew those conclusions, and
16 you come to, effectively, the same conclusion.

17 Q: All right. So now let's turn and give -- to
18 the Transfer Pricing Analysis and the Study in
19 this particular case.

20 So, before we start talking about the
21 actual Transfer Pricing Study and the policies,
22 what analysis or framework did you use in
23 carrying out analyzing Tractor Supply's
24 Transfer Pricing Study?

25 A: So in evaluating the Study itself, I am

1 primarily referring to, kind of, the principles
2 laid out in the Section 482 guidelines -- or
3 Section 482 of the Internal Revenue Code. The
4 broader principle of which those guidelines are
5 based is called, kind of, the arm's length
6 principle. Which, basically, it means that in
7 a -- in evaluating transfer prices or
8 intercompany prices, you expect to observe the
9 prices that would obtain in arm's length
10 dealings between third parties.

11 Q: And what guidance, if any, does -- do the 48-
12 -- §482 Regulations require, with respect to
13 functions, assets and risks of the related
14 parties?

15 A: So that's pretty much the first step. You have
16 to understand what each party does in a related
17 party transaction. What functions they're
18 performing, what assets they bring to the
19 table, what risks each are incurring, and
20 that's going to tell you ultimately what is a
21 reasonable, either apportionment of income, as
22 you think about it -- ultimately, from the regs
23 perspective, or the language in the regs, it
24 really helps to define what specific method,
25 analytical method you're gonna apply to



1 evaluate that transaction. As well as stepping
2 back and saying, okay, I see the -- there's a
3 logic -- that some -- that a taxpayer might
4 apply to a set of transactions, but is the
5 overall result consistent with that analysis of
6 the assets, functions and risks of the
7 respective parties.

8 Q: And did you perform that analysis in this case?

9 A: Yes, I did.

10 Q: Okay. And specifically, with respect to Texas
11 and TSC?

12 A: Yes, I did.

13 Q: Are there any guidance or references in the
14 §482 Regulations about the need to consider
15 economic substance of the transaction?

16 A: Yes. It appears in many parts of the §482
17 Regulations. And, again, it's because -- you
18 have to constantly remember that a related
19 party transaction can say the -- like the
20 contractual terms, if you look at a related
21 party contract, often times those contracts are
22 written by tax staff and they can say anything.
23 They can say whatever the tax staff decides to
24 put in those contracts, which may deviate
25 substantially between -- from what the party



1 actually does. So -- it also can assert that
2 different parties bear certain risks in the
3 contract and then in practice those risks
4 actually are not borne by the parties that are
5 asserted to go those risks in the contract.
6 So, there is a need -- and even -- it goes,
7 maybe so -- even more so than simply the
8 contract. It's also the broader
9 characterization of the transaction. It's
10 really important to know the regulations,
11 whether a contr- -- of a transaction is
12 appropriately characterized. Is it a provision
13 of a service, is it a sale of physical
14 inventory, is it a -- an intangible-type
15 transaction? So, I think that's where the
16 economists, or the analyst needs to look at the
17 substance of the transaction to see if that
18 substance conforms to what the, the -- how the
19 taxpayer is characterized in the transaction.

20 Q: And then, also looking at the §482 Regulations,
21 are there any guidance with regard to the
22 reasonableness of the overall results of the
23 transfer pricing methodology applied?

24 A: Yes. And that's -- I think I referenced it
25 obliquely earlier. But there are -- the



1 transfer pricing guidelines, the 482 guidelines
2 provide -- in some respect, some people would
3 think of them almost as a cookbook approach,
4 because there are very specific methods that
5 one could use, and so there is a possibility
6 that a taxpayer or an analyst may go through
7 and apply a series of what appears to be
8 logical steps to achieve a particular answer.
9 But at the end of the day, what matters is
10 whether that result comports with the arm's
11 length standard. So you -- sometimes you can
12 apply a certain logic to a series in a,
13 particularly, in a series of, of analytical
14 steps and get to a result that's absurd from an
15 arm's length perspective. And so, ultimately,
16 what governs, from a transfer pricing
17 perspective, is whether that result is
18 consistent with the arm's length standard even
19 if you get there through what would otherwise
20 facially appear as seemingly reasonable steps.

21 Q: All right. And as part of your review and
22 analysis in this case, did you review the
23 intercompany transaction agreements between the
24 related entities?

25 A: Yes, I did.

1 Q: Okay. All right. We're first gonna talk
2 about, what is -- been described as the leasing
3 of employees transaction.

4 What is your understanding of that
5 transaction?

6 A: So this is the, the agreement between, I
7 believe it's called a Shared Services
8 Agreement, between Michigan and TSC the parent
9 company, in which the -- even though the
10 employees are physically located in Michigan,
11 they are nominally employees of TSC and there
12 is a -- effectively, this cross-charge, or what
13 is ultimately, simply, I believe, an accounting
14 entry into the general ledger system to shift
15 costs from one legal entity to another.

16 So, here, this is -- it shows the -- their
17 intercompany payroll expense for the parent,
18 TSC, of about 23 million dollars. That's the
19 actual payroll cost for the Michigan employees.
20 You'll see down below, there's income of --
21 it's a -- the negative is actually the income,
22 the 23 million is a cost item, so their -- it
23 receives income of 25 million -- or 25.7
24 million dollars. The Delta is 10 percent. And
25 that's the 10 percent markup that the parent

1 company receives from Michigan. And there you
2 see, kind of, the expense at the bottom line,
3 that shared services expense of 25 million
4 dollars to show who's paying, who's paying whom
5 in this transaction. And you also see, kind
6 of, that, that next to the last column on the
7 right, the elimination, how it's ultimately
8 zeroed out in the total. These are simply
9 entries into the accounting statement, not an
10 actual payment of cash, and certainly not the
11 third party transactions.

12 **(Respondent's Exhibit Number 7 was referenced at this**
13 **time.)**

14 Q: And in your answer, you mentioned that there
15 appears to be a 10 percent markup. Are you
16 aware of any documentation provided by Tractor
17 Supply Company to -- associated with determ- --
18 determination of that 10 percent markup?

19 A: No.

20 Q: And if this were the only transaction at issue,
21 would you be -- would you consider it to be
22 consistent with the arm's length standard,
23 based on your experience?

24 A: I'll -- like I sa- -- it would, certainly,
25 would not arise to, kind of, any, I think level

1 of significance in undermining -- or, or to
2 suggest that the level of income reported by
3 TSC in South Carolina to an amount under-
4 reported. It is -- it reflects that there's
5 income being earned, so 10 -- there's a 10
6 percent markup that's being earned by TSC as
7 part of the provision of those employee
8 services. The -- certainly you would need to
9 do an analysis to ensure that that markup is
10 appropriate. I do think that in, in transfer
11 pricing analysis, when you look at the
12 provision of services like this, there is a
13 determination, is that service really important
14 to the functioning of Michigan, if so, you want
15 to attach some kind of markup to it. The
16 provision of retail employees would certainly
17 deserve a markup. I think the -- it does --
18 there is a, a oddity, from an economic
19 perspective, there's an oddity associate with
20 it that suggests a tax purpose, as opposed to
21 any kind of operational purpose, but that would
22 appear to be an issue for Michigan, i.e., there
23 may be an avoidance of tax in Michigan, but
24 certainly from a TSC issue, and from a TSC
25 issue in -- and it's income reported in South

1 Carolina, I don't think it ultimately distorts
2 that income in a significant way.

3 I do think it's really important though,
4 as a bit of a -- as a, as a marker. So, here
5 is a provision of labor services by employees
6 not located in that particular state, that the
7 company is compensating at-cost, plus a very
8 small -- or a modest cost -- I'll say modest
9 markup on the cost of those services. So even
10 though this is a very -- you can't sell
11 anything in Michigan without the retail
12 employees, they're only compensating it with a
13 10 percent markup. I'm not suggesting the
14 markup should've been any higher, I'm just
15 saying what they did in this transaction is
16 very different than what they do, particularly,
17 when they get to the -- a similar provision of
18 employee services between TSC and TSCT, with
19 regard to the procurement staff.

20 Q: All right. Let's move on to intercompany
21 transaction two.

22 Can you describe your understanding of
23 this intercompany transaction two and how the
24 company has implemented it?

25 A: Sure. And so, this is the, kind of, the second



1 agreement between -- intercompany agreement.
2 It is one between TSCT and TSC, and also, I
3 believe TSC and TSC Michigan. Basically, it
4 says, let's look at all the headquarters'
5 costs, I've been talking about all the
6 functions that are performed in Tennessee at
7 the store support center, and then, there's a
8 pro- -- allocation process of the -- to
9 allocate those costs to the different legal
10 entities. So the numbers to maybe focus on are
11 the ones in the bottom right corner. And so,
12 then you'll see, under that TX cost column,
13 you'll see 19.4 million dollars, and then under
14 the Michigan id- -- column you'll see 9.5
15 million dollars, and that's the result of
16 taking this total of 183 million dollars of
17 administrative expenses, again, across a broad
18 range of headquarters functions excluding
19 purchasing, and it is allocating those costs
20 then, either based, depending on the type of
21 cost, either based on employees in that first
22 group, or based on the number of stores in the
23 second group, or based on the number of
24 distribution centers, or DCs in that last, last
25 group.

1 **MS. WOOTEN:** (To Ms. Gamble) If you'll advance.

2 **Q:** Does TSCT and -- TSC Michigan and Texas pay
3 Tractor Supply Company and markup for those
4 headquarter allocation costs?

5 **A:** No, it doesn't. And that's why I went to the
6 trial balances to see if I could, kind of,
7 effectively, tic and tie the allocation of the
8 underlying costs to the actual charge. Recall,
9 that in the, in the case of the Michigan
10 employees we see an -- effectively, a markup
11 built into the cost incurred verses the
12 revenues received. Here, you simply see, kind
13 of, a matching of the, of the intercompany
14 admin expense. You see that 19.4 million
15 dollar expense for Texas, and then -- and a
16 similar 9 million dollar expense for Michigan,
17 and then the receipt of the parent company of
18 that 28 million dollars. So, there's simply a
19 cross-charge or a -- I even hesitate to call it
20 a cross-charge, it's simply, kind of, an entry
21 into the general ledger to account for this,
22 this notional allocation of costs among these
23 oth- -- these entities.

24 **Q:** All right. Similar with respect to what we
25 discussed with intercompany transaction one, if



1 this particular transaction was the only
2 transaction at issue, would you consider it to
3 be an arm's length standard based on your prior
4 experience?

5 A: Well, as with -- and I think in my discussion
6 earlier of the personnel costs, typically, you
7 want to go through and review the individual
8 cost items -- or the individual functions and
9 the services that are being provided. And
10 under the §482 Regulations, there are certain
11 types of services that typically are not cross-
12 charged at a markup, things like, like the HR
13 and maybe the finance functions. Other things
14 that are more -- that are essential to the
15 company's operations, like advertising and even
16 procurement, might have a markup on those types
17 of, of services. Here, there's no, there's no
18 markup. At the end of the day, the dollars at
19 issue with that markup are actually very small,
20 so even if one were to apply that markup, it
21 wouldn't, effectively, move the needle that
22 much. I do think it's an additional data point
23 thought, in terms of what I think is a much
24 more reasonable approach to, to assi- -- if you
25 have this structure that the company's



1 implemented with these distinct legal entities,
2 this is how you would allocate the cost and
3 have the transfer prices actually work between
4 the various entities. You have the
5 reimbursement of cost, maybe with or without a
6 relatively modest markup across those entities,
7 and it would be done consistently in those
8 three transactions, the leasing transaction,
9 the administrative services transaction and
10 then, also, the im- -- the procurement function
11 transaction. Effectively, it's almost like
12 what's good for the goose is good for the
13 gander. Here, I've got two geese. I've got
14 the Michigan transaction and the headquarters
15 allocation transaction, this is kind of what I
16 would've expected them to apply something
17 similar to the procurement function in reterms
18 -- in terms of how Texas should be compensated
19 for performing that function.

20 Q: All right. So, now, let's turn to the next
21 intercompany transaction.

22 Can you describe what intercompany
23 transaction, where we've been referring to is
24 as inventory or a procurement, can you describe
25 your understanding of this particular

1 transaction and how it relates to your opinion?

2 A: Sure. So, one thing, though, I was very
3 interested in trying to determine, and
4 surprisingly it took me a long time to find the
5 data point, was the actual costs associated
6 with performing that procurement function. So,
7 what are the actual employee costs that TSCT is
8 assertedly bearing as a result of the
9 implementation of the structure. So, maybe,
10 I'll start at the bottom of the levels -- the
11 bottom of this particular excerpt.

12 So this is from the Trial Balances. And
13 you'll see it reports about -- this is 439
14 million dollars of income to TSCT, the legal
15 entity, to Texas. So TSCT in this year, which
16 is 2015, I believe, has 439 million dollars in
17 income. Part of that -- kind of, the -- you'll
18 see the cost items are up above, and the cost
19 item on the right-hand column is the buildup of
20 the cost for that procurement function. So
21 you'll see the 8.18 million dollars at the very
22 top, is the salaries associated with the
23 individuals in the procurement function, so you
24 get a sense of the order of magnitude of how
25 much is being paid to those individuals. And



1 then, you kind of build, build that up all the
2 way through individual line items to get the
3 sense of the benefits and everything else that
4 are being incurred with these employees.
5 There's one additional one I've highlighted
6 here, the intercompany rent expense. I believe
7 the company's 30(b)(6) witness talked about,
8 kind of -- or, at least, maybe, it was in the
9 planning documents, they talked about the
10 transfer of assets from TS- -- of procurement
11 assets to TSCT with the restructuring. I
12 didn't really see that in the financials. I
13 didn't see an asset move-over, like, i.e., as
14 you -- actually, you wouldn't expect it because
15 the procurement people are occupying the
16 physical headquarters space in Tennessee. So
17 instead what appears to happen, is there is an
18 intercompany rental expense, so there's not an
19 asset, there's simply a rental expense where --
20 that T- -- that's being allocated to TSCT as
21 part of this -- these journal entries.

22 And then, there's the last thing, maybe,
23 I'd point out that additional -- there's a
24 million dollars of third party expenses, so
25 there's outside services. The total of thir-

1 -- approximately, 13 million dollars at the
2 bottom isn't all employee costs. Some of it
3 includ- -- includes third party services, as
4 well.

5 Q: And how does the, the magnitude of these costs
6 impact your analysis?

7 A: Well, again, this is -- maybe, a good way to
8 think about it is, kind of, compar- -- doing
9 that, that reasonableness test. Does the
10 result comport in any way with your
11 expectations of what parties -- how parties
12 would transact at arm's length. So, here I
13 observe 13 million dollars of expenses
14 associated, again, with this oddity of
15 employees -- procurement employees sitting in
16 Tennessee that are nominally employees of
17 Texas, in return for bearing this 13 million
18 dollars of expense, the -- TSCT gets hundreds
19 of millions of dollars of procurement income
20 through that, that 9.7 percent inventory
21 markup, that results in this huge
22 disproportional shift of income from both TSC
23 and, and Michigan to TSCT that dwarfs this
24 relatively modest amount of expenditure.

25 **MS. WOOTEN:** (To Ms. Gamble) Advance to the next



1 slide.

2 Q: And with regard to the transfer pricing markup
3 and the purchasing function, what does the
4 information that you prepared on slide 29 ---

5 A: So that provides ---

6 Q: --- demonstrate?

7 A: --- the dollars that -- when I just was
8 describing that, you know, hundreds of millions
9 of dollars that TSCT is -- or Texas is earning
10 somewhere between 300 and 350 million dollars
11 a year in response for -- or, I'm sorry, in
12 return for bearing that 13 million dollars of
13 expense. So from a transfer pricing
14 perspective, you simply would not expect a --
15 at arm's length, a party like TSC to, just, to
16 voluntarily say, here T- -- here Texas, feel
17 free to pay the, the salary costs, the 13
18 million dollars of salary costs, and in return
19 we're gonna forgo 300 million dollars of -- or,
20 350 million dollars of income. It's simply not
21 consistent with the reasonable alternatives
22 that the employee -- that TSC faced at the time
23 of the restructuring, or frankly, at any time
24 since.

25 **MS. WOOTEN:** (To Ms. Gamble) All right. Advance to



1 the next slide.

2 Q: All right. And can you describe the
3 information that you prepared on slide 30 and
4 how it impacts your analysis?

5 A: Certainly. So on this slide and the following
6 slide, this is taken from the company's -- this
7 particular slide is taken from the company's
8 Trial Balances. It's to give an indication of
9 the order of magnitude of the way in which the
10 income for TSC, in particular, as well as
11 Michigan, is impacted before and after the
12 transfer pricing policies are implemented.

13 So here, you can see that, as you'd
14 expect, based on the large percentage, the 80
15 percent of retail sales that TSC makes, and the
16 fact that it earns a similar margin as ever --
17 as any other retail store in Texas or Michigan,
18 it earns a disproportionate share of the
19 operating income before the transfer prices.
20 Now, if you flip to the bottom slide, you'll
21 see, kind of, a -- the second slide, you see
22 this reversal. You see this huge shift of
23 income, again, hundreds of millions of dollars
24 going from Tractor Supply over to Tractor
25 Supply Texas. So that gives you a sense of



1 the, kind of -- effectively, the extreme nature
2 of these adjustments. These are not small
3 levels of compensation that -- or, modest
4 levels of compensation that Texas receives, but
5 rather, it fundamentally, I think, distorts
6 Tractor Supply's operating income.

7 Q: Okay. Earlier, you stated that Tractor Supply
8 owned accounts for approximately -- and I'll
9 let you -- how much did you say that the
10 account for -- with respect to the company's
11 sales, what percentage?

12 A: Approximately, 80 percent.

13 Q: Okay. And you said that was on -- is that on
14 a pre-transfer pricing basis or a post-transfer
15 pricing basis?

16 A: So, it's revenue. So it's before you get to
17 any of the transfer pricing issues.

18 Q: Okay. What fraction of taxable income is
19 earned by Tractor Supply Company versus Tractor
20 Supply Company Texas, as a result of these
21 transfer pricing policies?

22 A: So you'll see that on the ---

23 **THE COURT:** Say that, say that again.

24 Q: What fraction of taxable income is earned by
25 Tractor Supply Company versus Texas as a result



1 of the transfer pricing policies?

2 **THE COURT:** Okay.

3 A: So you'll see this in the slide that's
4 currently up there. That TSC, even though it
5 accounts for 80 percent of the sales, it only
6 accounts for, effectively, 24 percent of the
7 taxable income, whereas Texas, which accounted
8 for -- again, I don't remember the exact
9 percentage, but I believe it was something in
10 the nature of, maybe, 13 percent of sales, it
11 accounts for 71 percent of the Company's
12 taxable income.

13 So, some of Texas' income is appropriately
14 attributable to its retail sales in that
15 location. Basically, what we saw on the first
16 of those two sli- -- those two slides with the
17 bar charts, where we saw before the transfer
18 pricing, but the vast majority of Texas'
19 profits are coming from its, its -- that
20 procurement markup, the 9.7 percent.

21 Q: Okay. And have you compared the amount of
22 operating profit earned by Texas from its
23 retail operations versus the purchasing
24 function we were just describing?

25 A: Yes.



1 Q: Okay. And what did you conclude?

2 A: Well -- so this is for Texas alone. So the
3 slide that's currently up there. You'll see
4 that it earns, I believe, it's somewhere in the
5 neighborhood of about 35 million dollars from
6 its retail store operations, whereas, it's
7 earning somewhere between 350 and 400 million
8 dollars from that purchasing function. So it's
9 a huge disproportion of Texas' income is being
10 driven by that purchasing function rather than
11 by its actual retail operations.

12 Q: And from an economic perspective, if the
13 parties were unrelated, would you expect to
14 observe a similar allocation of the fraction of
15 tran- -- or Tractor Supply Company's operating
16 profits to Texas for that purchasing function?

17 A: No. The -- imagine two parties in a joint
18 venture, even if someone -- one party said
19 they're going to be providing some particular
20 service, another party's gonna be providing
21 another sort of service, there is this vast
22 disproportion of the profits going to TSCT in
23 return for bearing this pur- -- the cost
24 associated with this purchasing function, which
25 is this small fraction of the broader



1 headquarters' function, is just inconsistent
2 with anything that I've seen in, in third party
3 transactions.

4 It is -- it's simply not how third parties
5 would negotiate a, a split of profit, even
6 assuming that profits should be attributable to
7 that sum total of those headquarters functions,
8 respec- -- irrespective of what actually goes
9 on at the retail level. And that's where I see
10 a, kind of, a disproportionate amount of the
11 company's capital, is really associated with
12 those retail functions. So the -- the other
13 oddity where you wouldn't expect this kind of
14 result is the oddity of the fact that in 2001
15 -- or prior to 2001, TSCT itself performed that
16 function. It's not like -- I'm sorry, TSC the
17 parent company, performed that function on an
18 int- -- on an integrated basis. So it's as if
19 I were to go to Microsoft today and say, hey,
20 Microsoft, I've got a deal for you, I'll cover
21 your software development expenses, in return
22 I want, you know, some huge fraction of the
23 profits you earn for that. And they're -- they
24 would say, why would we ever give up that
25 fraction of profits if it is far

1 disproportionate to the costs that you're
2 agreeing to, to incur? So that's where this 13
3 million dollars versus three- -- expense, versus
4 350 million dollar income, it simply is
5 contrary to everything I've seen in transfer
6 pricing.

7 Q: All right. Let's turn to the South Carolina
8 stores.

9 How much retail revenue is earned by
10 Tractor Supply's South Carolina stores?

11 A: So it's between 135 and 160 million dollars on
12 an annual basis during the years at issue.

13 Q: Okay. And as a result of the company's
14 transfer pricing policies, how much income is
15 apportioned to South Carolina?

16 A: So that's the -- see the number in the bottom
17 row, is the, is the ultimate income apportioned
18 to South Carolina, so it's about, I believe,
19 three percent of the company's sales.

20 Q: Okay. And for purposes of comparison ---

21 A: I'm sorry, when I said the company, I meant,
22 the amount of income apportioned to South
23 Carolina is approximately three percent of the
24 South Carolina retail sales.

25 Q: And for purposes of comparison, do you recall



1 -- we talked about this earlier, but do you
2 recall the company's consolidated operating
3 profit margin that we discussed earlier? Do
4 you recall?

5 A: Yes. It's about 10 percent.

6 Q: Okay. And have you calculated the percentage
7 of the company's employees who are employed in
8 the company's retail stores and distribution
9 centers?

10 A: Yes, I have. And it's a hu- -- as you'd
11 expect, as a retailer, a huge fraction of their
12 employees are the store employees or in the
13 distribution centers. So this is about 90
14 percent -- I'm sorry, more than 90 percent.
15 It's the -- the green bar is the stores and the
16 grey bar is the distribution centers, so I
17 believe that's gonna be, approximately, 97 or
18 98 percent of the employees are the people on
19 the ground moving the product and selling their
20 product, and interacting with customers. A
21 small fraction of the company's employees, the
22 remainder, is gonna be the corporate
23 headquarters of staff, of which a small
24 fraction of that are the, are the purchasing
25 staff.



1 Q: And of the Tractor Supply Headquarters staff,
2 do you know how many employ- -- are employed by
3 Tractor Supply Company versus Texas?

4 A: Yes. So, thinking back to, actually, to the
5 graph we were just -- the figure we were just
6 on. Maybe, go -- just, go back to the ---

7 **MS. WOOTEN:** (To Ms. Gamble) Go back ---

8 A: --- the one -- just so we can orient ourselves.
9 So we're talking about that, that yellow bar.
10 So the yellow bar is that -- approximately, 3
11 percent of the company employees that's
12 associated with the headquarters function.
13 Now, go to the next slide that has the actual
14 accounts.

15 So the co- -- the data on the left-hand of
16 the screen are the headquarters employees that
17 are employed by TSC, the South Carolina
18 taxpayer, so about 762 employees. This is,
19 again, as of 2016, per the header on the, on
20 the slide. Whereas, the ones on the right,
21 about 128 are Texas employees. You'll see --
22 I think one thing that's important about this
23 data, or at least helpful about the data, is
24 both the numbers and the job descriptions, and
25 what they -- the employees are doing. So this



1 is actually a summary table from, kind of, very
2 detailed other tabs in this same worksheet
3 provided by the company, that has the comp- --
4 the individuals job title, how long they've
5 been with the company, etcetera. And so, one
6 thing you can see is that -- first, we often
7 talk -- we've been talking a while about the
8 procurement function, the company appears to
9 refer to these individuals also as being part
10 of their broader merchandising function, in my
11 experience dealing with retailers,
12 merchandising refers to not just the
13 procurement itself, the ordering, the vendor
14 relationships, but a broader range of
15 functions, i.e., it's the presentation of the
16 products in the store. It's not just about
17 the, the procurement decision itself. But one
18 thing we see is, there is a -- on the one hand,
19 you see, kind of, this really broad category of
20 different types of individuals, and you can see
21 it by counts. I think the counts are
22 important. I believe the people who are buying
23 the product, or in that top row, that
24 merchandising that has 50 people in there, I
25 think the people ordering that are somewhere in



1 there. You see, kind of, a relatively modest
2 number of people in product development, about
3 eight people there. If you compare it to some
4 of the categories on the left, let's start with
5 the ones that are -- the, the rows in green.
6 You'll see that there are merchandising -- or
7 other departments that are doing functions that
8 appear to be related to the func- -- to the sa-
9 -- that same merchandising/procurement function
10 being performed in -- by the TSCT employees.
11 To me, that -- I take -- and based on my
12 understanding of how corporate headquarters op-
13 -- typically work, that reflects the fact that
14 there's a lot of integration in the way these
15 headquarters employees work. So you'll see
16 Del's merchandising as a, a merchandising
17 employee -- or three merchandising employee,
18 being a part of TSC not TSCT. You see the
19 executives, all the executives are in TSC,
20 including the executives who are supervising
21 the folks on the right-hand side of the column,
22 like Mr. Barbarick.

23 The accounts payable, that's an odd -- so
24 why would you ha- -- and just thinking in terms
25 of a, a structure of a company, if the purch-

1 -- if the purchasing folks are actually buying
2 the inventory and they gotta pay the people
3 that they're buying the inventory from, how can
4 the accounts payable be over on the other side
5 of the screen? So that, to me, suggests that
6 there's this intertwining of that function, or
7 that -- rather, that the purchasing function is
8 much more limited than the way the Taxpayers
9 characterized it in the, in the transfer
10 pricing studies, in particular. Same with
11 inventory control. There's inventory
12 management on the right-hand side, there's
13 inventory control on the left-hand side. So
14 you have inventory, that broader inventory
15 management being, kind of, a shared
16 responsibility between, even these two
17 entities, how they -- in the way that the
18 Company is actually allocated these
19 individuals. So you can go down the road with
20 all of -- actually, you have purchasing -- six
21 people in purchasing function on the left-hand
22 side of the screen, even though purchasing is
23 suppose to be over in the right-hand side of
24 the screen. Pricing, I think, we heard from
25 the 30(b)(6) witness that pricing was done

1 largely by Texas, but in fact, pricing --
2 there's 11 people in the pricing function in
3 the headquarters, i.e., in the T- -- on the TSC
4 side of the ledger.

5 So, there is a, kind of, a broader range
6 of activities, including these other ones that
7 I've also highlighted in yellow, that are
8 fundamental to how the -- this Company
9 operates. Like transportation, distribution
10 and logistics, all of these -- the customer,
11 the Customer Solution Center, marketing people,
12 the e-commerce, these are functions that are
13 being performed by the folks within Texas and
14 -- I'm sorry, within TSC the South Carolina
15 taxpayer.

16 Q: And in looking in these documents,
17 specifically, these employment records in your
18 analysis, how does the entire procurement
19 function, with relation to the responsibilities
20 of the individuals employed by Texas, relate to
21 those in TSC the parent company?

22 A: So, I ---

23 **MS. WOOTEN:** (To Ms. Gamble) So if you'll advance to
24 the next ---

25 A: So, I think, the issue really goes to that's

1 the -- I -- I referred to, kind of, Mr.
2 Barbarick, who -- I believe later on, he's
3 President of the company, in this time period
4 he's the Chief Merchandising Officer. Chief
5 Merchandising offer [sic] is the individual
6 who, presumably, sits on top of everybody with
7 a merchandising hat. And so, you saw in the
8 privat- -- the previous slide, the Texas
9 employees, many of them have this merchandising
10 title. So as I read through the job
11 descriptions, and even the other companies --
12 the accounts of the company, it's fairly clear
13 -- I mean, it's very clear that Mr. Barbarick
14 oversees that function and yet he is sitting on
15 the TSC side of the ledger.

16 Q: And does this information -- or analysis inform
17 your opinion regarding the overall
18 reasonableness, or lack of reasonableness, of
19 the company's results on a separate entity
20 basis, again, looking at it from the
21 perspective of the transfer pricing
22 implementation?

23 A: Yes. So, stepping back, and I, I mentioned
24 before, there's the -- the detail analysis we
25 go through in transfer pricing analysis, in



1 terms of selecting a method and selecting a
2 best method, looking at alternative financial
3 ratios, working up the numbers. And then,
4 there's the, the information presented here,
5 that I think on its face, it's fairly clear
6 that the result is inconsistent with what I
7 would expect in arm's length dealings. There's
8 simply a, kind of, this transfer of this
9 function from the parent company to this newly
10 created Texas company, that is inconsistent
11 with the company's available alternatives at
12 the time. You would not have that kind of
13 result at -- due to -- with arm's -- at arm's
14 length. And you also see this
15 disproportionality, in terms of the number of
16 people, even the number of people just within
17 the headquarters function. So, this 350
18 million dollar profit being allocated over to
19 inven- -- to Texas in return for that relativ-
20 -- with, I believe it's like 14 percent of the
21 headquarters staff, is a result that simply
22 defies, kind of, an arm's length explanation.

23 **MS. WOOTEN:** Your Honor, we're getting ready to move
24 into the actual Transfer Pricing Study. Would
25 it be an appropriate time to take a break

1 before we change topics, or do you want to keep
2 going?

3 **THE COURT:** All right. We'll take ---

4 **MS. WOOTEN:** I'm happy to give ---

5 **THE COURT:** --- a short, we'll take a short break.

6 **MS. WOOTEN:** Okay. All right. Thank you.

7 **(Off the record from 3:49 p.m. until 3:58 p.m.)**

8 (Whispering.)

9 **THE COURT:** All righty.

10 Q: All right. Now, we're gonna turn to the
11 Transfer Pricing Study at issue in this case.

12 **MS. WOOTEN:** (Whispering) If you'll advance to the
13 next slide. Okay.

14 Q: What is your opinion regarding the reliability
15 of the taxpayer's Transfer Pricing Study?

16 A: I think it's entirely unreliable.

17 Q: Okay. All right. Let's walk through -- and
18 what -- and do you have criticisms of the
19 Transfer Pricing Study?

20 A: Yes.

21 Q: Okay. And let's walk through those criticisms.

22 **THE COURT:** He just said it was entirely unreliable.
23 *(Laughter.)*

24 **MS. WOOTEN:** To what I said -- oh (laughter).

25 **THE COURT:** I imagine he has a little criticism.



1 *(Laughter.)*

2 **MS. WOOTEN:** It's, it's late in the day, we're all
3 tired.

4 **THE COURT:** Yeah, it is, isn't it?

5 **MS. WOOTEN:** Okay.

6 **Q:** This is an excerpt from the PwC Report on slide
7 39.

8 **A:** That is correct.

9 **(Respondent's Exhibit Number 33 was referenced at**
10 **this time.)**

11 **Q:** Okay. How does this impact -- or -- yeah,
12 impact your opinion in this matter?

13 **A:** Well, it demonstrates that they have
14 misapprehended the -- or mischaracterized the
15 functions that the related parties perform.
16 And again, I said before, that the functions,
17 assets and risk analysis is important to get
18 right, it's that first step in the analysis,
19 everything else flows from that. And there are
20 ways in which some of them -- some of the
21 statements are, I think, outright
22 misstatements, and other things are, kind of,
23 a mischaracterization of what actually happens.

24 **Q:** All right. So let's look at -- specifically,
25 first, at the distribution activities. Is that



1 statement consistent with your understanding of
2 Texas' functions?

3 A: No. That -- tec- -- my understanding, is that
4 Texas performs the distribution for its own
5 retail stores, so that Waco Distribution Center
6 largely -- or the vast majority of that, that
7 product goes to its own retail stores,
8 according to the deposition testimony of the
9 company's 30(b)(6) witness, only a small amount
10 goes to local -- to, to oth- -- to States
11 around that, namely, Louisiana and Oklahoma.
12 I went back and looked at some of the records
13 that were produced in discovery to confirm that
14 that is indeed the case. So it appears that
15 the vast majority of the TSC retail stores, the
16 inventory that they actually receive comes,
17 either directly to them, like a drop shipment,
18 I think that's about 30 percent of the
19 company's actual purchases go -- don't even go
20 to distribution, I think 30 percent goes
21 directly to the stores and the remain -- the
22 remainder 70 percent comes almost entirely from
23 the, the distribution centers in that area.
24 And then, also, with regard to Michigan, based
25 on its location, they -- it's my understanding,



1 you know, that the stores in Michigan would be
2 supplied by TSC and not by TSCT.

3 Q: And has Tractor Supply produced any vendor
4 contracts relating to whether Tractor Supply
5 Texas is the legal entity that signs those
6 contracts?

7 A: No.

8 Q: And has Tractor Supply produced any evidence
9 that Texas, rather than Tractor Supply Company
10 takes legal title to the goods sold by the
11 vendors?

12 A: No.

13 Q: Okay. Have you ---

14 **MS. WOOTEN:** (To Ms. Gamble) Go to the next slide.

15 Q: Have you reviewed this contract?

16 A: Yes, I have.

17 Q: Okay. And what is this contract related to?

18 A: So this is a Marine Cargo Insurance Contract.
19 And it is -- the assured is Tractor Supply
20 Company, i.e., the parent company. It's
21 covering a -- as you see at the bottom, about
22 5.7 billion dollars of gross sales, which would
23 account for almost the entirety of the
24 company's actual purchases. And I, as an
25 economist -- or in reviewing the, the



1 transaction, it seemed inconsistent to me with
2 the taxpayer's assertion that, that TSCT is the
3 legal owner of that inventory if TSC is the
4 company that's actually the insured for that
5 inventory.

6 Q: Okay. And according to testimony in the
7 contract, who is paying the premium associated
8 with this contract?

9 A: TSC the parent company.

10 Q: Okay. And again, you briefly mentioned this in
11 the tail part of your statement, so I don't
12 know if you were finished with it, but with
13 regard to TSCT performing the procurement
14 function, is that consistent with them acting
15 as the wholesale -- a wholesale distributor?

16 A: No.

17 Q: Okay. And what is your basis for that?

18 A: Well, think about what a wholesale distributor
19 does. Large wholesale distributors are buying
20 inventory, often times they're breaking it up
21 by -- it's called a break -- break-bulk
22 function, and then they're going to distribute
23 that and resale that to their own customers.
24 So, the procurement function is a very
25 different type -- and it's -- procurement is



1 one part of what a distributor does, just like
2 it's one part of what a retailer does, but it's
3 not -- it's by no means, kind of, the core of
4 what they do. The core of what they do is
5 provide that service to their customers of
6 buying a lot of inventory, having a huge
7 variety of parts, and then when their
8 customers, who might be any different -- any
9 number of different kinds of companies come to
10 them, they can then provide them. You see it
11 in pharmaceuticals, for example, McKesson is a
12 big name of a pharmaceutical distributor. If
13 you -- if you're CVS, you'll go to McKesson to
14 get your drugs, you won't go to every
15 manufacturer of the product for that particular
16 drug. So you see it in everything from lumber
17 to industrial supplies, to food, and any manner
18 of product.

19 Q: And do you recall in deposition testimony that
20 you reviewed, or testimony that you've heard
21 here this week, Tractor Supply's representative
22 testifying regarding, at the time the products
23 are shipped from vendors, who the buyer of the
24 product is, do you recall that testimony?

25 A: I, I do.

1 Q: Okay. And what was that testimony?

2 A: That testimony was that TSCT, Texas, is the
3 buyer at that time.

4 Q: And in your review of the records, have yo- --
5 and vendor payment records, have you seen
6 anything that is consistent or inconsistent
7 with that statement?

8 A: The only thing that I've seen -- all the
9 information that I've seen is inconsistent with
10 that statement.

11 Q: Okay. And if you'll look at slide 41. Is --
12 what does this demonstrate?

13 A: So, this is an excerpt from a set of records
14 that we received that shows the, the paying
15 entity being -- and you'll see in the second
16 column from the left, it's all TSC, so these
17 are payments -- vendor payments by TSC the
18 parent company, as I understand it, to the
19 actual vendors. And these were all -- in this
20 case, I believe, these are all U.S. vendors,
21 and it's -- you just see a regular stream of
22 payments. It's not like it was just a onesie-
23 twosie kind of thing. I didn't see any records
24 that showed TSCT as the payee for -- in, in
25 these proceeding -- in these, in these



1 transactions.

2 Q: All right.

3 **MS. WOOTEN:** (To Ms. Gamble) If you'll advance us to
4 slide 42.

5 Q: And could you walk us through how a vendor
6 purchases appear on Tractor Supply Company's
7 Trial Balances?

8 A: Sure. As you would expect, the -- or, as I, as
9 I would expect, if TSC were buying, you see
10 the, kind of, the sales -- I'm sorry, the cost
11 of goods sale -- sold. The -- let's go, kind
12 of, halfway down, you'll see that line labeled
13 501000 the cost of sales, you see those pop up
14 on -- under the parent company, and then you
15 see a certain amount under the Texas entity,
16 and then a certain amount under Michigan, those
17 are approximately in proportioned to the sales
18 that the company -- that each of those
19 companies make. So that would be inconsistent
20 with a, a view of the T- -- if Texas was really
21 performing a procurement function and at
22 wholesale distribution function, as I've seen
23 with other companies, where the parent company
24 might, in fact, actually take that inventory
25 and then be reselling it to international



1 related parties. Then you'll see a very
2 different flow of transactions, in terms of how
3 this whole -- all of the -- both the related
4 party and the unrelated party transactions
5 appear.

6 Here, I think, as we went through earlier,
7 the lines in yellow show the intercompany
8 transactions to account for, what I consider
9 more of a notional intercompany sale, but does
10 not appear to me, at least, based on the
11 information I've seen, to reflect TSCT, Texas,
12 purchasing that inventory in the first
13 instance.

14 Q: Okay.

15 A: And I -- down below, there's a line for
16 inventory, you see kind of a similar dynamic
17 there, where there's the third party inventory
18 cost of 997 that appears under the parent
19 company, and then -- again, this notional 82
20 million .6 dollar number. As for the markup,
21 that's the markup that's going to be paid to
22 Texas and that zeroed out, you'll see the
23 elimination line, and then the 00 for those
24 intercompany transactions.

25 Q: And -- we're advancing to the next slide. Are



1 there any other entries in the company's Trial
2 Balances that -- relevant for whether Texas
3 performs the wholesale distribution function?

4 A: Yes. And that's where -- if you'll look at
5 things like -- as simple as the accounts
6 payable, right. So accounts payable, these are
7 the amounts that are due to the vendors, and if
8 TSCT, if Texas is the one that has that legal
9 obligation to pay the vendors, I wouldn't
10 expect the accounts payable to be
11 disproportionately appearing under the parent
12 company column. So, I th- -- the -- and you
13 can kind of go down the rows here, and come up
14 with, kind of, this similar kind of conclusion
15 that the -- same thing on the, kind of, the
16 discounts earned that you see, kind of, similar
17 items appearing under the parent company.
18 Again, if these are discounts to be provided by
19 the -- from the vendors to the company, you'd
20 expect those to appear at the buyer of record,
21 which would be Texas not TSC. And then, even
22 down -- as simple as, they own the freight
23 charges, any import duties, the import storage,
24 if these are products that are being, you know,
25 shipped over to TSCT and then further

1 distributed to the parent company, these are
2 not charges I would expect to see in the parent
3 company. I would see -- I would expect them to
4 be in the Texas column. And you see Texas has
5 a lot of zeros in there.

6 The -- yeah, so, you see that also, even
7 down all the way to the bottom in the volume
8 rebates, and the price cut programs, very
9 similar conclusion.

10 **MS. WOOTEN:** (To Ms. Gamble) If you'll advance --
11 or, if you'll go back to 39.

12 **Q:** All right. So we're gonna go -- we're keeping
13 in with the PwC Memo and the description of the
14 functions by the Texas entity, the last
15 sentence where it discusses Texas has certain
16 private good labels manufactured by third
17 parties, in your review and experience, is that
18 an accurate statement?

19 **A:** Well, it, it -- in part, in terms of, it has
20 the -- there are people, we saw earlier in that
21 -- those job descriptions for employees that
22 are nominally associated with Texas, you have
23 a product development function associated with
24 that, so they are interacting with the vendors,
25 but the, the -- as I read that sentence, the



1 implications is that, Texas is making it -- is
2 having those goods made on beh- -- on its
3 behalf, on Texas' behalf for sell to the
4 retailers. And consistent with what I saw
5 before, in terms of the -- we just put it -- we
6 just went through, with regard to the other
7 vendor purchases, they -- it would appear to me
8 that the, the purchasing fu- -- all of the
9 product being made by these vendors is still
10 all being purchased by the, the -- by TSC
11 itself, to the extent that TSC is selling on
12 those products. So, Texas is doing the
13 contracting, and it may even be doing the
14 product development, but the, the payment
15 itself, the purchase of that product is --
16 appears to be -- appears to me to be by TSC.

17 Q: And along those same lines, keeping with that
18 last sentence in the PwC Memo, with respect to
19 Texas developing certain trade -- owns and
20 develops certain trademarks. In your review
21 and analysis, is that statement accurate?

22 A: Only in part. It does own -- Texas does own
23 the trademarks because of the -- this
24 assignment that happened back in 2001. TSC
25 previously owned it, effectively, gave them --

1 or contributed those trademarks to Texas, but
2 it certainly does not dev- -- Texas does not
3 develop those trademarks. And the word develop
4 has a certain connotation in transfer pricing
5 analysis. So, there's often a distinction that
6 transfer pricing economists are -- or need to
7 make -- and, frankly, the courts need to make,
8 in terms of who is the owner versus who is the
9 developer of a given intangible, because a
10 company in a related party transaction could
11 assign any of its transac- -- any of its assets
12 however it wants to, and can assign legal
13 ownership, but it's important to assess who is
14 actually -- which entity engages in the further
15 development of those, of those assets. In this
16 case, the trademarks would've been developed by
17 TSC prior to the reorganization in 2001, it
18 already developed those. It developed those
19 based on, probably, some combination of its
20 advertising and its store support, and its --
21 the overall customer goodwill that is generated
22 prior to 2001. And even after 2001, TSC the
23 parent company, continues to be in charge of
24 the advertising function. The advertising is
25 not -- and that's typically what economists

1 look to, as part of trademark development.
2 Same thing in terms of the, the sto- -- the
3 retail store experience is really driven by
4 things that are being done by TSC the parent
5 company and its locations, not by anything that
6 Texas or even the procurement staff are doing
7 in those except, perhaps, to some kind of
8 incremental degree, to the extent they are
9 combined.

10 Q: All right. So, looking at -- again, going --
11 we're gonna go back to -- switching back --
12 discussing more in the transfer pricing
13 analysis. From a big picture's perspective,
14 how does PwC go about doing their transfer
15 pricing analysis? And, specifically, what
16 method do they use?

17 A: So they apply something called the comparable
18 profits method, which in broad-brush terms
19 involves the -- you need to identify which --
20 a related party you wanna test, and then you
21 try and find comparable companies and look at
22 their profitability benchmarks of those
23 companies, and then use that to either set or
24 test the profitability of the tested party.

25 Q: And can the use of this CPM method be



1 problematic in transfer pricing analysis?

2 A: Yes, it can. First of all, it needs to be the
3 most reliable method, and there's an entire
4 long discussion in the Regs -- the §482
5 Regulation that describe the need to ensure
6 that whichever method you choose is gonna be
7 reliable. One -- so, it has to conform to the
8 functions, assets and risks of the, the
9 particular party. You have to be able to find
10 reliable comparables, and if -- you have to be
11 able to make reasonable adjustments, etcetera.
12 And, more importantly, I think the broader
13 concern is that these are often called one-
14 sided tests, but they can be used in order to,
15 kind of, shift income from one entity to
16 another. Typically, it's being -- it's often
17 -- it's often used to identify a different
18 related party as the tested party, given them
19 a very small return, call it a routine return,
20 and then have everything else, all the
21 additional profits being attributable to the
22 other tested party. Here, PwC has done,
23 effectively, a mix of both because it does the
24 -- a, what I'll call, kind of, a two-step CPM.
25 They do a comparable profits method test of the



1 procurement function, and they do a separate
2 one of the retailer function. At the end of
3 the day, the 9.7 percent company -- markup that
4 they use is ultimately driven by what they use
5 for the retailer.

6 Q: And in applying the CPM method, which party did
7 PwC select as the tested party?

8 A: So, for this initial phase, if you read through
9 the report, the first thing they look at as the
10 tested party, is the -- is Texas.

11 Q: Okay. And do you think there's any difficulty
12 in applying the CPM to Texas and Tractor Supply
13 Company in this context that you've just
14 described?

15 A: Yes. And part of the inherent difficulty of
16 doing a CPM-type analysis for a retailer is
17 that the retailer -- the whole reason of being
18 for a retailer is to make those retail sales.
19 I have been involved in other companies -- or
20 with other companies that had a distinct
21 manufacturing arm, and a manufacturing arm in
22 one country and lots of different distribution
23 affiliates in other countries, those are the
24 kinds of companies you can then reasonably
25 benchmark that distribution function. Here,



1 there's an integration of that purchasing
2 function with a broader headquarters function,
3 and it's not a distribution function. So, it's
4 really hard to come up with accurate and
5 reliable comparable companies if you're just
6 trying to pull out this one little function
7 called purchasing, and try and figure out what
8 the arm's length return for that function is.

9 Q: All right. So now, we're gonna go into current
10 -- within more detail of how PwC implemented
11 its analysis of Texas' profitability. And
12 you've already testified that PwC assumes Texas
13 performs the functions as the wholesale
14 distributor. Have you per- -- ever performed
15 transfer pricing analysis for a wholesale
16 distributor, or distribution using a CPM
17 approach?

18 A: Yes, I have, many times.

19 Q: Okay. And can you describe that approach for
20 the Court?

21 A: So, generally, you will look across SIC codes,
22 standard industrial codes, for companies that
23 are engaged in wholesale distribution. And you
24 will then use -- look at the various
25 profitability metrics for those. Like I said,



1 the ones that I recall doing are primarily, if
2 not exclusively in the manufacturing sector.
3 I've seen, I've seen them also applied in
4 pharmaceutical distribution, for example. So
5 these are -- again, where the function that you
6 are trying to benchmark is this wholesale
7 distribution function and not a procurement
8 function.

9 Q: And in general, what are these functions that
10 the wholesale distributors perform?

11 A: Well, it is buying the -- buying product. It's
12 storing it as inventory. It's going out --
13 often times, it's making a market, it's going
14 out and actively soliciting customers. It is
15 breaking bulk, it's engaged in transportation.
16 In some segments of distribution, they are
17 actually going one step further in providing
18 things -- I don't know if you've heard of just-
19 in-time inventory management, but sometimes
20 they will -- manufacturers are increasingly,
21 highly dependent on, kind of, a very tight
22 supply chain. They don't want to hold a lot of
23 inventory, so they want distributors to ha- --
24 to carry it close to where they are so that at
25 the moment they need it, they can then pull it

1 into their particular location. So, it can
2 really run the gamut of the types of things
3 that they, that they do, but the core function
4 they provide is that holding inventory across
5 a wide range of products and then being able to
6 provide whatever the commercial customers that
7 are one step below them ultimately need in
8 providing their services, either as a
9 commercial enterprise or as a retail
10 enterprise.

11 Q: And did you consider that a reliable approach
12 in this instance?

13 A: No.

14 Q: Okay. And can you explain the basis for that
15 statement?

16 A: Well, again, it's just -- I -- it goes to the
17 characterization of, what does Texas do? Texas
18 does not perform this wholesale distribution
19 function for TSC. Texas performs this one
20 piece. And trying to isolate how much of a
21 return should be allocated from -- for that
22 procurement function alone, from this broader
23 return that a wholesale distributor is earning,
24 is just not going to lead to any kind of
25 reliable result.



1 Q: And how did PwC identify comparables for this
2 Tractor Supply distribution function?

3 A: So, they -- consistent with what I would
4 generally do in a comparables search, we first
5 go to look at various SIC codes. Ultimately,
6 you're going to be drawing the financial data
7 for your comparables from a company like CapI-
8 -- like a commercial provider, data provider
9 like CapitalIQ or Cap IQ. So they first went
10 through and identified a whole bunch of SIC
11 codes in this, both durable and non-durable
12 goods sectors. They obtained a big num- -- a
13 large number of companies and they winnow down
14 that company through a combination of, what's
15 called, qualitative screening and quantitative
16 screening. So it'll eliminate companies that
17 have insufficient financial data or they're
18 bankrupt, and then they'll go through and make
19 a determination in -- on a company-by-company
20 basis, is -- should the company be in or out of
21 their ultimate set.

22 Q: And just for the record, what is an SIC code?

23 A: A standard industrial classification code.

24 Q: Okay. And setting aside your criticism of the
25 wholesale distribution benchmarking issue and



1 analysis, would you include these, generally,
2 these SIC codes as part of your search criteria
3 for this particular analysis?

4 A: Well, certainly not for the company -- for
5 Texas. I think that if you were to do it in a
6 diff- -- for a different company -- for the
7 wholesale distribution company, the SIC codes
8 that they selected are reasonable, but they're
9 not reasonable as they apply to Texas.

10 **MS. WOOTEN:** (To Ms. Gamble) If you'll slide to the
11 next one. Okay.

12 Q: And do you recognize, on slide 45, the
13 comparables -- or -- yeah, the wholesale
14 distributors that PwC used to benchmark in this
15 matter?

16 A: Yes, I do.

17 Q: Okay. And, again, setting aside the criticism
18 for the approach, we're just looking at these
19 set of comparables, would you consider this to
20 be a reasonable set of wholesale distributors
21 for a wholesale -- or, general, wholesale
22 distribution function?

23 A: No, I would not.

24 Q: Okay. And can you explain your basis for that?

25 A: So think about the analysis they went through,



1 or the analysis that I would go through as a
2 funneling process. You start with a lot of
3 companies, initially, you have these broad in-
4 -- SIC codes that you establish, you get a lot
5 of company data, and then you start winnowing
6 down based on this combination of quantitative
7 and qualitative criteria to then establish your
8 final set. The bottom line is, these companies
9 that they select, they have a fairly broad
10 range of SIC codes that they start with, but
11 they end up with a relativ- -- a very narrow
12 range of distrib- -- wholesale distributors
13 that are very -- that have a -- whose returns
14 are biased upwards because they are in a
15 particular segment of the wholesale industry
16 that does not really reflect a broader
17 wholesale distribution function. Many of these
18 -- and I've, I've come across many of these
19 companies, and they are -- the vast majority of
20 them are, what's called, MRO companies,
21 maintenance repair and operations companies.
22 So, when I talked before about, manufacturing
23 companies will often outsource a lot of the
24 inventory holding to third parties, those
25 compan- -- those third parties, the

1 distributors will often help them with their
2 broader supply chain management. They can
3 charge a significant amount of money for that,
4 because they're relieving the manufacturer of
5 a lot of otherwise cost and headache associated
6 with managing inventory. So as a result, these
7 companies are able to earn sig- -- on average,
8 they're able to earn significant profitability
9 and significantly higher than I would expect
10 from a more representative set.

11 So, I have used some of these companies
12 before as comparables, but as part of a broader
13 set because there is a range that you need to
14 establish, and ultimately, your relying on
15 interquartile range. And so, as long as you
16 have a reasonable mix of distributors, some of
17 these may be reasonable to include, but the
18 companies -- but having them exclusively in
19 this set, I think is reas- -- gives you an
20 unreliable range of profitability metrics, even
21 if they had been correct, that wholesale
22 distribution was the right way to go to
23 benchmark Texas.

24 Q: All right. So, we're briefly gonna take a look
25 at some of these companies. And again,



1 briefly.

2 What criticism do you have with the
3 particular companies that we just looked at on
4 that prior slide?

5 A: So, because there's a lot of words on this
6 slide and on the next -- and, and I think on
7 the next as well, I don't want to go through
8 them in detail, but just broadly, if you read
9 through them you'll see references to -- like,
10 under the second company, Applied Industrial
11 Technologies, that very first line, it talks
12 about maintenance, repair and operational
13 needs. Other companies, like the W.W.
14 Grainger, down below, the first line refers to
15 MRO, so that's an acronym that you'll see
16 referred to here. So these are large providers
17 of wire and cabling, and these MRO-type
18 providers that ultimately biases this -- the
19 range upwards because of the way that the comp-
20 -- that PwC excluded a lot of other companies
21 in those other SIC codes that, at its
22 inception, PwC said it was reasonable to
23 consider. So that's where I think the end
24 result is a very biased -- a very bias set
25 towards high-profit companies, many of which



1 have, kind of, broader value added services
2 that they provide in addition to pure
3 wholesaling.

4 Q: And again, these, I think this slide and I
5 believe the next slide, continue to talk about
6 these distribution companies, do any of these
7 particular companies have a different -- or do
8 you have a different criticism other than what
9 you just referenced on slide 46 with those
10 companies?

11 A: No. It's just -- it's a fairly detailed review
12 of each of the business descriptions, it's not
13 an excruciating amount of detail, but there's
14 just -- you need to kind of review the
15 description to really understand what each one
16 does, but they all give you, I think, the same
17 -- or give me the same conclusion, mainly that
18 they are part of this MRO/industrial
19 distribution network that is very different
20 from the broader wholesale distribution
21 function, even if you -- even if that's what
22 Texas did for TSC.

23 Q: And what is the markup on total costs that PwC
24 derives from those set of companies?

25 A: So if you scr- -- there we go.



1 So, the range -- and this is based on 2011
2 to 2013 data, and they derived a range in
3 between 3.8 percent and 11.9 percent markup on
4 total costs, so the operating margin's gonna be
5 a little bit lower than that, but I think the
6 markup on total costs is the, is the measure to
7 focus in on as we start to evaluate the 9.7
8 percent that the company actually implemented.
9 So the median is seven percent.

10 Q: Okay. And looking at these results, are they
11 consistent with the markups that you typically
12 obtain in benchmarking in a wholesale
13 distribution function in your transfer pricing
14 analysis?

15 A: No, they are substantially higher than that
16 range. And again, not by a tiny amount, but by
17 a very large amount. So, I've done wholesale
18 distribution studies, pretty much, consistently
19 since 2000, if not even before then, and you
20 generally will see -- year in and year out, I
21 see it with different comparable sets and
22 different approaches, and different approaches
23 that tax -- the different authority -- tax
24 authorities or taxpayers do, you will see a two
25 percent operating margin or maybe a three

1 percent operating margin as being the median,
2 not a seven percent medi- -- not a seven
3 percent number. And with a range -- reasonable
4 range somewhere between, maybe, at the low-end
5 one to one -- maybe one and a half percent
6 margin, or the high-end maybe three and a half
7 percent, maybe four in a good year, but not
8 this range of 3.8 to 11.9.

9 Q: And what accounts for the difference between
10 the PwC numbers and what you would expect to
11 see -- or that you have obtained in wholesale
12 distribution?

13 A: PwC's exclusion of a large number of otherwise
14 reasonable comparable distributors, if you were
15 -- if that was the function that you were
16 appropriately benchmarking. So companies from
17 other sectors.

18 Q: All right.

19 *(Whispering.)*

20 A: I'm sorry. When I say other sectors, I mean,
21 wholesale distributors who are serv- -- who are
22 distributing other kinds of products to other
23 types of customers.

24 Q: How does PwC apply this markup on total costs
25 to Texas to derive the inventory markup?

1 A: So it just goes through a two-step process
2 here. And part of this is to show, okay, how
3 do they go from seven percent -- the seven
4 percent median from the study, to the 9.7
5 percent they implemented. And one possibility
6 is that they're taking a markup on total costs
7 and they need to convert it to an inventory, a
8 markup on inventory, which is gonna be a subset
9 of your total costs.

10 So, here, they add up what they consider
11 to be Texas' total costs, the -- which is the
12 top line, a 2.8 billion dollar number, but --
13 and then, they calculate the markup on total
14 costs to get the transfer price, the --
15 effectively, the profit element, the -- and
16 then, they apply that to the inventory actually
17 sold, which is three-quarters of the way down
18 that spreadsheet, to then get the markup on
19 inventory. It's just -- it doesn't move the
20 needle that much because mo- -- they -- these
21 other costs are not that large a portion of the
22 costs they include. The one thing I would call
23 out, though, is again, a -- what I consider
24 committing a fundamental inconsistency in the
25 approach, and it shows they have a lack of, of

1 review of the functions and assets and risks,
2 is they include in that top footnote, it's in
3 the -- it's a footnote, footnote 13, but they
4 include not just the Texas' purchasing costs
5 center, but these total Waco expenses. So
6 they're including the distribution costs in
7 there, which I don't think are, are relevant
8 for calculating that co- -- its markup. But,
9 most importantly, is they're putting what
10 they've re- -- what they call Texas'
11 intercompany costs of sales. So this is not
12 actually -- as I've gone through the
13 accounting, these are not literally expenses
14 that Texas is incurring prior to selling the
15 inventory to the related parties.

16 Q: And what is the effect of this approach on the
17 company's transfer prices?

18 A: So the effect is to, effectively, assert that
19 there is a, kind of, a very large fraction of
20 the profits in the company that should be
21 earned by this very small purchasing function
22 by implementing what I consider a very
23 unreliable approach.

24 Q: Okay. And, you stated earlier you believe that
25 the -- or, not that you believe, you stated



1 earlier that the inter -- the markup is 9.7
2 percent. Do you consider that to be with an
3 arm's length range of the results?

4 A: No, I don't.

5 Q: Okay. And can you explain your basis for that
6 statement?

7 A: Okay. So, some of it goes to how they derived
8 the nine -- I think first it's helpful to
9 figure out how they derived the 9.7 percent,
10 because I think that helps to show that the --
11 even though they're setting the transfer
12 pricing study up as if it were simply testing
13 the distribution function, that they then move
14 over and test the retail function and then give
15 everything else -- and figure out what they
16 need to provide the retail function, and then
17 leave everything else to the purchasing
18 function. But, ultimately, the fact that it's
19 not a -- within the arm's length range, I --
20 it's something I have concluded based on, one,
21 my opinion that says this whole exercise is off
22 base from the get-go because they
23 mischaracterized the functions, they're using
24 a wrong set of comparables, but even if they
25 were, even if they had characterized it



1 correctly, even if wholesale distribution was
2 the way to go, this -- they, they have a -- the
3 9.7 percent is so far above a range of
4 reasonable wholesale distribution margins that
5 you'd be out of -- they'd be out of the range
6 already, but their transfer prices would be
7 inconsistent with the arm's length range -- and
8 even setting aside the issue of whether you
9 should apply that to the inventory that it does
10 not appear TSCT ever really pays for.

11 **THE COURT:** And that's wh- -- I was gonna ask you
12 about what the significance of the markup on
13 inventory at the bottom, explain that a little
14 further for me.

15 A: So, it's because you have to -- if you kind of
16 read through their analysis, it's a, kind of,
17 a step-wise progression for them to get to the
18 ultimately 9.7 percent number. So, they get
19 this -- that first number, that seven percent
20 on the top part of that chart, that's ---

21 **THE COURT:** The median?

22 A: --- liter- -- the median, correct. And I keep
23 referring to the medians because that's
24 generally what a transfer pricing economist
25 would go to in recommending a company to use,



1 if it's gonna be using it as a -- to say, this
2 is what we think you the Taxpayer should use to
3 set your transfer prices. So, they derived the
4 seven percent from the comparables, that was
5 the prior figure. So I have a bunch of
6 comparable companies, I calculate the median,
7 seven percent is the median, that gives me the
8 markup on total costs that Texas should earn.
9 But then they stop and say, well, wait a
10 second, what we need to do is derive the markup
11 on the inventory. So, there's the -- the
12 inventory's simply gonna be cost of goods sold,
13 and if this were another kind of company, you
14 would just say, okay, how much is the cost of
15 goods sold -- (sneezing) ---

16 Q: Bless you.

17 A: My apologies. And -- how much is the cost of
18 goods sold, and so I need to convert that
19 markup on total costs to a markup on inventory,
20 which could be a higher number. So that's why
21 I said -- when I went through this initially,
22 I was trying to figure out, is the difference
23 between seven percent and 9.7 percent because
24 they're effectively using, kind of, a different
25 cost basis when they're converting markup on

1 total costs to markup only on inventory costs.
2 But, here, you see at the end of the day, it
3 doesn't really move the needle, that's why that
4 number at the bottom, it's still a seven
5 percent medium, it's moved the, the bo- -- the
6 lower quartile and the upper quartile by a very
7 small amount.

8 **THE COURT:** Yeah.

9 Q: And on the slide that we looked at earlier,
10 PwC's analysis was based on comparables from
11 2011 to 2013, correct?

12 A: Correct.

13 Q: Okay. Did PwC update their study for the years
14 at issue?

15 A: Not that I have seen.

16 Q: Okay. And have you calculated the markup on
17 total costs for PwCs comparables during the
18 years at issue?

19 A: Yes, I have.

20 **MS. WOOTEN:** (To Ms. Gamble) Next slide, please.

21 Q: Okay. And if you could describe to the Court
22 what's on slide 51.

23 A: So these are the comparables we just discussed.
24 These are the PwC wholesale distribution
25 comparables. It's just updating their



1 financials for 2014 through 2016. And so, this
2 is the markup on total costs that they earn.
3 So, if you wanna compare the, kind of, the more
4 contemporaneous number would be 6.3 percent
5 here, is the median, versus the seven percent
6 that they got from the earlier years. So,
7 their number didn't move that much -- or the
8 number for the comparables didn't move that
9 much. That's consistent with my view of the
10 profitability and the sustained profitability
11 of these inappropriate comparables.

12 Below is the -- this is the consolidated
13 markup on total costs for Texas as a whole so
14 it's gonna include retail, it's gonna include
15 the purchasing function, and effectively it
16 assumes that the, that the inventory is
17 actually purchased in the first instance by
18 Texas, so that's gonna be in the denominator of
19 that percentage. So you already see that it's
20 pushing towards the, the odds well above the
21 median, the, kind of, the average over this
22 time period is 10 and a half percent before you
23 separate things out. Typically, in the
24 transfer pricing analysis, to do it
25 appropriately, you want a segmented view of the



1 tested party that only shows the profitability
2 of that particular trade flow. So this is
3 Texas including retail, which, as an economist,
4 that's not the number I need. The number I
5 need is the markup on total costs that, that
6 Texas earns on its procurement function. And
7 what is the cost associated with that
8 procurement function, we saw that earlier, it's
9 13 million dollars. So the number -- the
10 appropriate number is not the hundreds of
11 millions of dollars that TSCT earns divided by
12 some notional intercompany inventory cost, but
13 rather divide that hundreds of millions of
14 dollars by the 13 million dollars of costs that
15 it actually incurs. Those are the only out-of-
16 pocket expenses -- and again, out-of-poxes --
17 out-of-pocket is a notional number here -- or
18 a notional concept because these are simply
19 journal entries.

20 Q: And have you calculated any other profitability
21 ratios for PwC's comparables during the years
22 at issue?

23 A: Yes. And, and even before we left that, I
24 should have said, that the net result of doing
25 that appropriate calculation of markup on total



1 costs would put TSCT so far -- just incredibly
2 way outside the interquartile range of even
3 PwC's own comparables. So, that -- as an
4 economist -- or as a transfer pricing
5 practitioner, I would say demonstrates they are
6 far outside the arm's length range. I've done
7 that similarly with other -- with using other
8 PLIs, these profit level indicators, and they
9 all lead to the same conclusion. They all also
10 have the same problem of trying to get a
11 comparable measure of the comparables, the
12 profitability relative to Texas' isolated
13 profitability of its procurement function
14 alone.

15 So this is the return on assets. Now,
16 what's in the assets here, in the -- in Texas'
17 assets, are all of its retail stores. The
18 retail stores have nothing to do with a
19 procurement function. The only asset tha- --
20 and Texas has no assets of the headquarters,
21 even. The headquarters is all part of
22 headquarters, they're just having a rental
23 expense. So there is a, apparently, a small --
24 relatively small. There is a -- it's in the,
25 maybe, even like 80 million dollars of, of

1 freight -- or some kind of inventory cost that
2 the pur- -- that the purchasing entity has, but
3 you divi- -- you still have a -- if you divide
4 the hundreds of millions of dollars of
5 procurement profits by that small number of
6 actual operating assets for the procurement
7 function, you get an -- a return on assets of
8 upwards of 500 percent. So these are
9 exorbitant ROAs -- or exorbitant return on
10 assets relative to the comparables, and
11 certainly, relative to any CPM analysis I've
12 ever done.

13 Q: And have you calculated any other profitability
14 ratios for PwC's comparables during the years
15 at issue, in addition to return on assets?

16 A: Yes. I've done something called the Berry
17 Ratio. I referred to that earlier. The Berry
18 Ratio is this operating -- gross, gross margin
19 -- gross profit divided by operating expenses.
20 So, if you think about it, it's basically,
21 what's the amount of profit that the Company is
22 generating on a gross level that can cover all
23 of the operating expenses. It's a stand --
24 again, a st- -- all -- not, not a -- it's a
25 standard PLI reference in transfer pricing

1 analysis. It's not used as frequently as the
2 others, but it is occasionally used,
3 particularly, in the distribution context. And
4 generally, you expect numbers in the range of
5 -- numbers that are above one, because it's
6 gonna have enough gross profit to cover its
7 operating expenses, so that would be one --
8 that ratio would be one, and if it was just
9 enough to cover them. But generally, in the
10 range of 1.02 to 1., maybe, 25. So, that's
11 the, kind of, the -- effectively, it gives you
12 the coverage of its operating expenses.

13 Here, as I would expect, these
14 distributors earn a median Berry Ratio about
15 1.06. By comparison, Texas -- again, on the
16 consolidated basis of Texas, including its
17 retail, it's already earning well above the
18 interquartile range, a Berry Ratio above three.
19 And a Berry Ratio of three, for a transfer
20 pricing economist, is shockingly high already.
21 Now, what happens if I exclude all of the, kind
22 of -- if I try and think about what number
23 would I likely come up with if I were actually
24 to have a segmented view of the Texas
25 procurement function alone, what's the

1 operating expenses it needs to cover? It's got
2 13 million dollars, we saw that before. It's
3 that same 13 million dollars. So I divide the
4 gross profit, divided by the, by the -- this
5 hundreds of millions of dollars of gross profit
6 divided by the 13 million dollars of operating
7 expenses and you get something like a, a Berry
8 Ratio of 20. So it's a huge number.

9 Q: And considering all of these, these analy- --
10 this analysis that you've done, how does that
11 relate to your opinion in the reliability, or
12 lack there of, of PwC's benchmarking analysis?

13 A: It demonstrates it's entirely unreliable, and
14 even if one were to use the method that PwC
15 implemented, even if one accept -- were to
16 accept the unreliable comparables it chose,
17 they still should've concluded that the company
18 was outside the arm's length range.

19 Q: And have you prepared an alternate set of
20 distribution comparables?

21 A: Yes, I have.

22 Q: Okay. All right. If you will describe what's
23 on slide 54.

24 A: So, this is consistent with, kind of, a -- my
25 general approach to distribution comparables.



1 And it's also -- because the first time I saw
2 their results and I saw their comparables set,
3 PwC's comparable set, it struck me as
4 inconsistent with my previous experience, so I
5 went back to the, the Cap IQ data set. I
6 pulled distribution companies using largely
7 similar criteria -- search criteria, in terms
8 of SIC codes, except I just kept in companies
9 like, AmerisourceBergen, which is a
10 pharmaceutical distributor, and Avnet, which I
11 believe is a electronics distributor, roofing
12 supply companies. So, this al- -- continues to
13 have some of the other comparables that PwC
14 included, like Anixter International, is one of
15 their companies, and Graybar and Houston Wire
16 & Cable, but it's just, either -- encompassed
17 within a more representative set of
18 distribution, some of which who will be, kind
19 of, high -- more -- higher profit companies,
20 and some of which will be lower profit
21 companies.

22 **MS. WOOTEN:** (To Ms. Gamble) Please advance to the
23 next slide.

24 **A:** And so, it continues on to this next page. So,
25 it's a fairly broad set just to give you --

1 give -- and also, if my -- confir- -- to
2 confirm my own opinion that says that, if it
3 had been done reliably I would expect a
4 distribution operating margin -- or, in this
5 case, markup on total costs, in this two to
6 three percent range. And so, that's what in
7 fact it does. It provides 2.9 percent is the
8 average for these, even before -- and so, this
9 one shows that, had they done it re- -- had PwC
10 done the analysis reliably, even before you get
11 to the issue of segmenting out Texas, they
12 would've observed that Texas would've been
13 outside of the arm's length range, ergo, the
14 9.7 percent would be not an arm's length
15 result.

16 Q: All right. And what is the inventory mark --
17 or MOTC earned by Texas within the
18 interquartile range of these results?

19 A: So, if you just do the 9.7 percent, then the
20 9.7 percent would be outside that interquartile
21 range. And again, that 9.7 percent is on a
22 cost basis that I think is unreasonable --
23 unreasonably inflated because it has the
24 inventory costs that they don't pay -- that
25 Texas doesn't pay in the first instance. The



1 appropriate calculation, I still think the
2 costs should be something like that 13 million
3 dollars of purchasing costs.

4 Q: And again, how does this analysis inform your
5 opinion on the reliability of PwC's Transfer
6 Pricing Study?

7 A: So, as with the, the -- the ultimate conclusion
8 is the same as with -- if I take PwC's
9 comparables or I take my comparables, they tell
10 you the same story. The, the -- both on -- the
11 retu- -- if you use a return on assets, Texas
12 is gonna be way outside of the arm's length
13 range. So it's earning far too much money
14 relative to comparable, comparable companies,
15 assuming that Texas is performing a wholesale
16 function. The real difference between those
17 two sets, is that the -- I think the operating
18 margin -- or the, or the -- the markup on total
19 costs of my set is much closer to what I
20 would've thought PwC would've come up with had
21 they implemented just that search criteria in
22 a reasonable way, even befo- -- even setting
23 aside all their other issues.

24 Q: All right. So now, we're gonna talk -- we've
25 been talking about distribution, let's switch



1 over to retail, the retail function that PwC
2 described in their memo.

3 PwC claims to've identified comparable
4 companies to TSC's retail function, correct?

5 A: Correct.

6 Q: All right. And ---

7 **MS. WOOTEN:** (To Ms. Gamble) If you'll advance to
8 the next slide.

9 Q: Are these industries the, the ones that PwC
10 used for those comparable retailers?

11 A: Yes.

12 Q: Okay. And did PwC also apply quantitative
13 screens?

14 A: Yes.

15 Q: Okay. And do you consider those screens to be
16 reasonable?

17 A: Well, the first one is pretty generic, you all
18 -- I think you generally exclude companies that
19 have -- don't have enough financial
20 information. But the second one, I think, is
21 a -- an egregious error. The fact that they're
22 excluding companies with sales greater than a
23 billion dollars, effectively, excludes a lot of
24 more profitable retail companies. As you would
25 expect in retailing, national retailers with a



1 greater footprint can earn significantly higher
2 margins than smaller retailers. So,
3 effectively, as I saw the, kind of, the
4 language in the report, it ass- -- the whole
5 report attempts to shift the -- any kind of
6 benefits of economies of scale from the company
7 as a whole over to this very narrow purchasing
8 function that Texas performs, and that is
9 entirely inconsistent with standard transfer
10 pricing analysis, and, I think, reflects the
11 kind of income shifting approach to purchasing
12 that, that international tax authorities have
13 long been concerned about.

14 Q: And do you recall what the annual retail sales
15 volume of the Tractor Supply legal entities are
16 ---

17 A: Yes.

18 Q: --- or is?

19 A: So, I have a slide for it, where the -- TSC has
20 about, I believe, five billion dollars in sales
21 -- or, the total company has about between five
22 and six billion dollars of which 80 percent is,
23 is TSC. So, the blue bars here reflect TSC, so
24 it's four and a half in the -- in 2014, rising
25 to above five and a half in 2016. The, the



1 entities with less than a billion dollars of
2 sale are actually TSCT and TSC. Nonetheless,
3 I think that in doing this analysis, even if it
4 were reliable, I don't think the whole retail
5 benchmarking has a reasonable data point, but
6 even if you were to do it, you wouldn't apply
7 this billion dollar sales screen. It think it
8 biases your results.

9 **THE COURT:** Would it -- well, to be clear, it
10 doesn't have a reasonable data point because
11 of, why?

12 **Q:** Well, the -- there's a conceptual issue I have
13 with the entire approach of say, that it's
14 appropriate to try and benchmark TSC's retail
15 operations relative to a set of other
16 retailers. You can- -- I don't -- as we saw
17 early on, that long list of retailers, there
18 are a lot of reasons why individual retailers
19 have high and low results that are really
20 reflective of the specific products they carry,
21 their local market conditions, the -- PwC is,
22 I think, ultimately, down a fool errand of
23 trying to establish what they, what they are
24 calling, I believe in other areas, a routine
25 retail return. I don't believe there's any



1 such thing as a routine retail return in this
2 context, all you're doing is trying to --
3 you're, effectively, assuming from the
4 conclusion. You're basically saying, well, the
5 -- I see other retailers earning a three
6 percent margin, therefore whatever -- even if
7 -- any re- -- any high profit or high margin
8 retailer like Tex- -- like Tractor Supply, all
9 that excess above three percent, that's gonna
10 go back to some other entity, whether it's
11 purchasing, whether it's a, a payment of a
12 royalty, that's the effect of this whole --
13 kind of, marching down this line of calling TSC
14 a retailer and trying to benchmark that routine
15 retail function. It also doesn't really
16 reflect what TSC does. TSC has a headquarters,
17 that headquarters is more than simply this
18 asserted routine retail function.

19 So the exercise is, is ill-advised to
20 begin with. The attempt to find comparables to
21 TSC -- reach a comparable -- retailers to TSC,
22 is also something that I don't think you can
23 reliably benchmark because other companies
24 aren't like TSC. TSC earns the retail profit
25 it does because of the products it carries.

1 It's not gonna be the same as a marine supply
2 retailer that earns a very small margin. So,
3 that's my primary concern about it. At the
4 implementation level, even this basic billion
5 dollar screen is -- kind of, ups the ante
6 further, because by virtue of that billion
7 dollar screen they're effectively trying to get
8 to a result ---

9 **THE COURT:** You mean, the billion dollars is -- a
10 billion dollar limitation?

11 **Q:** Correct. So, they're saying the only retailers
12 that are gonna be comparable to this, what
13 they're gonna call a routine retail function,
14 is gonna be retailers that earn -- that, that
15 make less than a billion dollars of revenue a
16 year. But what does that do? The impa- --
17 that, that excludes a ton of companies from
18 their set. You go through their report and it
19 shows the number of companies and which
20 companies are excluded, and it recovers -- it
21 excludes all the names you would expect, all
22 the household names, the big retailers that we
23 generally know from our own day-to-day
24 experience. And those companies, had they been
25 included, that would've bumped up that retail

1 return that they're trying to benchmark
2 considerably relative to the 3.2 percent that
3 the company -- that PwC derives from their bias
4 set, and ultimately that -- the, the punch line
5 is, that's the number that the 9.7 percent
6 ultimately is derived from. It's not derived
7 from the seven percent that they, they derive
8 markup on total costs from the wholesale
9 distribution set, they're backing into that
10 number based on what they get for the retail.

11 *(Whispering.)*

12 Q: All right. In the company's accounting record,
13 which legal entities are allocated vendor
14 rebates and volume discount?

15 A: Well, I saw al-- -- I saw those allocated
16 substantially to TSC, as well as -- I believe,
17 some of those individual ones -- oh, yeah,
18 here, we -- you have it on -- I'm sorry.

19 I saw it on the earlier accounting
20 records, but here's the summary. And a
21 substantial portion of these volume rebates are
22 being allocated to TSC. Again, it would be an
23 additional indicator if we -- if one needed
24 one, that using this billion dollar sales
25 screen to, to get rid of volume discounts is an



1 entirely inappropriate way of implementing the
2 CPM.

3 Q: And what are the results of PwC's retail
4 comparables analysis?

5 A: So, it gives you a, kind of, a median of about
6 3.2 percent over this three year time period
7 that we see in the bottom range, and then this
8 interquartile range of between 0.5 and 5.6
9 percent.

10 Q: And do consider this -- that reasonable to
11 apply to Tractor Supply Company?

12 A: No. For the reasons that I expressed in my
13 prior testimony -- in my prior answer.

14 Q: Okay. All right. Then let's, let's turn and
15 look at the royalty part of the Transfer
16 Pricing Study.

17 According to -- or on the related party
18 contracts, after the 2001 restructuring when
19 the trademarks and trade names were transferred
20 from TSC to TSC Texas, TSC has been licensing
21 the use of those company trademarks and trade
22 names back from Texas, correct?

23 A: Correct.

24 Q: Okay. Has Tractor Supply Company paid Texas a
25 royalty for the use of those trademarks and



1 trade names?

2 A: It does not charge an explicit royalty, no.

3 Q: Okay.

4 A: Or it's -- I would say, it has chosen not to
5 charge one as -- at least, during the years at
6 issue.

7 Q: Okay. And in this Transfer Pricing Study at
8 issue, does PwC analyze the company's
9 trademarks and trade names and come up with a
10 royalty rate?

11 A: Yes, it does.

12 Q: Okay. And how does PwC perform that analysis?

13 A: So, it applies a -- or a, a general methodology
14 that I have seen applied, and I myself have
15 applied often in trademark licensing issues.
16 It's something called a comparable uncontrolled
17 transaction method, a CUT analysis. It's where
18 you search the publically available information
19 for licensing transactions between independent
20 parties, and you assess the -- their royalty
21 that one party pays another party in return for
22 using the license.

23 Q: And what type of search was this? Was this a
24 broad or narrow search?

25 A: It was a very broad search for the, for the



1 broader wholesale trade durable goods category.

2 Q: Okay. And what are the results of this
3 analysis?

4 **MS. WOOTEN:** (To Ms. Gamble) Go to the next slide.

5 A: So, so the results are -- they come up with
6 five different comparables -- or that they
7 assert are comparables. I would say, at the
8 outset I should've said that -- again, you need
9 to take into consideration who the developer
10 is, the developer of the value of the
11 trademarks. Both, as of 2001, and even as of
12 2000 -- even, even as of the years at issue,
13 that entity is TSC the parent company. Under
14 that set of circumstances, it's my opinion,
15 that zero royalty would be paid at arm's length
16 by the developer of that -- by the original
17 owner TSC and by the continued developer of
18 that -- of those trademarks, and the value of
19 those trademarks, namely TSC. So, in my view,
20 the whole exercise to beg- -- to get -- from
21 the get go, is an inappropria- -- is going down
22 the wrong path to begin with. So, again, back
23 to the notion that you can apply a method
24 identified in the regulations, but you can come
25 to an unreasonable result and if you don't step



1 back and try and understand the facts and
2 circumstances of who's doing what and what
3 happened at the time of a restructuring in
4 particular.

5 Sitting aside -- sitting that aside, they
6 came up with five comparables -- or five
7 asserted comparables. I consider those
8 comparables to be entirely unreliable, not just
9 in their totality, but each of them
10 individually. I think they -- if they had gone
11 through and done a more reasonable, thorough
12 search -- or review of these five, they
13 should've eliminated each of those five. So
14 the bottom three, Snap!, Cherokee, and ESH
15 stran -- strategies Branding, they operate in
16 entirely different industries. Snap! is an
17 internet service provider, or at least that
18 license involves internet service provider.
19 Cherokee is a product that's being licensed to
20 Target, it's not a -- something like -- assume
21 RadioShack were to license it's name to some
22 other company that wanted to open up a new
23 store, so that's not what this Cherokee license
24 is with Target, it's a product license. EHS
25 Branding is also a license for a -- I believe

1 it's a hotel. So, those three should be out
2 all together based on the difference in the
3 industry and the products all together. It
4 does not reflect the royalties that one would
5 expect inde- -- third parties to pay for the
6 use of a retail trademark on a retail store.

7 With regard to the top two, those do perf-
8 -- pertain to retail stores. Sears is probably
9 the easiest one to dispose of because this is
10 a company that went bankrupt in 2018. Now, I
11 would not expect a company that's going into
12 bankruptcy to be -- or ano- -- a third party,
13 to be licensing, and much less, paying an 8.7
14 percent royalty to a company that is basically,
15 you know, going down the tubes in the years
16 leading up to it's bankruptcy. This is also a
17 Canadian license done back in the early 2000s.
18 I don't know the specifics of it, but the
19 bottom line, the fact of the -- of Sears'
20 financial distress does not indica- -- to me
21 indicates it is an unreliable comparable. So
22 we're left with one last one, the Episode
23 versus Mothers Work, hap- -- it happens to be
24 the highest one, so -- but, nonetheless, it is
25 a -- Mothers Work was, as I understand it, a

1 maternity clothing retailer, they decided to
2 buy the assets of this distressed company
3 called Episode, you know, they were trying to
4 extend their product line into a different
5 area. They -- this was in the late 90s, almost
6 immediat- -- I believe it was the year after
7 they, they clo- -- they closed that deal, they
8 shutdown Episode, so. And it was also tied in
9 with a broader procurement contract. So,
10 Episode had stores, it had a brand, and it had
11 a supply chain. And so, there was a, kind of,
12 a complicated interconnection between the
13 license of the brand name with the other
14 transaction -- with the rest of the transaction
15 between those two companies, or the rump
16 company's left over after Episode goes
17 bankrupt, that is not a reliable data point.
18 And again, this is late 90s, and it quickly
19 goes out of business. So at the end of the
20 day, there's no royalty rate that they're
21 coming up with, had they done this analysis in
22 a reasonable way.

23 Q: So turning to the alternative procurement
24 comparables for TSCT, have you don't any
25 analysis of other types of comparables to

1 confirm whether or not the 9.7 percent
2 inventory markup is not an arm's length?

3 A: Yes.

4 Q: Okay. And did you prepare this table on the
5 markup of total costs for other publically
6 traded companies that perform a procurement
7 function?

8 A: Yes.

9 Q: Okay. And can you explain this and how you
10 derived, how you derived this information and
11 demon- -- what it demonstrates?

12 A: Well, again, I think I said earlier that it's
13 really hard to benchmark the procurement
14 function, 'cause you have to find companies,
15 that's all they do is procurement, and most
16 companies that are doing procurement are doing
17 it as part of a broader set of operations. One
18 of the few times when I actually delved into
19 that issue, is -- with any degree of
20 particularity, was back when I was working at
21 KPMG, I analyzed a company called Li and Fung.
22 Li and Fung is not the -- was not the client,
23 but it was the subject of the analysis,
24 primarily because it's a, actually, a very well
25 known company in Asia, a large company that has



1 enga- -- for sometime, that has engaged in,
2 what I'll call, procurement-plus type
3 arrangements. If you want a woman's sweater of
4 a particular color and a particular style, go
5 to Li and Fung, they will find a manufacturer
6 in China, Mainland China or in Hong Kong, who
7 will make that for you in a huge number of
8 volumes that you can then sell in your retail
9 store. So, that was kind of the closest analog
10 that I ca- -- I have, in my career, that I've
11 come to companies that are more comparable to,
12 to procurement func- -- companies. But,
13 nonetheless, they still have -- in Li and
14 Fung's case, they actually do design, as well,
15 they're not simply going out -- they're not
16 simply a middleman, they are going and saying,
17 well, what kind of design do you want? Do you
18 -- what -- let's go through the design process
19 in designing -- helping you with that design
20 process.

21 So, I went through the, the -- our
22 database of financial information for other
23 companies, most of these companies are al- --
24 or actually, all of these companies are Asian-
25 based companies, and they all do, generally,

1 similar things in different industries. So,
2 again, it was a way to try and say, if one were
3 to benchmark the procurement function, what's
4 a reasonable set -- what's a reasonable
5 approach, and what are the types of markups
6 that you wou- -- you tend to -- would tend to
7 observe. I observed something in the, for this
8 set, around 2.4 percent. Again, as a markup on
9 total costs measure, as a PLI, it's not that
10 far off, what we observe in the distribution
11 function. It does still raise the question of
12 markup on what? I -- is there inventory that's
13 being, kind of, marked up on this, or is it
14 really a markup on their design costs, their
15 administrative costs, whatever their operating
16 expenses are.

17 So, even if -- so, if the taxpayer had
18 gone down this road -- or this route and said,
19 let me just benchmark the procurement function,
20 they would've still come up with a number that
21 is far outside where a -- where TSC Texas is
22 far outside of the interquartile range using
23 this approach. And this is -- again, with all
24 these slides where I have TSC Texas there, it's
25 a consolidated number, the right number I think



1 is a trade -- is a trade flow, a specific
2 number that's not in here, that we -- I don't
3 have the information from the client to
4 calculate that, that's gonna be much higher
5 than these numbers.

6 Q: All right. And did you also analyze the return
7 on assets for the purchasing company?

8 A: Yeah ---

9 **THE COURT:** Before you leave this screen though ---

10 **MS. WOOTEN:** Yeah.

11 **THE COURT:** You picked Hang Pin, which is negative
12 10.6 and 12.9, why, why that one?

13 A: So, again, this is kind of what the, what the
14 data -- what comes out of the database search,
15 there's just not that many companies that are
16 publicly traded ---

17 **THE COURT:** So you just pick them all?

18 A: I pick them all -- excuse me, all the ones that
19 I can identify that appear to provide this
20 procurement function.

21 **THE COURT:** Okay.

22 A: They all happen to be in Asia, there's not a
23 confined ---

24 **THE COURT:** I understand now.

25 A: --- U.S. company. There's gonna be a lot of



1 variability. I think a lot of companies that
2 do this function are probably smaller companies
3 that are not publicly traded companies, there
4 are a lot of them out there. It's not just
5 that there are only this number, there's a
6 gazillion and in Hong Kong, especially, the
7 economy is heavily dependent on those kind of
8 firms that provide that procurement, sourcing,
9 or full-on manufacturing service. But this is
10 what the database has.

11 **THE COURT:** Okay.

12 Q: All right. We were discussing if you also
13 analyzed the return on assets for the
14 purchasing company, can you describe the
15 information that you prepared on slide 67?

16 A: Yes. And again, it's the question of, what's
17 the right PLI to use, what's the right
18 financial ratio to use to benchmark the
19 taxpayer's return.

20 **THE COURT:** PLI?

21 A: I think -- I'm sorry, the profit level
22 indicator. I apologize for inserting an
23 additional acronym.

24 But it's the -- so you have the choice of
25 operating margin or markup on total costs, or



1 return on assets, or the Berry Ratio, and
2 there're pros and cons associated with each one
3 depending on the company. Here, I do think,
4 kind of, the -- and because I don't have a lot
5 of visibility, in terms of the -- these
6 comparables costs basis, like how much -- are
7 they actually holding inventory and then
8 marking up that inventory to customers, versus
9 just selling their service? Their assets is a
10 lot easier to benchmark, it's just -- these are
11 the assets they have, they're not earning on
12 ave- -- it's a huge variation, negative seven
13 percent versus 29 percent, but the average is
14 around two percent. It still tells you that
15 the margin -- that the amount of profit that
16 TSCT should earn for that procurement function
17 is actually a rel- -- is a very modest amount.
18 Also, because Texas is not really contributing
19 a lot of assets in that procurement function.

20 **MS. WOOTEN:** (Whispering.)

21 **Q:** Are you familiar with the term -- I believe
22 this is the last slide. Are you familiar with
23 the term realistic or allvail -- available
24 alternative, as is described in the §482
25 Regulations?



1 A: Yes. And here, it's a quote from the §482
2 Regulations. It talks about it's realistic
3 alternative. I think different people
4 sometimes use the word realistic available
5 alternatives, or realistic economic
6 alternatives, but generally, it's about saying
7 the thing -- of the -- the approach that a
8 transfer pricing analysis -- that a transfer
9 pricing analyst should take and that the
10 Commissioner, the IRS, takes is to examine what
11 a taxpayers realistic alternative is to the
12 transaction that's actually being tested. So,
13 if there is an opportunity for a taxpayer to
14 earn a lot higher profit, or retain a lot of
15 profit in -- particularly, in terms of keeping
16 a transaction as it was previously structured,
17 relative to the restructuring. At arm's length
18 that's what the taxpayer would do. A taxpayer
19 would not -- at arm's length, a company's not
20 going to voluntarily give up hundreds of
21 millions of dollars of profit in return for
22 someone taking over the purchasing function,
23 particularly, if that purchasing function was
24 previously done by the, by the company.

25 So, that's incr- -- it's a, it's a -- part

1 of the analysis that the IRS is increasingly
2 focusing on, and it's been a part of, I think,
3 a lot of my work in transfer pricing litigation
4 now for some time.

5 *(Whispering.)*

6 **MS. WOOTEN:** She's gonna switch over, I apologize.

7 (To Ms. Gamble) Two Excel spreadsheets.

8 Q: So, on slide 30 -- excuse me, slide 24 of the
9 Demonstrative the. The source exhibit was
10 SCDOR Exhibit 30, and it's at TSC -- I'm sorry

11 **MS. WOOTEN:** (To Ms. Gamble) you got the -- yeah.
12 Oh, let's start with 29.

13 Q: All right. So slide 26 the source is SCDOR
14 Respondent's Exhibit 29 at TSC00004356. Can
15 you identify the Excel spreadsheet that's on
16 the screen?

17 **(Respondent's Exhibit Number 29 was introduced into**
18 **the record at this time.)**

19 **MS. GEER:** Nikki, just to clarify. Mine says 4355
20 on my screen, and you said 4356?

21 **MS. WOOTEN:** Sorry. It -- sorry, that Exhibit is
22 like the Trial Balances ---

23 **MS. GEER:** Yeah.

24 **MS. WOOTEN:** --- there's three Excels within one.

25 **MS. GEER:** Oh.



1 **MS. WOOTEN:** So this one -- 55 is 2014 ---

2 **MS. GEER:** Okay.

3 **MS. WOOTEN:** 56 would be 2015. And I think the
4 slide he used was -- yeah, 2015, so this one.

5 **MS. GEER:** Okay.

6 **MS. WOOTEN:** TSC4356.

7 **Q:** Can you identify the Excel that's on the
8 screen?

9 **A:** Yes. It's the, the source file from the
10 company that shows the way in which the
11 administrative services are being allocated --
12 the headquarter services are being allocated
13 out to Texas and Michigan.

14 **Q:** And did you rely on this information in your
15 opinion?

16 **A:** Yes, I did.

17 **Q:** Okay. And is this type of information
18 routinely relied upon by professionals in your
19 field?

20 **A:** Yes, it is.

21 **Q:** Okay. And where did you get this information?

22 **A:** It was produced in discovery. I'm trying to
23 remember when. I think it was one of the later
24 productions, it might've been either November
25 or even December.



1 **MS. WOOTEN:** Your Honor, at this time the Department
2 would move in exhibit -- Respondent's Exhibit
3 30, which is a combination of three Excel
4 spreadsheets, one for each year. It's 4355,
5 4356 and 4357. I'm sorry, excuse me. It's
6 Respondent's Exhibit 29.

7 **(Respondent's Exhibit Number 29 was offered into**
8 **evidence.)**

9 **MS. BUCKNER:** 29?

10 **MS. WOOTEN:** 29.

11 **MS. GEER:** 29 is these three ---

12 **MS. WOOTEN:** Yes.

13 **MS. GEER:** --- that are ---

14 **MS. WOOTEN:** 29 is 4355, 4356, 4357.

15 **THE COURT:** They're admitted.

16 **(Respondent's Exhibit Number 29 was admitted into**
17 **evidence.)**

18 **MS. WOOTEN:** Thank you.

19 **Q:** All right. Now, if we'll flip to Respondent's
20 Exhibit 30.

21 All right. And can you identify this
22 document?

23 **(Respondent's Exhibit Number 30 was introduced into**
24 **the record at this time.)**

25 **A:** Yes. It's a, a document that was provided in



1 discovery.

2 Q: And what type of information does it have on
3 it?

4 A: So it has the store profit for 2015 and 2016
5 for certain states. And so, this is -- I
6 referenced this in my earlier testimony, in
7 comparing the, both, the sales and the
8 operating margins for the South Carolina stores
9 versus the Michigan and Texas stores. You will
10 see a series of tabs to the right of the
11 summary tab that has the detail, and I used
12 that detail to calculate those -- both to
13 identify the revenues and to calculate the
14 operating margins before the transfer pricing
15 adjustments.

16 Q: And is this the type of information that
17 professionals, such as yourself, routinely rely
18 upon in transfer pricing analysis?

19 A: Yes, it is.

20 Q: Okay.

21 **MS. WOOTEN:** At this time, Your Honor, the
22 Department would move to of- -- would offer
23 Respondent's Exhibit 30 into evidence.

24 **(Respondent's Exhibit Number 30 was offered into**
25 **evidence.)**



1 **MS. GEER:** I'm sorry, I just didn't follow every --
2 is this a document that is a document created
3 by Dr. DeRamus?

4 **MS. WOOTEN:** No, this was produced by y'all in
5 discovery ---

6 **THE COURT:** Yeah.

7 **MS. GEER:** Okay.

8 **MS. WOOTEN:** TSC0- ---

9 **MS. GEER:** Then I'm good on ---

10 **MS. WOOTEN:** --- 6263 ---

11 **THE COURT:** Yeah. He just said ---

12 **MS. GEER:** No objection. I just didn't follow.

13 **MS. WOOTEN:** Okay. Okay.

14 **THE COURT:** It's admitted.

15 **MS. WOOTEN:** Thank you.

16 **(Respondent's Exhibit Number 30 was admitted into**
17 **evidence.)**

18 **THE COURT:** Who's Jennifer Gamble?

19 **MS. WOOTEN:** (Indicating to Ms. Gamble.) The lovely
20 Ms. Jennifer Gamble.

21 **THE COURT:** Oh, okay.

22 **MS. GAMBLE:** Happy to meet you.

23 *(Laughter.)*

24 **THE COURT:** You keep seeing that name on all these,
25 so.



1 **MS. WOOTEN:** Okay. So going back to the
2 demonstrative. I believe that's taking care of
3 slides 24 and 26? The Department would remove
4 slide 20, we didn't agree with that earlier,
5 which is fine. And then, that leaves us -- oh,
6 we would also remove -- based on Judge
7 Anderson's ruling, we would remove slide 12 and
8 14.

9 **MS. GEER:** I must have the wrong pagination. 12 is
10 this one (indicating)?

11 **MS. WOOTEN:** If it has red writing at the bottom ---

12 **MS. GEER:** Oh, sorry. I -- now, I see the source.

13 **MS. WOOTEN:** Yeah.

14 **MS. GEER:** Okay. So it's all ---

15 **MS. WOOTEN:** And then, also slide 14.

16 **MS. GEER:** And 15?

17 **MS. WOOTEN:** Probably, it's -- yeah.

18 **MS. GEER:** Okay. Thank you.

19 **MS. WOOTEN:** Yes, 15.

20 And the Department would move -- would
21 offer Respondent's Exhibit ---

22 **MS. GAMBLE:** 33.

23 **MS. WOOTEN:** --- 33 into evidence.

24 **(Respondent's Exhibit Number 33 was offered into**
25 **evidence.)**



1 **MS. GEER:** And I apologize, Your Honor, I just wanna

2 ---

3 **MS. WOOTEN:** That's okay.

4 **MS. GEER:** --- double check. I think that's good.

5 (Reviews documents.)

6 *(Whispering.)*

7 **MS. GEER:** So the red is what's indicating whether
8 it was already in ---

9 **MS. WOOTEN:** That's correct.

10 **MS. GEER:** --- a Joint?

11 **MS. WOOTEN:** Yes.

12 **MS. GEER:** Yeah.

13 **MS. WOOTEN:** With the exception of the two slides 8
14 and 9 with CapitalIQ, and we're happy just to
15 talk about that, but everything else it's
16 implied.

17 **MS. GEER:** So it's everything past 35?

18 **MS. WOOTEN:** Yeah. Well, I could -- 26 -- slide 26
19 was the last one.

20 **MS. GEER:** Okay.

21 **MS. WOOTEN:** Is what I had marked.

22 **MS. GEER:** And 26 came in?

23 **MS. WOOTEN:** It did.

24 **MS. GEER:** Okay. And what ---

25 **MS. WOOTEN:** Those were the two Exce- ---



1 **MS. GEER:** --- we had -- eight and nine?

2 **THE COURT:** Yeah. That's ...

3 **MS. WOOTEN:** CapitalIQ. It was at the very
4 beginning of our discussion you lashed an
5 objection on those.

6 **MS. GEER:** Yes. And what -- did we -- so we have
7 not decided that?

8 **MS. WOOTEN:** I don't believe so.

9 **MS. GEER:** So -- I mean, I don't have any problem
10 with it being a demonstrative that the Court
11 considers he relied on, I just don't think it
12 should come in as evidence.

13 **THE COURT:** I don't know what it is right now.

14 **MS. WOOTEN:** I'm sorry.

15 **THE COURT:** I said, I don't know what it is right
16 now ---

17 **MS. WOOTEN:** (To Ms. Gamble) Can you pull the
18 demonstrative back up for us, please, and go to
19 slide eight and nine?

20 *(Whispering.)*

21 **THE COURT:** Oh, that was one of the ones pulled out.

22 **MS. WOOTEN:** I had offered it. We ---

23 **THE COURT:** Oh, that's okay. I just wanted -- I
24 thought we were ---

25 **MS. WOOTEN:** Yeah. No, we pulled some of the, the



1 analogs from -- excuse me, the earnings call
2 and a presentation, those were the ones that we
3 pulled out ---

4 **THE COURT:** This ---

5 **MS. WOOTEN:** --- based on your earlier ruling.

6 **THE COURT:** This -- is this the one in which he said
7 was based on staff?

8 **MS. WOOTEN:** No, that ---

9 **THE COURT:** The underlying data?

10 **MS. WOOTEN:** No, Your Honor, that was earnings
11 calls.

12 **THE COURT:** Oh, okay. All right.

13 **MS. WOOTEN:** This is CapitalIQ and that is a
14 database -- it's a commercial database that ---

15 **THE COURT:** It's commonly relied upon.

16 **MS. WOOTEN:** --- is commonly relied upon. It has
17 houses financial data that he uses. He used it
18 in all of the other data comparable sets that
19 he put in here. Ms. Geer's -- well, I'll let
20 her speak to her objection. But this is his
21 analysis. It's obviously using data from this
22 commercial database, which is the basis for all
23 of the other data ---

24 **THE COURT:** Yeah.

25 **MS. WOOTEN:** --- in the exhibit, but that is his



1 analysis.

2 **MS. GEER:** I just feel like it's this -- a similar
3 situation to the other one where it's not been
4 authenticated. I understand he can rely upon
5 it, I just don't think it comes in as
6 substantive evidence.

7 **MS. WOOTEN:** It's his opinion and his testimony.
8 I'm not ...

9 **THE COURT:** So, are you saying that, if he offers an
10 opinion, and uses a demonstrative evidence to
11 explain his opinion, that the demonstrative
12 evidence -- well, the demonstrative exhibits
13 that's based on his opinion can not come in as
14 an exhibit -- into evidence ---

15 **MS. GEER:** I ---

16 **THE COURT:** --- under your theory of evidentiary
17 law?

18 **MS. GEER:** I ---

19 *(Laughter.)*

20 **THE COURT:** Taking you down the path ...

21 **MS. GEER:** I know, I mean it ---

22 **THE COURT:** Is ---

23 **MS. GEER:** But the way I look at it, is that this is
24 from a website, the document has not been
25 authenticated as, as it is what it reports to



1 be, and it's being -- it -- I think the laws of
2 evidence allow him to rely on things that
3 aren't admissible.

4 **THE COURT:** Yep, that's correct.

5 **MS. WOOTEN:** And I don't know if this is -- maybe,
6 clearing it up, this is not a graph that he
7 received from somebody else, this is a ---

8 **THE COURT:** Yeah, you ---

9 **MS. WOOTEN:** --- graph he, he prepared ---

10 **THE COURT:** That's what I was trying to explain.
11 It's one he ---

12 **MS. WOOTEN:** Okay.

13 **THE COURT:** --- he designed himself.

14 **MS. GEER:** I'm sorry, say that again.

15 **MS. WOOTEN:** This is not a graph that he received
16 from someone else, this is a graph he prepared.
17 The underlying data is ---

18 **MS. GEER:** So, your description of the -- the name
19 at the bottom is not the source -- I mean, it's
20 the source for what he ---

21 **MS. WOOTEN:** The data ---

22 **MS. GEER:** --- created.

23 **MS. WOOTEN:** The data comes from there, like a
24 databa- -- commercial database, the source is
25 not where he obtained this graph.



1 **MS. GEER:** Okay. It's ---

2 **THE COURT:** This graph is supporting his opinion.

3 **MS. GEER:** Yeah. And so ---

4 **MS. WOOTEN:** And I -- I'm happy to take the source
5 CapitalIQ off ---

6 **MS. GEER:** No.

7 **MS. WOOTEN:** --- if that's the problem.

8 **MS. GEER:** So, it -- if that is -- if it -- I did
9 misunderstand that part. So, I would revise my
10 objection to say that, I realize that expert's
11 opinions are going to continue working on them,
12 but it sort of defeats the point of taking the
13 deposition if they're going to create all of
14 their analysis after the fact, and then not
15 give it to you as an exhibit when we identify
16 trial exhibits. Like, to me, if you, if you
17 continue doing work and then you wanna use
18 something as substantive evidence to support
19 your opinions, you would identify it on your
20 trial exhibit list and share it with counsel
21 before trial. Now, I'm in the, you know,
22 position of not having seen it until the day
23 he's being examined.

24 **THE COURT:** I agree with all of that. I would be
25 prejudiced by that ---



1 **MS. GEER:** Well, if you let us go tonight, I guess,
2 I can't argue much.

3 *(Laughter.)*

4 **THE COURT:** Well, then, I'm glad ---

5 **MS. GEER:** But, I don't ---

6 **THE COURT:** I'm glad you ---

7 **MS. GEER:** --- know, because I haven't had time to
8 look at it.

9 **THE COURT:** I'm letting it in, right now. If you
10 want to come back and articulate ---

11 **MS. GEER:** That's very fair. I, I ---

12 **THE COURT:** --- prejudice ---

13 **MS. GEER:** Yes.

14 **THE COURT:** --- I will allow you to.

15 **MS. GEER:** I would appreciate that.

16 **THE COURT:** Okay.

17 **MS. WOOTEN:** And I ---

18 **THE COURT:** I'm very fair.

19 **(Respondent's Exhibit Number 33 was admitted into**
20 **evidence.)**

21 *(Laughter.)*

22 **MS. WOOTEN:** I will -- well, I'll stop. We can talk
23 about that tomorrow.

24 **THE COURT:** Yeah. I will sa- -- so, I know it's
25 after five and you don't like to keep the



1 Court. I do have about 15 more ---

2 **THE COURT:** Oh, I -- I'm always fine to work late.

3 I -- I've got a court reporter that Mr.
4 DeRamus?

5 A: Yes, sir.

6 **MS. WOOTEN:** Dr. DeRamus.

7 **THE COURT:** You're Dr. DeRamus. His talking
8 probably wore her out.

9 *(Laughter.)*

10 **THE COURT:** I don't know if you notice how fast he
11 talks.

12 **MS. WOOTEN:** She has a sign for him that actually --
13 to -- tells him to slow down.

14 **MS. GEER:** I've noticed it, my hand hurts. I can
15 barely keep up.

16 **THE COURT:** I've got a sign that I actually -- that
17 a previous law clerk had, that I almost brought
18 out for you, it -- for you to hang up.

19 **COURT REPORTER:** *(Indicating.)*

20 *(Laughter.)*

21 **THE COURT:** This sign was a, don't make me release
22 the flying monkeys.

23 *(Laughter.)*

24 **MS. WOOTEN:** Oh, gosh. So, I'm not sure if we're at
25 a good stopping point. Dr. DeRamus has



1 probably about 20 more minutes of testimony, so
2 I don't know if you want me to finish him or if
3 we wanna stop here ---

4 **THE COURT:** No, let's finish it.

5 **MS. WOOTEN:** --- and come back tomorrow.

6 **MS. GEER:** Finish.

7 **MS. WOOTEN:** (To Ms. Geer) Finish him? Is that okay
8 with everyone?

9 **MS. GEER:** Yes.

10 **MS. WOOTEN:** Okay.

11 **MS. GEER:** Absolutely.

12 **THE COURT:** Yeah, see I'm the one that matters the
13 most, I'm the one that makes the ruling.

14 *(Laughter.)*

15 **MS. WOOTEN:** I'm trying to make sure ---

16 **THE COURT:** But you can solicit their opinion --
17 their ---

18 **MS. WOOTEN:** I'm trying to be reasonable.

19 Q: All right. Let's pick up back where we were,
20 Dr. DeRamus.

21 What is the comparable uncontrolled price
22 method?

23 A: So, the comparable uncontrolled price method is
24 a method defined in the §482 Regulations. It
25 basically says, occasionally, often times if



1 you're very lucky, if you are trying to figure
2 out what a third party price is for a related
3 party transaction, or if you're trying to
4 figure out what an arm's length price is --
5 sometimes you actually have third party
6 transactions that will tell you, here's a
7 product -- and there has to be a lot of
8 similarity between that particular product
9 price that you obtain -- or that is observed in
10 third party transactions, relative to the
11 product that is, that is being transacted for
12 -- in a related party transaction.

13 **THE COURT:** And where does the very lucky part enter
14 in?

15 A: Because, I think it actually applies in this
16 case.

17 **THE COURT:** Oh.

18 Q: All right. Have you considered the
19 applicability of the comparable uncontrolled
20 price method to the transactions at issue here?

21 A: Yes, I have.

22 Q: Okay. And what was your conclusion?

23 A: I consider it to be generally applicable, in
24 the sense that the price that -- the products
25 at issue are all being purchased from third



1 parties. So, we have a third party vendor
2 selling to, nominally, Tractor Supply Texas,
3 and then Tractor Supply Texas, again,
4 nominally, is selling it to, to TSC. And
5 ultimately -- if they're -- that -- to the
6 extend that this -- there's not been a physical
7 transformation of a product, which is often a
8 barrier to applying the comparable uncontrolled
9 price method. The -- you have to have the
10 exact product. Here, we have the exact
11 product. It's the very products that TSC is
12 purchasing, we know what the third party price
13 is. So, ultimately, that's -- and then you
14 look to see whether there's any value added in
15 that process as it, even nominally -- let's
16 assume for the sake of argument, that TSCT,
17 that Texas takes title for a split second in
18 the original purchase or for a couple days, or
19 whatever the term is, until TSC -- the Parent
20 company actually receives that product, there's
21 been no transformation of the product. So, the
22 value add in that process is minimal, in which
23 case I would think that even if you -- so, if
24 you applied the comparable uncontrolled price
25 method, you'd effectively get very little, if

1 any, profit going back to TSC Texas.

2 Q: And we've talked a good bit today about TSC
3 performing the headquarters functions, correct?

4 A: Correct.

5 Q: Okay. And so, from a transfer pricing
6 perspective, how should Tractor Supply Company
7 be compensated for those other headquarter
8 services?

9 A: So, Tractor Supply Company -- generally, you
10 would go through and identify which of those
11 services are more, for lack of a better word,
12 value added functions versus more routine
13 accounting or finance functions, and things
14 like advertising or even procurement.
15 Generally, in a transfer pricing analysis, you
16 attach a markup to the cost of providing those
17 services. So, just like -- the Company applied
18 a 10 percent markup on the Michigan employee
19 expenses, you -- I would expect some general
20 markup of that range applied to the
21 administrative services, or a subset of the
22 administrative services that the headquarters
23 provides to Texas -- and, by the same token,
24 for the purchasing function that Texas provides
25 to the company. You could also do -- and I



1 have seen this with my, with my clients, is
2 often times -- because the dollars at issue are
3 not that great, and because the scrutiny, and
4 because the, the issues that different tax
5 authorities have, have largely been with the
6 costs themselves, or the cost appropriately
7 allocable, as opposed to the markup, often
8 times my clients have not charged a markup on
9 some of these services simply because, for lack
10 of a better word, it's not worth a candle.
11 The, the markups that you end up having to
12 derive is a lot of time to fill up accurate
13 markups, and at the end of the day, the greater
14 issue is, are the costs ultimately being
15 absorbed by the entities that are, that are
16 receiving the benefit of the services. So,
17 technically, I would expect a modest markup to
18 be applied to a subset of the services that
19 headquarters pay -- provides to Texas and
20 Michigan, and vice versa, kind of similar level
21 of markup applied to, again, just the services,
22 that 13 million dollar salary cost that Texas,
23 nominally, provides the parent company, on a
24 proportionate basis.

25 Q: Okay. So, let's turn to the restructuring.

1 Have you reviewed information on the company's
2 2001 restructuring that lead to the creation of
3 Texas and Michigan?

4 A: Yes, I have.

5 Q: Okay. And is that relevant to the transfer
6 pricing analysis for the years at issue?

7 A: Yes.

8 Q: Okay. And why is that?

9 A: Well, back to my earlier statement about
10 reasonable alternatives, that gives you a sense
11 of what the -- what company -- what position
12 the company was in prior to the restructuring
13 versus the company -- the position it was in --
14 the parent company is in after the
15 restructuring. I would not expect a big delta
16 between those two things absent a fundamental,
17 operational change in the way the entire
18 company was structured. The, the other element
19 that is important to assess is, did their --
20 well, was there an operational change, because
21 that's going to impact that transfer pricing
22 analysis.

23 Q: So the restructuring was before the years at
24 issue in this case, how is that relevant?

25 A: Well, because it does inform the, the



1 reasonable alternatives. Because I know --
2 even today, those contracts -- those related
3 party contracts are your yearly contracts.
4 There is -- so the realistic alternative that
5 pertained in 2001, I think per- -- still exists
6 as of 20- -- during the years at issue. TSC
7 the parent company -- if the deal is a non-
8 arm's length deal, at arm -- or, if the, if the
9 -- the end result of that transaction is an
10 allocation of too much profit to the purchasing
11 company, at arm's length a company would let
12 that, that contract expire and simply build out
13 -- rebuild out its own purchasing function.
14 Let's assume that it hived it off to a
15 different related party, then it's not going to
16 continue to pay out hundreds of millions of
17 dollars for that function that it could then
18 recreate in-house, or simply contract with a
19 third party like a Li and Fung to take over
20 that, that operation. So, it has relevance in
21 how we think about the pricing of that
22 transaction, even in the years at issue.

23 Q: Okay. And when -- in your review of the
24 documents -- of the restructuring documents,
25 did you find any information related to the

1 operational effects on the company?

2 A: Yes.

3 Q: Okay. And did those restructuring documents
4 suggest that there would be any change in the
5 location of the national merchandising
6 function?

7 A: They said there would not be a change in the
8 location.

9 Q: Okay. And how does that impact your opinion in
10 this matter?

11 A: So, both that, and the fact that the -- those
12 documents also referred to a lack of
13 operational changes to the company, to me, it
14 shows that the -- in evaluating the con- --
15 that there's no -- in evaluating the
16 transaction in that restructuring in 2001, that
17 it was a largely, if not entirely, a tax driven
18 transaction and not something that would lead
19 me, as an economist, to expect the company to
20 be able to do anything operationally that --
21 different, or in a way that would allow it to
22 increase its profitability.

23 Q: And have you reviewed any documents related to
24 the tax implications of the restructuring?

25 A: Yes, I have.



1 Q: Okay. And did those documents impact your
2 opinion in this matter?

3 A: Yes. So, back to this issue about whether
4 there were operational consequences or
5 financial benefits to the company associated
6 with the restructuring, as the company's
7 asserted, those analyses documented on the
8 contrary that there were expected tax savings
9 associated with it. There were specific
10 calculations that I went through and followed
11 and replicated. So estimating that there were
12 about, I believe at the time they did the
13 analysis, about 1.5 million dollars in annual
14 tax savings. But keep in mind, that was done
15 with a much -- at a time when that procurement
16 -- the markup, that inventory markup was much
17 lower. In that analysis they use, I believe,
18 a 3.6 percent inventory markup, as compared to
19 the 9.7 percent that was being used during the
20 years at issue. So those tax savings would've
21 been much higher with a higher -- as that, as
22 that percentage increase -- increased over
23 time, and the dollars also would've increased
24 because the dollars of the, the sales of the
25 company have expanded considerably since the



1 2000, 2001 time period of the restructuring and
2 today. It went from about 800 million dollars
3 in annual revenues to five to six billion
4 dollars during the years at issue. So you're
5 growing the dollars and then you're growing
6 that procurement income, which means those tax
7 savings are substantially higher than what were
8 calculated in that initial analysis.

9 Q: All right. So we've looked at the operational
10 side, we've looked at the tax side, let's turn
11 to the financial side.

12 Did you review or observe any document
13 regarding whether the restructuring of the
14 company allowed it to identify and track the
15 financial performance of the various segments
16 of, segments of the company's business?

17 A: I'm sorry, did I review any documents showing
18 me how they did that, or ---

19 Q: Yeah.

20 A: Okay. I -- so, I have reviewed statements by
21 the company that -- something to the effect
22 that the -- or documents, maybe, in -- by the
23 company, referring something to the effect that
24 the restructuring would allow them to, to track
25 the finances better. I have reviewed the

1 documents that were in my earlier testimony
2 that show that the company appears, in the
3 ordinary course of business, to actually track
4 the performance of the stores without the
5 transfer pricing. So, that's -- and all of the
6 additional complexities that are associated
7 with the transfer pricing policies that it's
8 implemented, I -- in my opinion as an
9 economist, get in the way of an accurate view
10 of the finances of the company. So, just by
11 way of -- quick example, back to that South
12 Carolina store example. So if you look at the
13 South Carolina stores net of the transfer
14 pricing, and you compare that to the Texas
15 stores, the Texas stores would look to be
16 wildly more profitable than the South Carolina
17 stores. So then, a financial analyst would
18 say, well, we need to open more stores in Texas
19 and shutdown the ones in South Carolina,
20 particularly, for capital constraint. But
21 that's -- the -- that data point does not
22 accurately reflect the actual profitability of
23 those two stores.

24 So the transfer pricing gets in the way of
25 an accurate financial representation of the



1 performance of the stores.

2 Q: All right. And in your review of the documents
3 and the various accounting ---

4 **THE COURT:** Wait a second. It gets in the way of
5 the actual performance of the stores, you mean
6 the evaluation?

7 A: Correct, Your Honor.

8 **THE COURT:** Of the performance ---

9 A: Yes.

10 **THE COURT:** --- of the store.

11 A: Correct.

12 **THE COURT:** All right.

13 A: It distorts that in, in ways -- and, frankly,
14 based on the -- some of those schedules that I
15 received from the company, that's why it looks
16 like they do track that information excluding
17 those transfer pricing adjustments. So you
18 have a more clean comparison to compare the
19 performance of a South Carolina store relative
20 to a Texas store, for example.

21 **THE COURT:** Okay.

22 A: But you do that before you do any of the tran-
23 -- get into any of the transfer pricing.

24 Q: And, in your opinion, did the tax restructuring
25 simplify the tax accounting?



1 A: Well, it -- no. It complicated, what I would
2 con- ---

3 **OBJECTION:**

4 **MS. GEER:** Your Honor, I would object to that
5 question being asked since it's a tax
6 accounting ---

7 **MS. WOOTEN:** I will ---

8 **MS. GEER:** --- question.

9 **MS. WOOTEN:** I will rephrase.

10 **MS. GEER:** Okay. Thank you.

11 **MS. WOOTEN:** I did not mean to put tax in there.

12 *(Laughter.)*

13 **MS. WOOTEN:** Did the tax restructuring simplify the
14 accounting?

15 A: No, it als- ---

16 **OBJECTION:**

17 **MS. GEER:** Your Honor, I would have the same
18 objection to that.

19 **THE COURT:** Well, same objection or is it gonna be
20 different, 'cause the last one you commented
21 objection was because of tax, now ---

22 **MS. GEER:** Well, now it's just ---

23 **THE COURT:** --- it's because the use the word ---

24 **MS. GEER:** --- an accounting -- he's ---

25 **THE COURT:** --- accounting ---



1 **MS. GEER:** --- not an accountant. They just had an
2 accountant up here.

3 **THE COURT:** Oh, okay. So her objection on his lack
4 of accounting, I guess, knowledge.

5 **MS. WOOTEN:** I think, as he's demonstrated in the
6 last five hours, his testimony has largely
7 relied on their accounting records, their trial
8 balances, and that's the ---

9 **THE COURT:** I overrule that objection.

10 **A:** So, I -- based on -- with my review of the
11 accounting records and the documents that the
12 company provided, the transfer pricing
13 restructuring or the tax restructuring
14 significantly complicated their accounting.
15 So, for example, there is a provision that says
16 -- as an integrated company, you would expect
17 occasionally there to be transfers of inventory
18 from TSC to Michigan, or from TSC to Texas and
19 vice versa, well, under the structure they've
20 put in place, they have to characterize these
21 transactions that would normally, simply be
22 intercompany sales -- or simply transfers
23 between, kind of, a unitary company, and so an
24 allocation of costs from one store to another,
25 they become things like, in the case of



1 Michigan, if TSC provides -- sells things to a
2 Michigan store, it's accounted for as a
3 contribution of capital. Now, a contribution
4 of capital is very different than the sell of
5 a product, both from an accounting perspective
6 and from a financial analysis perspective, and
7 an economic analysis. But, nonetheless, that
8 is simply the consequences of how they have to
9 implement it and record the, the transaction in
10 their accounting records. Vice versa, if their
11 -- if Michigan is -- a Michigan store is
12 sending a product -- or a bunch of products to
13 TSC then it's a net -- it's a netting against
14 the capital contribution that TSC has
15 previously made to Michigan.

16 Similar complications go with regard to
17 transactions where TSC is providing inventory
18 to Texas, then it's considered a return of
19 product. But, from an economic perspective,
20 that product was never sold, in a sense that it
21 was never originally purchased by Texas, and
22 then literally sold and delivered to TSC. So
23 there's a lot of complications, and a lot of
24 additional entries that just -- that the
25 accounting records have to do -- have to keep

1 track of, even with regard to things like the
2 rental payment for the allocation of the, of
3 the portion of the headquarters that's
4 associated with the purchasing function.

5 Q: All right. So that's the transfer pricing, now
6 let's turn to your opinion from an economic
7 perspective. Including the transfer pricing
8 study as well as the overall economics of
9 transfer -- Tractor Supply business, what is
10 your economic opinion regarding the reliability
11 of the taxpayer's use of separate entity
12 reporting in this matter?

13 **THE COURT:** What is your ---

14 **OBJECTION:**

15 **MS. GEER:** Your Honor, just for the record -- I'm
16 sorry, go ahead.

17 **THE COURT:** What, what is your economic opinion?

18 **MS. WOOTEN:** Uh-huh. Trying to make sure he's
19 giving it from an economic perspective.

20 **THE COURT:** Well, that would be what is your opinion
21 about economic, but -- okay. Go ahead. (To
22 Ms. Geer) Do you object?

23 **MS. GEER:** I object based on that earlier objection
24 that was overruled, but just to keep ---

25 **THE COURT:** Yeah.



1 **MS. GEER:** --- preserve it for the record.

2 **THE COURT:** It is preserved.

3 **MS. GEER:** Thank you.

4 A: It's my opinion that the application by the
5 taxpayer of separate entity reporting and it's
6 specific use of the transfer pricing policies
7 that we've been discussing will result in a, a
8 reported amount of income for South Carolina
9 that does not reasonably reflect the economic
10 activity in the State of South Carolina, and
11 that is inconsistent with the income that I
12 would expect, had the transfer pricing been
13 done correctly.

14 Q: And as an expert on transfer pricing issues,
15 what is your opinion regarding the combined
16 entity apportionment result, in terms of South
17 Carolina taxable income compared to the
18 taxpayer's activity in South Carolina with the
19 associated prices that it uses in its transfer
20 pricing report.

21 **OBJECTION:**

22 **MS. GEER:** Your Honor, again, just for the record of
23 my objection to this third opinion.

24 **THE COURT:** Third opinion?

25 **MS. GEER:** She just did the second opinion, now



1 she's going to the third opinion. The second
2 opinion is dealing with separate entity
3 reporting, the third opinion is dealing with
4 combined unitary reporting.

5 **THE COURT:** Oh. And that regard. But she's moved
6 to another opinion?

7 **MS. GEER:** She has.

8 **MS. WOOTEN:** I have.

9 **THE COURT:** And that opinion, it's another opinion -
10 --

11 **MS. GEER:** It is another opinion.

12 **THE COURT:** And so, it's objectionable to ask for
13 another opinion?

14 *(Laughter.)*

15 **MS. GEER:** No, no, no. Earlier in the day, when we
16 first started many, many hours ago.

17 **THE COURT:** Oh. Okay. So you're doing another
18 continuing ---

19 **MS. GEER:** A continuing objection.

20 **THE COURT:** Yes. Okay.

21 **MS. GEER:** Yes. Thank you.

22 A: So it's my view that combined entity
23 apportionment, or combined entity apportionment
24 method would result in a more reliable amount
25 of income -- of taxable income for Tractor



1 Supply as compared to the separate entity
2 reporting method that the taxpayer has used
3 encompassing it's transfer pricing policies.

4 Q: And as a transfer pricing economist, what is
5 your opinion on whether the Department can
6 derive an alternative apportionment method by
7 adjusting the taxpayer's transfer prices used
8 to derive the separate -- the taxpayer's
9 separate entity tax return position.

10 A: Well, I would say the taxpayer's transfer
11 pricing methodology is wholly unreliable, has
12 a bases for ---

13 **OBJECTION:**

14 **MS. GEER:** Your Honor, I apologize. It sounds like
15 it's a fourth opinion. I just wanna -- I don't
16 -- just don't -- I don't wanna not preserve my
17 objections.

18 **THE COURT:** I understand.

19 **MS. GEER:** So ----

20 **THE COURT:** I think that's what he's already
21 testified to ---

22 **MS. GEER:** Okay. Well, if I ---

23 **THE COURT:** --- right at the beginning.

24 **MS. GEER:** --- can just have a running objection on
25 this topic so I don't interrupt you again.



1 **THE COURT:** Yeah. Well, I'd rather you object when
2 you have an objection.

3 **MS. GEER:** Okay. Thank you, Your Honor.

4 **THE COURT:** But I ---

5 **MS. GEER:** It sounds like it's a fourth opinion, but
6 it's possible I misheard it.

7 **THE COURT:** Well, the only difference is, it's got
8 two derives in it, but -- I'm -- I'll overrule
9 it.

10 A: So it's, it's my opinion that it would be
11 wholly unreliable to derive the -- Tractor
12 Supply's taxable income based on it's transfer
13 pricing policies, and applying those to its
14 separate reporting method.

15 Q: And on that topic of the combined entity
16 apportionment method, how, in your opinion,
17 does it reasonably approximate the results that
18 one would tak- -- obtain, if the taxpayer had
19 implemented the arm's length transfer prices?

20 A: So, I think that at -- based on my review of
21 the data, the analysis that I've done and the
22 computations I've done, I expect that the,
23 effectively, the number you would get, the
24 taxable income that you would derive by
25 applying a reasonable transfer pricing method



1 to the company's actual intercompany
2 transactions, it would get you to a number very
3 close to the number that you get through a
4 combined entity apportionment method, that
5 effectively, the result is you are going to
6 allocate out the administrative costs among the
7 entities under a -- if you were to do it
8 applying, what I would consider reasonable
9 transfer pricing approaches, you'd -- you're
10 gonna allocate those, those costs out so that,
11 effectively, all the dif- -- the different --
12 the three different entities would be bearing
13 a pro rata share of those costs, and so that
14 the net result, in terms of the taxable income,
15 would then be -- would be similar to what you
16 would get if you simply take that consolidated
17 income and allocated it using a sale -- a sales
18 factor, for example. You could, in the
19 alternative, apply a modest markup. And I say
20 modest, in turn the percentage would -- let's
21 call it, for example, 10 percent, again, I
22 don't have a study that documents the 10
23 percent, but I can see the taxpayer applying a
24 10 percent markup to the administrative
25 services cost of all the different

1 administrative services we've been talking
2 about to date. So, apply it to the Michigan
3 employees, like they did. Apply it to all, or
4 a subset of the administrative headquarters
5 costs that are incurred by TSC, the taxpayer,
6 and apply that to the 12 million dollars of
7 purchasing costs that, that Texas incurs, the
8 net is effectively going to be a wash. There's
9 a much larger share, there's a much larger
10 amount of administrative services costs being
11 borne by TSC, so you're applying the 10 percent
12 to, what is probably a larger number, then
13 you're going to allocate a portion of that to
14 the different taxpayers, so there's gonna be a
15 little bit of income flowing in to TSC from
16 that. And again, these are very modest
17 amounts, relative to the taxable income that
18 we're talking about for the company as a whole.
19 By the same token, there's a little bit of
20 income that's coming back -- or, take the --
21 adjust if for round numbers, you have 12
22 million dollars of, of expenses -- procurement
23 expenses by Texas, you apply a 10 percent
24 markup to that, it's 1.2 million dollars, apply
25 80 percent of that, which would be the share --

1 the responsibility of TSC. So, round numbers
2 you're about a million dollars of income that
3 goes the other way, towards Texas, plus you
4 have additional monies coming in, the 10
5 percent markup from Michigan to TSC. Net, net
6 all those number should washout, particularly,
7 in terms of -- kind of a reasonable level of
8 approximation relative to the number that you
9 would get if you just said, let's consolidate
10 the three entities and let's apply a sales
11 factor to those entities based on each entities
12 sales relative to the -- or the South Carolina
13 sales relative to the everywhere sales, for
14 example.

15 Q: All right.

16 **MS. WOOTEN:** Your Honor, that's all from the
17 Department.

18 **THE COURT:** All right.

19 **MS. GEER:** Your Honor, I think it would be a good
20 time to take a break on the day.

21 **THE COURT:** That's what I figured you'd say.

22 *(Laughter.)*

23 **THE COURT:** Yeah, I'm gonna break. We gonna be back
24 -- are we on track or do we need to start a
25 little earlier?

1 **MS. GEER:** I think we're on track. (To Ms. Wooten)
2 What do y'all think?

3 **MS. WOOTEN:** I don't know. I think that would
4 probably be a question better for you, 'cause
5 I don't know what you have in mind for your
6 case, but we're winding down on our Case in
7 Chief.

8 **MS. GEER:** Do y'all have another witness, or not?

9 **MS. WOOTEN:** Not on our Case in Chief.

10 **MS. GEER:** Okay.

11 **MS. WOOTEN:** We will in rebuttal.

12 **MS. GEER:** Okay. Yeah, I mean, I think, let's start
13 at 10 tomorrow, and then if we need to adjust,
14 we'll adjust Thursday, Friday.

15 **THE COURT:** Okay. Well, let me -- I said I wanted
16 to break at one, maybe 1:30, so I'm gonna break
17 tomorrow around 1:00. My meeting's at 1:30.
18 I hope to be back by 2:00.

19 **MS. GEER:** Okay.

20 **THE COURT:** It's possible I may not be back ---

21 **MS. GEER:** Well, we could also go a little later
22 tomorrow.

23 **THE COURT:** Oh, okay.

24 **MS. GEER:** Since we have a longer break in the
25 middle.



1 **THE COURT:** Thank y'all.

2 **(DAY TWO of the hearing adjourned at 5:45 p.m.)**

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DAY THREE - WEDNESDAY, JANUARY 25, 2023

THE COURT: Hey, ya'll. Be seated. Thanks.

COURT REPORTER: Good morning.

THE COURT: (To Dr. DeRamus) You're still under oath.

DR. DERAMUS: Indeed. Thank you.

THE COURT: All right. Y'all ready?

MS. GEER: Yes, Your Honor.

Your Honor, may it please the Court?

THE COURT: Uh-huh.

DR. DERAMUS - CROSS EXAMINATION BY MS. GEER:

Q: Good morning, Dr. DeRamus.

A: Good morning.

Q: We've met before, but it's nice to see you again.

A: Likewise.

Q: All right.

THE COURT: You say that now.

(Laughter.)

Q: All right. So, you have worked for the Department on other matters besides this case, correct?

A: That's correct.

Q: Okay. And when did the Department hire you for the first time?



1 A: It would've been several years ago. I don't
2 recall the exact date.

3 Q: Okay.

4 A: If you'd like me to give an estimate, I think
5 I could give a reasonable estimate.

6 Q: Sure.

7 A: I think it would probably have been about four
8 or five years ago, at this point.

9 Q: Okay. And you've been retained by the
10 Department for -- is it seven cases total, as
11 of now?

12 A: Again, I don't recall specifically, if you'd
13 like me to take a moment and run through the
14 ones that I recall, I can---

15 Q: Yes.

16 A: --- tell you.

17 Q: Sure.

18 A: I think that would be approximately correct.

19 Q: Okay. And would you agree that you've never
20 declined to serve as an expert when asked by
21 the Department to do so?

22 A: That's correct.

23 Q: And has every one of those other -- it -- let
24 me, let me make sure I got this number right.
25 Is the seven including this one?



- 1 A: Again, I'm dealing ---
- 2 Q: Approximately?
- 3 A: I'm dealing with approximations, so ---
- 4 Q: Okay.
- 5 A: --- yes, that would be including that.
- 6 Q: So in the other six -- approximately, six cases
- 7 involving the Department, do those all require
- 8 -- or are those all cases where the Department
- 9 required combined unitary reporting?
- 10 A: So, I -- I'm a little careful in talking about
- 11 other cases, because ---
- 12 Q: I don't want you ---
- 13 A: --- I'm not quite ---
- 14 Q: --- to list any taxpayers.
- 15 A: Certainly. I would say some of them I have not
- 16 begun work in earnest on, so I don't know the
- 17 extent of the tax -- of the, of the
- 18 Department's position on some of those cases.
- 19 But I would say, generally, the issue of
- 20 separate reporting versus combined reporting is
- 21 -- has come up in the ones where I have begun
- 22 more substantive work.
- 23 Q: Okay. So how many have you begun substantive
- 24 work in?
- 25 A: I would say approximately four.



1 Q: Okay. And the other three, you have not looked
2 at the facts enough to know whether or not the
3 Department has invoked combined unitary
4 reporting in those cases?

5 A: No. I would say, my general under- --
6 expectation is that it would have something to
7 do with those issues, but I don't recall
8 specifically the exact -- the nature -- the,
9 the full allegations in those disputes.

10 Q: Yeah. And I don't -- certainly, am not
11 expecting to -- you to know the full
12 allegations, I would just think you would know
13 whether it's -- they've invoked combined
14 unitary reporting, but you're saying no?

15 A: I'm saying ---

16 Q: Yeah, I ---

17 A: --- I haven't gotten into the details of those
18 to know specifically how the, the Department
19 has challenged those disputes, but ---

20 Q: Okay.

21 A: --- like I said, my expectation is that,
22 generally, that they are dealing with issues
23 similar to the issues here.

24 Q: Okay.

25 A: With regard to separate reporting versus



1 combined reporting.

2 Q: Thank you. Do you know whether all of those
3 cases involved the alternative apportionment
4 statute?

5 A: I do not.

6 Q: But if they involved separate entity reporting
7 and combined unitary reporting, is it most
8 likely that they do involve the alternative
9 apportionment statute?

10 A: So, I'm not an attorney, so ---

11 Q: Okay.

12 A: --- I'm not su- -- sure, by exactly which
13 statutes would necessarily be invoked, but that
14 would be my general understanding.

15 Q: Okay. All right. And of the -- well, just --
16 I'll just keep talking about the six, and we'll
17 know that it's approximately six cases other
18 than this one.

19 A: Okay.

20 Q: In those six other cases -- or I'll just say in
21 the other cases. In the other cases, how many
22 involved retailers with subsidiaries? The
23 taxpayer being a retailer with subsidiaries.

24 A: As I sit here today, I would say, probably, all
25 but one.



1 Q: And not identifying the taxpayer, but what
2 industry is that taxpayer in, the one that's
3 not a retailer?

4 A: The only reason I'm hesitant to do so is
5 because I'm concerned that it might actually
6 reveal the taxpayer inadvertently by ---

7 Q: Okay.

8 A: --- even calling out the industry.

9 Q: All right. And the other cases, besides this
10 one, how many involved the existence of
11 intercompany transactions between related
12 parties?

13 A: So, certainly, all the ones that I have worked
14 on substantively, have involved intercompany
15 transaction.

16 Q: Okay.

17 A: Again, I haven't gotten into the other ones,
18 but I would assume that the others similarly
19 involve intercompany transactions.

20 Q: Okay. And of the other cases, how many involve
21 a related entity providing procurement services
22 for the group?

23 A: I think it would've been encompassed in, at
24 least, the one -- the other ones that I've
25 worked on, to date.



1 Q: Okay.

2 A: So those cases might've involved other types of
3 service as well, not just procurement services.

4 Q: Okay. So they would've had, potentially,
5 multiple services, but all of them would have
6 involved procurement services as well? To the
7 best ---

8 A: I thi- ---

9 Q: --- of your knowledge.

10 A: To the best of my knowledge, yes. Again, these
11 are the ones where I have begun to wor- -- that
12 I've worked on substantively.

13 Q: But your ---

14 A: And, I'm sorry. I should've said, this would
15 be with regard to the ones involving retailers.

16 Q: Okay. Fair enough. And of the other cases,
17 how many would involve an entity leasing
18 employees to a member of the group?

19 A: Well, one in particular, but I don't recall the
20 others.

21 Q: Okay. So at least one?

22 A: Yes.

23 Q: Okay. And some of the others you haven't
24 gotten into enough to know whether it might
25 also have employee leasing as an issue?



1 A: Correct.

2 Q: Okay. And of those other cases, how many
3 involve a related entity providing support
4 services like the payroll, advertising, IT,
5 that type of thing?

6 A: At least one.

7 Q: Uh-huh.

8 A: May- -- I'm -- again, this is a bit of a, a
9 memory test so I'm ---

10 Q: Yes, sorry ---

11 A: --- trying to recall the scope of the -- some
12 of the others that I've been involved in. My
13 general recollection, is that those other ones
14 would've involved with a broader range of
15 services and not just procurement. But I,
16 again, I ---

17 Q: So you mean ---

18 A: --- can't state -- say so factually.

19 Q: Okay. But you think it's likely that some of
20 the other cases also involve administrative
21 services being provided by one related entity?

22 A: Yes.

23 Q: Okay. And of those other cases, how many
24 involved the use of a transfer pricing study by
25 the taxpayer?



1 A: I would say all the ones that I have done
2 substantive work on, to date, have had -- I
3 believe have had a transfer pricing study. I'm
4 sorry, give me one minute to ---

5 Q: Yeah.

6 A: --- make sure. I believe that's correct, at
7 least, with regard to the retailers.

8 Q: Uh-huh. All right. And so, of those other
9 cases, are there any where you have concluded
10 that the transfer pricing study was
11 appropriate, in your lingo, I think, satisfies
12 the arm's length principle?

13 A: Of the other cases that I've worked on for the
14 Department?

15 Q: Yes.

16 A: Where I've reviewed the transfer pricing study?

17 Q: Yes.

18 A: I have, I have not concluded that the -- or, I
19 have not concluded that their studies were
20 reasonable or appropriate.

21 Q: Okay. All right. In this particular case,
22 with respect to the procurement function, PwC
23 -- the PwC study used the comparable profits
24 method, is that your understanding?

25 A: That's correct.



1 Q: Okay. And I'm not sure if I understood you
2 correctly yesterday, so maybe, I'm just gonna
3 ask you. What method did you use?

4 A: Well, my task was to review and evaluate that
5 study.

6 Q: Right.

7 A: So, I applied a similar approach in -- well,
8 first, I think I went through it yesterday, why
9 I concluded that the comparable profits method
10 in -- was not an appropriate method,
11 particularly, the way in which the party had --
12 -

13 Q: Right. And we'll get into that later. Right
14 now, my question's just focused on -- you know,
15 you're a transfer pricing expert, you have the
16 knowledge and expertise to be able to do your
17 own study, right?

18 A: That's correct.

19 Q: Okay. So I'm interested in understanding
20 whether you did your own study, and if so, what
21 method did you use?

22 A: So, as I described yesterday, I did redo the
23 comparables -- actually, I should say, I first
24 up- -- I updated their comparables. I'm saying
25 this first, in terms of the order in which I



1 presented the analysis yesterday. So I, I took
2 their comparables and I updated those to bring
3 them current to the years at issue, 2014 to
4 2016. I re-ran the comparables search using
5 what I consider to be a more reasonable
6 approach, even assuming that wholesale
7 distributors were comparable companies, so I
8 did implement that as a method in that sense.
9 And I also did an alternative analysis using a
10 different set of comparables entirely, using
11 those procurement comparables, again, centered
12 on that company called Li and Fung.

13 Q: Right.

14 A: So largely the Asian comparables. So I would
15 consider that as, certainly, a comparable
16 profits method-type approach.

17 Q: Okay. So you used the same method that PwC did
18 to do your analysis, you just used different
19 comparables, is that what you're saying?

20 A: Yes. I, I used it in my -- as part of my
21 analysis. I did not offer it as my affirmative
22 opinion as to the -- in terms of calculating
23 the -- or recalculating and redoing the
24 transfer prices. I consider it to be, kind of,
25 a reasonable benchmark to show what one would



1 likely come out to if one did a more reasonable
2 CPM benchmarking the procurement service alone,
3 as opposed to benchmarking this broader
4 wholesale distribution function.

5 Q: And I may just not be understanding the
6 distinction you're making there. Would you say
7 that you did your own study, or are you saying
8 that you just were critiquing the other study?
9 I'm not fully understanding that.

10 A: Well, when somebody asks me if I did my own
11 study, typically, it's in the context of, am I
12 providing a conclusion about the definitive
13 number that actually should be either -- would
14 -- should -- a taxpayer should actually use ---

15 Q: Right.

16 A: --- or the number that actually should be
17 reported in the tax return. And that's -- that
18 was not the scope of my analysis here.

19 Q: Okay.

20 A: So, it is a -- an analysis that I did, in terms
21 of, A, redoing their analysis; and B, applying
22 alternative set of comparables that I consider
23 to be more appropriate ---

24 Q: Okay.

25 A: --- so directionally, I consider that to be a



1 strong indicator of where I would likely come
2 out if I were to do a full-blown study. But,
3 part of the problem with the -- with me redoing
4 their study is a, kind of, a lack of complete
5 visibility I have ---

6 Q: Okay.

7 A: --- into the company's operations, the factual
8 basis ---

9 Q: Right.

10 A: --- there's some conflicting data points. And
11 even, as I said before, not having, kind of, a
12 clean set of audited financials that separate
13 out the procurement function from the other
14 function ---

15 Q: So ---

16 A: --- that's, that's what I would need in order
17 to have an actual study of my own.

18 Q: So, if you were gonna do your own study, would
19 you want to do things like interview personnel
20 at Tractor Supply?

21 A: Yes, I would.

22 Q: Okay. And, maybe, tell me, tell me -- start at
23 -- let's start out with some gener- -- general
24 numbers. The analysis that you did, just that
25 piece, I know you did a lot as part of your



1 expert witness duties, but the part where you
2 were doing your analysis of the different set
3 of comparables ---

4 A: Yes.

5 Q: --- how long did that analysis take you,
6 approximately?

7 A: You mean to pull the, the purchasing
8 comparables, or to do all ---

9 Q: Just ---

10 A: --- of the comparables analysis that I did?

11 Q: All of the comparables analysis that you did.

12 A: In terms of hours, it's a little hard to say.

13 Q: Yeah.

14 A: I wouldn't say it's -- was not a, a huge effort
15 on my part, personally ---

16 Q: Yeah.

17 A: --- because I did have my staff pull the data.
18 I reviewed the search criteria. So these are,
19 again, being pulled from a commercial database,
20 and ---

21 Q: Okay.

22 A: --- some of our staff regularly pull those for
23 me. I give them the broader search criteria --
24 -

25 Q: Yeah.



1 A: --- we'll review the SIC codes, and then I read
2 a lot of business descriptions to ensure that
3 I agree with the ultimate selection. So, it
4 would've been a -- some number of hours, but
5 not a huge number of hours.

6 Q: Okay. So, like, more than a day?

7 A: All total, probably, yes. In -- with regard to
8 all the different comparable sets and reviewing
9 the comparable descriptions, I would say,
10 somewhat more than a day, yes.

11 Q: Like, two days? I'm just trying to get a ---

12 A: Order of magnitude, two days sounds about
13 right, over the course of the engagement.

14 Q: And ---

15 A: And again, in terms of analyze -- it probably
16 would've been more if you include the, the
17 royalty comparables ---

18 Q: Uh-huh.

19 A: --- because I did do a fair amount of research
20 on ---

21 Q: Okay.

22 A: --- those comparables.

23 Q: Let's just talk about the procurement for right
24 now, just to try to narrow our focus.

25 For the procurement analysis that you did,



1 approximately, two days. And then you
2 mentioned staff, how many staff members
3 would've been involved in helping you?

4 A: Well, when you said procurement comparables, I
5 meant both -- this is both for, kind of, the
6 wholesale distribution comparables that I had
7 and those Asian procurement comparables. Just
8 so we're ---

9 Q: Yes.

10 A: --- speaking the same ---

11 Q: Yes.

12 A: --- language.

13 Q: Yeah.

14 A: So, I'm sorry. How many staff do I have ---

15 Q: Yeah.

16 A: --- working for me?

17 Q: Yeah, for this particular issue -- or part of
18 the project.

19 A: Correct. I would say, it was largely two staff
20 members.

21 Q: Okay. And would you guess that they were doing
22 about two days of work too, or how much work do
23 you think they needed to do?

24 A: There was a bit of an iterative process on
25 that. There was a -- I did find a -- the error



1 in how there was an adjustment being made.

2 Q: Uh-huh.

3 A: I think it was a LIFO to FIFO adjustment, an
4 accounting adjustment that might -- might've
5 been done one way, and then we corrected that.

6 Q: Okay.

7 A: So -- and there was -- the search process
8 itself is pretty quick ---

9 Q: Yeah.

10 A: You enter in the SIC codes, draft the terminal,
11 it downloads the information. All the other
12 data verification, the review of the business
13 descriptions, that can take up a substantial
14 amount of time. And given the sheer number, I
15 don't wanna underestimate how much time ---

16 Q: Okay.

17 A: --- they took to -- took on those. The Asian
18 companies were, were harder ---

19 Q: Okay.

20 A: I don't, generally, do those -- or I don't, I
21 don't often benchmark that procurement
22 function. Whereas, the wholesale distribution
23 comparables, I do those on a routine basis.

24 Q: Okay.

25 A: So that, that would've been quicker, although,



1 there still was a fair amount of effort to
2 review those.

3 Q: Okay. So, two days for you, maybe three days
4 for them? Is that fair?

5 A: I'd pro- -- I wanna say a little bit longer,
6 because I do remember the time they -- the time
7 -- the -- on the -- the iterations of it, but
8 ---

9 Q: Okay.

10 A: But that, for lack of a better number, sure,
11 let's call it three days.

12 Q: Okay.

13 A: If three full, three full days.

14 Q: Okay. And I'm wanting to get you next to, kind
15 of, contrast with that, with an estimate of
16 what you would think that you and your staff
17 would spend if you were doing a full-blown
18 study where you obtaining all the factual
19 information that you would normally want.

20 A: Well, for the comparables analysis, I think I
21 just mentioned a minute ago, about the
22 wholesale distribution set is one -- or that
23 approach is something that I use on a routine
24 basis ---

25 Q: Okay.



1 A: --- so I wouldn't expect that to take that much
2 longer, in terms of the data pull itself.

3 Q: Right.

4 A: Sometimes there is an issue of -- you know,
5 each jurisdiction has, you know, maybe their
6 own issues that I need to address. So I do a
7 lot of work in Mexico and -- and with -- for
8 U.S. taxpayers in Mexico, and so those have
9 certain concerns that I might need to address
10 to ensure that the comparables I select are
11 specific for that particular business. But
12 other than that, the mechanics of pulling the
13 wholesale distribution comparables would be, at
14 this point, pretty routine, given how often
15 I've done it.

16 Q: Okay.

17 A: Again, the, the largest component of time
18 required in these analysis is really
19 understanding the company's business.

20 Q: Right. And that's the part -- piece I'm trying
21 to get you to quantify now.

22 A: Sure.

23 Q: Yeah. How long, how long do you think you
24 would -- or what is -- what amount of time do
25 you typically spend learning the taxpayer's



1 business?

2 A: A sig- -- especially, if it's the first time
3 that I do the work for -- like rigging a
4 taxpayer ---

5 Q: Right.

6 A: --- it would be a significant amount of time.

7 Q: I mean, weeks, months?

8 A: I would say, generally, weeks, but sometimes
9 months. It depends if it's an adversarial
10 proceeding. So, that's why I end up spending
11 a lot of time reviewing documents in discovery,
12 reviewing interrogatories and things like that,
13 in order to try and get a full picture of what
14 the company actually does and then ticking and
15 tying statements the company makes in, maybe,
16 a deposition with information that I review and
17 company 10-Ks. There's a lot of that -- so
18 that can take many months ---

19 Q: Right.

20 A: --- if I don't have direct access to the
21 company. If it's a client I've been working
22 for yea- -- for -- I've been working for for
23 years, it's a pretty perfunctory process
24 because I already know their business ---

25 Q: Right.



1 A: --- very well.

2 Q: Okay.

3 A: From the inception, it will be at least a
4 couple weeks and maybe a little bit longer.
5 I'd say a couple weeks to maybe a month. It
6 would depend on the, the trade flow at issue,
7 like a -- the use of intangibles always is more
8 complicated than a, what I would consider, a
9 more straight-forward trade flow like a
10 wholesale distribution for a manufacturer ---

11 Q: Uh-huh.

12 A: --- is pretty straightforward.

13 Q: Yeah.

14 A: And then, high-tech manufacturers would require
15 probably more time.

16 Q: And so, back to the distinction I was trying to
17 understand earlier about what -- whether you
18 used a method in this case.

19 So what you've just described for us is
20 the process that you would go through if you
21 were doing your own transfer pricing analysis
22 from the start. And I assume, in that
23 situation, you would be doing your own full-
24 blown report and would pick a particular best
25 method, right?



1 A: That's correct.

2 Q: Okay. So, so the distinction I was trying to
3 understand is, would you call what you did in
4 this case, during the litigation -- it's not a
5 full-blown analysis, it's a litigation
6 analysis, I'll just call it for short-term to
7 refer to everything you've described for us,
8 but would you call that -- that you've selected
9 your own method and are picking that as the
10 best method here, or not?

11 A: I would, I would say, that certainly parallels
12 to what I would do -- or a lot of parallels,
13 what I did here versus what I would do if I
14 were hired directly by a client to do -- like
15 a corporate client to do their transfer pricing
16 documentation from scratch. I -- and, again,
17 I'm not trying to, kind of, parse it out too
18 finely, it's just that there are -- there's a
19 different scope of analysis in this case, and
20 what I've been asked to do, versus in a
21 typical, typical case.

22 I would say that, I think there are
23 inherent difficulties here in the retail
24 business wit- -- because I see it as this
25 integrated function that -- there is, there is



1 an inherent difficulty from a transfer pricing
2 perspective to slice and dice it into these
3 various functions, because it's very hard to
4 reliably benchmark that function separate and
5 apart from the broader functions the company
6 does. Now, I -- at the end of the day, I would
7 say tha- -- a reasonable proximation, or a
8 reasonable way to treat it would be to evaluate
9 as a service, as an administrative service --
10 or a headquarters service. And I have done
11 those, done those in other contexts, but those
12 would typically be an international
13 conglomerance structure, or an international
14 corporate structure where there's a
15 headquarters in the United States, for example,
16 and they provide certain services that benefit
17 a foreign subsidiary. So in those regard --
18 the -- those situations, I would do it -- an
19 analysis like the one I've done here, using the
20 headquarters as the tested party, and then
21 trying to find comparables that provided a
22 reasonable markup, if any, for that particular,
23 that particular cost. There's a different
24 level of analys- -- diff- -- you know, on the
25 international side, there's often rigorous



1 scrutiny with the allocation of costs even more
2 so than the, than the actual markup percentage,
3 so there's a lot more that would go in that for
4 a, for a corporate client because those often
5 are challenged by international tax
6 authorities. You have to show the benefit that
7 the foreign subsidiary receives of the activity
8 that the U.S. is actually performing and that's
9 a -- that can be an incredibly involved
10 process. So, I've not -- I -- that's why I'm
11 having a little trouble ---

12 Q: Yeah.

13 A: --- mapping what I've ---

14 Q: Well ---

15 A: --- done here versus for a typical client.

16 Q: Well, I mean, I just want to try to condense
17 where we are. So tell me if I'm saying this
18 right.

19 You did not do a full-blown study,
20 correct?

21 A: Correct. A full-blown study in the ---

22 Q: Doing a --

23 A: --- sense ---

24 Q: --- full-blown transfer pricing study, that you
25 would -- like you would do if you were starting



1 with a new client from the start.

2 A: That's correct.

3 Q: Okay. And you would expect the study that --
4 you would not call what you did in this case,
5 doing a full transfer pricing study, you would
6 call it an analysis of the transfer pricing
7 study that existed?

8 A: Yes, but I would say, it's not simply reviewing
9 a document -- I didn't, I didn't just review
10 the PwC document and then provide an opinion,
11 I did an extensive additional amount of
12 research, and I said -- as I said, pulling my
13 own comps ---

14 Q: Right.

15 A: --- in order to satisfy myself, that at the end
16 of the day, if the, the transfer pricing had
17 been done correctly, you would've gi- -- you
18 would have obtained a result -- or I would have
19 obtained a result that would be very similar to
20 what -- you know, in terms of taxable income to
21 South Carolina, to what you would get if you
22 used a combined entity apportionment method.

23 Q: Okay. But you did a much more limited analysis
24 in this case than you would do if you were
25 doing a full-blown case, correct?



1 A: I did a more limited analysis, in the sense of
2 coming up with a final number. I did a pretty
3 extensive analysis of the documents, because
4 sometimes in a litigation there's actually more
5 work than when you're dealing with a private
6 sector client, because I'm having to make
7 inferences and tie and tie different sources of
8 information.

9 Q: Well, I think you told me earlier, that it
10 would take weeks or a month to get all of the
11 factual information tied down from the cli- --
12 meeting with the client, interviewing different
13 departments and the client to understand how
14 the client works. I mean, you would do all of
15 that if you were doing a full-blown analysis,
16 and you can't do that in the litigation
17 process, right?

18 A: Right. But in a litigation process, the flip
19 side is, I have access to a lot of information
20 in discovery, I have depositions I need to
21 review. I've reviewed the PwC reports, both
22 the -- I'm sorry, their Planning Memo, that
23 we've -- I discussed yesterday, as well as
24 their 2012 Report. So there is a greater
25 volume of documents to review in a litigation



1 matter, not just in this matter, but in all my
2 litigation work, than in a typical engagement
3 for a company where I'm typically starting from
4 a blank slate and I'm just going in and doing
5 my own interviews with the company. Unless the
6 company already had a transfer pricing study in
7 place and they were using me to either replace
8 the prior consultant or as a Blue Team review.

9 Q: But as a factual matter, in terms of learning
10 all the things you need to know about the
11 taxpayer's business, would you not agree that
12 you have access to more information when you
13 are working with your client and can ask them
14 anything you want and interview anyone you
15 want, versus litigation where you're limited to
16 whatever has been obtained through the
17 discovery process?

18 A: Well, I would agree that I am more limited in
19 the -- in a litigation context, in terms of my
20 access to the company itself, but I am also, in
21 a litigation context, able to access a fairly
22 wide range of information with regard to what
23 the taxpayer has, at least, appears to have
24 told its other advisors. I do extensive
25 amounts of, like I said, research for analyst



1 reports and earnings calls trying to tie and
2 tie all the pieces of information. So I do
3 have a lot of information in this, in this case
4 and in my litigation cases, generally, to do
5 what I consider to be a reasonable analysis,
6 and sometimes all the way to calculating an
7 income adjustment. So I do that in certain
8 cal- -- in certain cases.

9 Q: And believe me, I understand the volume of
10 documents that are created during the
11 litigation process, and I know you would get a
12 lot of documents, but I think that we would
13 all agree that, if you have access to the
14 client there is an unlimited amount of
15 information that you can get from them about
16 the facts of their company, that you would
17 want, to be able to do a transfer pricing
18 study, right?

19 A: I would say, there is a greater amount of
20 direct information, effectively, from the
21 principles involved, where I'm able, generally,
22 where I'm able to sit down and talk with them
23 about their business.

24 Q: I mean, you could ---

25 A: I wo- ---



1 Q: You could ask the client for all the
2 information that they provided in discovery,
3 right?

4 MS. WOOTEN: Can you -- can she let the witness
5 finish his statement ---

6 MS. GEER: I apologize.

7 MS. WOOTEN: --- before ---

8 THE COURT: Yeah.

9 MS. WOOTEN: Thank you.

10 MS. GEER: Yeah.

11 A: So, I think it's pretty -- should be pretty
12 clear what the differences are, in terms of the
13 information set I have. On the one hand, the
14 plus-side of working for a private sector
15 client directly, outside of the litigation
16 process, is you get to do interviews.

17 Q: Right.

18 A: I can talk to people -- department heads. I
19 can cross-reference what one person says versus
20 another. I can draw my own conclusions. I can
21 also supplement that with my own research. By
22 the same token, the -- your typical transfer
23 pricing engagement does not involved the
24 production of reams of material with regard to
25 how a company might have restructured it at one



1 point -- or in the past. So there is a good --
2 more of a limited vie- -- I don't have access
3 to deposition transcripts where people under
4 oath are being asked questions about certain
5 things, certain things about their company. So
6 I'm -- when I'm working for the client, I'm
7 dependent entirely on what the client tells me,
8 again, supplemented by this -- my own research,
9 whereas in litigation there's a different set.
10 But the one piece I am missing is that direct
11 access to company officials. That's one of the
12 reasons why I spend a fair amount of time
13 reviewing depositions by company -- or
14 depositions of company officials.

15 I'm sorry, I al- -- should have said as
16 well, in this instance I, I have reviewed the
17 notes that Dr. Andrade -- or someone on Dr.
18 Andrade's staff took when he interviewed some
19 of the people ---

20 Q: Yeah.

21 A: --- of those -- at the, at the company.
22 Although, those were notes that I only obtained
23 very late in the process, I believe it was
24 December.

25 Q: And going back to the other cases, not this



1 case, did you use the comparable profits method
2 in your analysis in those cases too?

3 A: I would say generally, yes -- to avoid a long
4 answer, generally, yes, in the same way I've
5 used it here.

6 Q: Okay.

7 A: I was not ever asked to recalculate the actual
8 transfer prices to come up with an adjustment
9 that should go into the actual Department
10 Deter- -- Determination, for example.

11 Q: Okay.

12 A: And here, I'm talking about just the ones for
13 the Department of Revenue.

14 Q: And let me just say that I appreciate your
15 attempt to do a -- short answers. I like it.
16 I can always ask you follow-ups.

17 All right. And -- so would that include
18 the case that you testified in -- I don't --
19 can't remember exactly how many months ago it
20 was, but would that case have involved the
21 comparable profits method in your analysis as
22 well?

23 A: Yes, again, simply to all the caveats that I --
24 -

25 Q: Yes.



- 1 A: --- said before.
- 2 Q: All right. And I apologize if you said this on
3 direct, but you're not a CPA are you?
- 4 A: I am not.
- 5 Q: Okay. And you're not a lawyer?
- 6 A: Nope.
- 7 Q: And not -- just not a practicing lawyer, but
8 you don't have a law degree, correct?
- 9 A: That's correct.
- 10 Q: Okay. And you've never prepared any type of
11 tax return, state or federal, for a client?
- 12 A: No.
- 13 Q: And you've never published anything discussing
14 the use of combined reporting versus separate
15 reporting, correct?
- 16 A: Correct.
- 17 Q: And you've never published anything relating to
18 allocation or apportionment of income or
19 alternative apportionment, correct?
- 20 A: Correct.
- 21 Q: You've never taught any seminars or given any
22 presentations about any of the issues I just
23 mentioned?
- 24 A: About the use of, again, combined ---
- 25 Q: Combined versus separate reporting, allocation



1 and apportionment methods, and alternative
2 apportionment.

3 A: Correct. If those terms are being used here in
4 this proceeding ---

5 Q: Okay.

6 A: --- that's correct.

7 Q: And, and I'll be more general, have you had any
8 publications, seminars, or presentations that
9 discuss any aspect of state corporate income
10 tax issues?

11 A: A state inco- -- state corporate ---

12 Q: State corporate income taxes.

13 A: No, I have not.

14 Q: Okay. Have you ever participated in
15 discussions with the state legislature about
16 state separate reporting versus combined
17 reporting filing methods?

18 A: No.

19 Q: Have you ever spoken to a state legislature
20 about any state corporate income tax issue?

21 A: No.

22 Q: Okay. And other than your recent testimony in
23 South Carolina while serving as an expert for
24 the Department, you've never testified in any
25 case -- any court case involving a state tax



1 issue, correct?

2 A: Correct.

3 Q: And other than your work for the Department,
4 over all, you've never worked for another
5 state taxing agency on any state corporate
6 income tax issues, correct?

7 A: Correct.

8 Q: And you've never assisted any client with any
9 state corporate income tax issue, correct?

10 A: Not directly. I think in my deposition we
11 discussed the fact that I was at KPMG and
12 occasionally I would get inquiries from some of
13 my colleagues about state issues, so -- but I
14 would consider my involvement on those to be
15 relatively tangential, i.e., my -- I may have
16 been asked about certain issues, or I may even
17 have reviewed an analysis at one point, but
18 this is over 25 years ago, it's hard for me to
19 recall exactly the scope. But if it, if -- it
20 would've been a very limited scope. It was
21 enough to understand, generally, what they were
22 doing, but not -- I would not consider it a
23 substantive amount of work on my, on my part.

24 Q: And are you saying they were coming to you to
25 get advice on state corporate income tax issue,



1 or they were coming to you for other expertise
2 on their state income tax issue?

3 A: It would've been a ta- -- transfer pricing
4 issue ---

5 Q: Okay.

6 A: So it was with the national tax -- or in the,
7 kind of, the national tax group. I was
8 technically part of this different group and
9 that's where the transfer pricing was being
10 held ---

11 Q: Okay.

12 A: --- as part of national tax. So, occasionally
13 you get -- the individuals that were dealing
14 with state and local taxes in the field would
15 make inquiries to the national office.

16 Q: All right. And I keep drinking my water and
17 looking at you, do you have water?

18 A: I do, thank you.

19 Q: (Laughter.) Okay.

20 A: I will try not to spill it today.

21 Q: I was feeling very guilty. And actually, I'm
22 out, so let me grab -- I'm gonna grab another
23 one. Talking makes me need water.

24 All right. All right. I'm gonna move on
25 to a different topic. I'm gonna talk about the



1 alternative apportionment statute in South
2 Carolina, that's at 12-6-2320(A). Are you
3 familiar with that?

4 A: Generally.

5 Q: Okay. But you don't know when it was adopted,
6 correct?

7 A: Correct.

8 Q: And you don't know what prompted the
9 legislature to adopt it?

10 A: That's correct.

11 Q: And you're not familiar with the Uniform
12 Division of Income for Tax Purposes Act, which
13 we all often call UDITPA?

14 A: Only in the most general of fashions.

15 Q: And you're not familiar with the purpose of
16 UDITPA?

17 A: No.

18 Q: And you're not aware that the -- our
19 alternative apportionment statute was modeled
20 after a mo- -- a UDITPA-model statute?

21 A: That's my understanding today. I was not aware
22 of that at the time of my deposition.

23 Q: Okay. And you've never looked at any other
24 state's alternative apportionment statute that
25 is similar to South Carolina's, have you?



1 A: No, I have not.

2 Q: Okay. And you're not familiar with the
3 particular states that require separate
4 reporting versus combined reporting, correct?

5 A: Well, I'm familiar with -- in general, with
6 those states, but I'm not a -- an expert on
7 exactly which state has which particular
8 reporting requirement.

9 Q: And you don't know how long South Carolina has
10 been a separate reporting State?

11 A: No, I don't.

12 Q: And You didn't become aware of the alternative
13 apportionment statute until you were hired by
14 the Department, I think you said four or five
15 years ago?

16 A: Correct.

17 Q: Is that correct?

18 A: I think -- it's probably five years at this
19 point ---

20 Q: Okay.

21 A: But then, I'm losing track of the years.

22 Q: Time flies. All right.

23 And would you also agree that you had
24 never looked at any other state's alternative
25 apportionment statute before being retained by



1 the Department?

2 A: That's correct. And I should've clarified, I
3 still have not reviewed any other state's ---

4 Q: Okay.

5 A: --- alternative apportionment statutes.

6 Q: And if you recall, the statute refers to the
7 allocation and apportionment provisions of this
8 Chapter. I'm gonna ask you some questions
9 about that.

10 A: Yes.

11 Q: So regarding that language, you have not looked
12 at the allocation and apportionment provisions
13 of this Chapter, have you?

14 A: Certainly not before my deposition, I had not.
15 I believe I reviewed it at some point
16 afterwards. But I -- so I have a general
17 understanding.

18 Q: Okay. And, at the time of your deposition you
19 did not know the difference between allocation
20 and apportionment?

21 A: Not with regard to how it's applied in the
22 Cali- -- the South Carolina Statute.

23 Q: Okay.

24 A: I had -- as I believe I discussed, those are
25 terms that, as an economist, you use them



1 pretty much interchangeably, as -- in terms of
2 an allocation of costs as opposed to the
3 allocation of some kind of in- -- a certain
4 type of income versus an apportionment of other
5 types of income.

6 Q: And you did not know if apportionment is
7 defined in our statutes?

8 A: At the time of my deposition, I did not know
9 that ---

10 Q: Yeah.

11 A: --- correct.

12 Q: Okay. And at the time of the deposition, you
13 had not looked at the apportionment provisions
14 of the South Carolina Code?

15 A: I believe that's correct. I've reviewed it --
16 I've been working on these issues for a while
17 and I believe -- I don't recall reviewing some
18 of the stat- -- the statute in that detail
19 before.

20 Q: All right. And then, regarding apportionment
21 factors, at the time of your deposition, you
22 were not aware of any apportionment factors
23 other than the sales factor, is that correct?

24 A: Well, I was -- I think, I -- we talked a little
25 bit about the Finnigan versus the Joyce factors



1 that are -- I was aware, in my review of
2 certain, I believe, certain legal decisions,
3 that there were references to those factors, so
4 I did look up what they were.

5 Q: Okay.

6 A: And I was aware that the Finnigan factor of the
7 sales factor is what the -- what South Carolina
8 uses.

9 Q: Okay. And at the time of your deposition, you
10 did not know what apportionment factor the
11 Department had used in its combined reporting
12 calculation in this matter?

13 A: I don't recall at this point, I'm sorry.

14 Q: Yeah.

15 A: I know, I know today. I don't recall at what
16 point I, kind of, went through those
17 calculations in detail.

18 Q: What do you -- what would you say it is today?

19 A: The sales everywhere factor -- the sales
20 factor.

21 Q: And at the time of your deposition -- oh,
22 sorry, hold on. I lost my place.

23 And would you agree that an apportionment
24 factor seeks to measure the taxpayers business
25 activity in the state?



1 A: I'm sorry, could you repeat the question?

2 Q: Yeah. Would you agree that an apportionment
3 factor seeks to measure the taxpayers business
4 activity in the state?

5 A: It almost sounds like you're asking me for a
6 legal interpretation of what the statute
7 requires. I would say that that would be
8 generally my expectation.

9 Q: Yeah. And at the time of the deposition, you
10 did not know whether taxpayer, as used in the
11 alternative apportionment statute, is defined?

12 A: That's correct.

13 Q: And you believe that taxpayer, from an economic
14 perspective, means Tractor Supply and its
15 related entities, correct?

16 A: Well, I would say, as I have used that term
17 throughout my dep- -- my testimony, I've
18 generally been referring to Tractor Supply
19 Company, the parent company. So I often refer
20 to the taxpayer, the South Carolina taxpayer.
21 And so, in referring to that, I was referring
22 to TSC. I would say, in my transfer pricing
23 work, generally, I look at the related parties
24 of the taxpayer on a combined basis, so I think
25 in my deposition I was probably cons- --



1 thinking about my analysis of the company at
2 large, i.e., TSC, plus Texas, plus Michin --
3 plus Michigan.

4 Q: So, I -- I just wanna make sure I understood
5 you. So, from an economist's perspective, how
6 you view the definition of the word taxpayer is
7 -- do you view it to be the single taxpayer
8 that is filing, or do you view it as the group?

9 A: So, in my economic analysis, in the econom- --
10 economic analysis of transfer pricing, whenever
11 I've talked about the taxpayer, I've generally
12 been referring to, kind of, a group of
13 companies ---

14 Q: Okay.

15 A: --- because you're looking at the taxpayer's
16 combined activities and trying to price those
17 intercompany transactions. But, ultimately,
18 there is a -- an particularly here, when it
19 comes to -- particularly, for a litigated
20 matter, it's a very -- it's a -- much more of
21 a focused inquiry into a various -- here, a
22 specific taxpayer. And even in Federal Court
23 it will be the, the income adjustment to a
24 specific taxpayer, a U.S. taxpayer, generally.
25 So, I think there's probably a, probably a



1 looser way in which I think about the word
2 taxpayer in a, in a general sense in doing my
3 analysis because I need to look at the entirety
4 of the group to figure out what that taxable
5 income is or should be for a particular
6 taxpayer.

7 Q: Okay. All right. And now, looking at the word
8 business activities. So, just to refresh your
9 memory; if the allocation and apportionment
10 provisions of this Chapter do not fairly
11 represent the extent of the taxpayer's business
12 activity in the State, that's the phrase we're
13 talking about now.

14 A: Yes.

15 Q: From an economic perspective, you're viewing
16 business activity, as used in the statute, as
17 being the totality of the Tractor Supply
18 group's business activity, correct?

19 A: I would say I see it either way, i.e., I would
20 come to the same conclusions if the analysis
21 were narrowed to TSC, because -- the actual
22 taxpayer, because the retail stores in South
23 Carolina are part of TS- -- the TSC taxpayer,
24 and I would come to the same conclusion if the
25 question was really about, kind of, the broader

1 group of companies, including Texas and
2 Michigan.

3 Q: Okay. And you do not know whether the way
4 you're viewing business activity is the same as
5 the legislature's -- how the legislature is
6 viewing business activity?

7 A: I, I do not, I do not know how the legislature
8 -- what the legislature intended, nor how the
9 legislature -- how they deliberated in coming
10 up with those -- with that term. I'm just ---

11 Q: And you're not ---

12 A: --- providing my, my view as an economist ---

13 Q: Right.

14 A: --- of, of whether, ultimately, the income
15 reported by the taxpayer, TSC ---

16 Q: Right.

17 A: --- in South Carolina is consistent with the
18 economic activity that it performs in the
19 State.

20 Q: Okay. And similarly, you do not know how
21 business activity is intended to be measured or
22 quantified under the alternative apportionment
23 statute, you're not looking at it from that
24 perspective?

25 A: I'm focusing on your word, intent.



1 Q: Yeah.

2 A: No, I don't know what the intent of either --
3 of the legislature was.

4 Q: And you're not attempting to op- -- apply that
5 statute in your analysis?

6 A: No. I have, like I said, I've reviewed the
7 statute, but I'm providing my opinion as an
8 economist ---

9 Q: Right.

10 A: --- not as a, as a legal expert.

11 Q: Okay. How many transfer pricing reports have
12 you prepared in your career, like a full-blown
13 report? Referring back to our earlier
14 terminology.

15 A: Many. I think I, I might have thrown out a
16 number in my deposition ---

17 Q: I couldn't find it ---

18 A: Okay.

19 Q: --- that's why I didn't, didn't suggest one to
20 you.

21 A: So, it will be in the, I wanna say, dozens. I
22 don't know how many dozens. So, certainly, in
23 the cases that have proceeded to, to deposition
24 in Federal Court or in Tax Court, those have
25 all involved preparing, what I consider, full-



1 blown analyses where I'm actually deriving a
2 proposed income adjustment. In my consulting
3 work since -- in the past 30 years, I would say
4 there was a, probably, a significant volume per
5 year in the first five years when I was working
6 for KPMG. So, those would've been prepared on
7 a regular basis for multiple clients. So at
8 the -- during the time that I was working at
9 A.T. Kearney, there would have been fewer of
10 those. It was not a -- there's -- in the
11 transfer pricing world, there's something
12 called, kind of, the documentation world, and
13 then -- and that documentation world tends to
14 be all -- to have a lot of reports because
15 every comp- -- every company with significant
16 cross-boarder transactions wants to document on
17 an annual basis that its true -- that its
18 prices are arm's length. So this is a regular
19 recurring thing that they need to do, and they
20 need to do it for all their trade flows.

21 The work that I've been doing since the
22 time I was at A.T. Kearney all the way to the
23 present, involved some documentation, but those
24 were for a smaller number of clients, so those
25 would've been -- some clients had been doing it



1 regularly, three or four study -- individual
2 reports a year. And then, other ones, they are
3 in the context of an advance pricing agreement,
4 an APA, so the elements of a study are there,
5 i.e., the core -- in terms of the numbers, but
6 they're not packaged in a report, a
7 documentation report in the same way that it's
8 a study that you prepare and that you'd put on
9 -- the taxpayer puts on its shelf for when the
10 IRS asks for the study at the -- during the
11 audit period.

12 Q: Okay. Because I'm not as familiar with this
13 world as you are, I'm not sure I followed
14 everything, so I might ask you a couple of
15 follow-ups.

16 All right. So, A.T. Kearney, what period
17 of time were you there?

18 A: '98 to '99.

19 Q: And was -- would that've been when you first
20 started doing transfer pricing reports, or had
21 you been doing ---

22 A: No.

23 Q: --- studies before then?

24 A: I've been doing them since 1993.

25 Q: Okay.



1 A: When I was at KPMG.

2 Q: So -- okay. That was -- I couldn't remember
3 the order. All right. So, KPMG was first. So
4 were you, were you at KPMG from '93 to '98?

5 A: Correct.

6 Q: Okay. All right. So you started with the
7 later and then went to the earlier. All right.
8 Let me start with the earlier.

9 You started with KPMG and -- full-blown
10 studies where a client was coming in to you ---

11 A: Yes.

12 Q: --- that is, how many?

13 A: I'm sorry, that's lots.

14 Q: Okay.

15 A: I could -- and simply because, at KPMG that's
16 what a lot of the work was ---

17 Q: Okay.

18 A: --- was documentation study -- the routine
19 documentation studies. I was involved in some
20 litigation at the time ---

21 Q: Okay.

22 A: I was not a testifier ---

23 Q: Yep.

24 A: --- but I was assisting the testifier. And
25 then I worked on other cases that were not



1 transfer pricing related. So, if I had to
2 guess at a number, I would probably say, maybe,
3 25 studies, five a year. But that might be a
4 little bit of an overestimate, because I --
5 there were some time periods where I was doing
6 -- I was tied up with entirely other types of
7 litigation.

8 Q: Okay. So those would've been non-litigation
9 matters?

10 A: Correct. Some combination of non-litigation
11 and litigation. So I just -- I'm sorry, I'm
12 having a hard ---

13 Q: So not ---

14 A: --- time ---

15 Q: --- correct (laughter).

16 A: I'm sorry?

17 Q: I said, those would've been non-litigation, and
18 you said litigation and non-litigation.

19 A: Yes. I was -- in factoring in the number, I
20 was probably ---

21 Q: Yeah.

22 A: --- including a couple of litigation matters
23 that ---

24 Q: Okay.

25 A: --- I worked on.



1 Q: How many non-litigation matters, where you're
2 just doing a straight-up study for a client?

3 A: While I was at KPMG?

4 Q: Yeah.

5 A: That's a hard -- I'm sorry, it's a hard number
6 to come up with this many years later. But I
7 would say, maybe, it was 15 ---

8 Q: Okay.

9 A: --- studies.

10 Q: And would any of those be repeat customers, or
11 would those all be separate clients?

12 A: Some of them would've been repeat customers,
13 yes.

14 Q: What, what percentage would -- do you think
15 would be repeat? Is repeat a large portion of
16 what you're doing then, or not?

17 A: Of that 15?

18 Q: Uh-huh.

19 A: Again, I'm trying to peel back the years. They
20 would've been repeat customers for the clie- --
21 for KPMG, I just don't recall how much I was
22 moved from one to another.

23 Q: So some of them might've been preliminary,
24 first time, you probably have to do some more
25 work, and some of them would've been repeat



1 customers where you were updating?

2 A: That's correct.

3 Q: Okay. And, was it 50/50, or?

4 A: I -- that's probably a reasonable ballpark,
5 yes.

6 Q: All right. And then, A.T. Kearney non-
7 litigation matters where you were doing just
8 for clients?

9 A: Yes. Those would not have been -- well, they
10 would've been full-blown studies ---

11 Q: Uh-huh.

12 A: --- ultimately, with a view towards, towards
13 documentation, but it would not be -- I'd put
14 it in a different bucket than the other -- it
15 was primarily a planning project ---

16 Q: Okay. So ---

17 A: --- that I was working on.

18 Q: --- planning projects versus the full-blown
19 studies. KPMG was full-blown and A.T. Kearney
20 was ---

21 A: Well ---

22 Q: --- planning?

23 A: --- planning can be a full-blown study ---

24 Q: Okay.

25 A: It's just that it's not the same format, in



1 terms of -- you know, car- -- your typical
2 documentation study is -- the client is already
3 engaged in intercompany transactions, you go in
4 and you're trying to review and test whether
5 that transaction is arm's length.

6 Q: Okay.

7 A: A planning study can be actually much more
8 involved, and it's just a different end
9 product.

10 Q: Okay.

11 A: It's more as part of an advisory service that
12 the -- that A.T. Kearney was providing at the
13 time.

14 Q: Okay. And, I'm sorry, I have a lot of numbers
15 written here. I don't think -- did you give me
16 a number for how many of those you would've
17 done at A.T. Kearney?

18 A: So at A.T. Kearney, I don't think I did any --
19 what I would consider the -- more of the
20 routine documentation studies ---

21 Q: Okay.

22 A: --- I was focused primar- -- I was not there
23 that long. The largest project I worked on was
24 a planning study.

25 Q: Okay.



1 A: I was working on another tax litigation matter

2 ---

3 Q: Okay.

4 A: --- that did not involve transfer pricing.

5 Q: So, you did one planning study and then you
6 worked on one litigation matter. What else
7 were you doing there?

8 A: I worked on a number of other business
9 consulting matters.

10 Q: Okay. All right. And then, after '99 ...

11 A: After '99, I was with Bates White.

12 Q: Okay.

13 A: And there, I've had certain clients -- well,
14 one client in particular, since pretty much the
15 time we started the firm, and I have -- I was
16 doing transfer pricing studies for them on a
17 routine basis, basically from the, the start.
18 Those evolved into, what I would consider more
19 routine documentation studies on an annual
20 basis, that I continue to do to this day.

21 Q: And, I'm sorry. Did you say client or clients?

22 A: This was one particular client ---

23 Q: Okay.

24 A: --- that I'm thinking of.

25 Q: Okay. So you had one client at Bates White



1 where you re- -- you would've done a full-blown
2 study, and then continued working with them
3 doing routine documentation?

4 A: Generally. I'd probably characterize it
5 slightly differently. But I would say, one
6 client where I ha- -- at a certain point in
7 time, early on, I began doing routine
8 documentation studies for them for several of
9 their trade flows in addition to other work for
10 them as well. I did a broader range of work
11 for them, but part of my work would've been
12 routine documentation studies that I've ---

13 Q: For that ---

14 A: --- continued ---

15 Q: --- one client?

16 A: Yes, for ---

17 Q: Okay.

18 A: --- that one client.

19 Q: Okay.

20 A: There are other clients that I've also done
21 work on -- on their -- on APAs, advance pricing
22 agreements ---

23 Q: Okay.

24 A: --- for example, with -- these are, again,
25 agreements with, not just the U.S. Tax



1 Authorities, but other International Tax
2 Authorities.

3 Q: Uh-huh.

4 A: And I have worked on other documentation that
5 I would consider not particularly routine. It
6 was a one-off study ---

7 Q: Okay.

8 A: --- because -- yeah. I'll just -- I'll leave
9 it at that.

10 Q: Okay.

11 A: There's non- -- I'll put it this way, it was --
12 there was a nonrecurring transaction, so it
13 just needed one documentation.

14 Q: Okay.

15 A: And for the past, probably, six years, most of
16 my transfer pricing work, in terms of the hours
17 of my time, has been involved with litigation.

18 Q: Okay.

19 A: And most of that work has been on behalf of the
20 government, the -- on the enforcement side
21 rather than on the taxpayer's side. Although,
22 I did do some work early on for a taxpayer.

23 Q: Okay. All right. Of those studies that you've
24 done over all of that time period, how many of
25 those involved taxpayers that were retailers?



1 A: That were retailers?

2 Q: Yeah.

3 A: I believe we talked about this in my
4 deposition. The only one I could remember
5 being a retailer was -- well, for transfer
6 pricing ---

7 Q: Yes.

8 A: I did other work for retailers, but ---

9 Q: No, just ---

10 A: --- for tran- ---

11 Q: --- for -- just transfer pricing.

12 A: I just -- again, it is -- it would've been in
13 the context of Li and Fung. I keep coming back
14 to the ever-present Li and Fung.

15 Q: Yes.

16 A: So this was a company I -- as I analyzed that
17 company back in the '90s when I was working at
18 KPMG, and it was an engagement on behalf of a
19 retailer, I just don't recall the metes and
20 bounds of that ---

21 Q: Okay. So, maybe ---

22 A: --- engagement.

23 Q: --- one retailer?

24 A: Yes.

25 Q: Or, definitely, one retailer.



1 A: Yes, one retailer. And again, I just don't
2 recall the full ---

3 Q: Okay.

4 A: --- extent of what we were asked to do.

5 Q: Okay.

6 A: I just remember looking at the Asian
7 procurement function in quite some detail.

8 Q: Okay. So you remember the Li and Fung part
9 more so than the taxpayer in what you were
10 doing in that particular matter?

11 A: Correct. In terms of the scope of the work.

12 Q: Right.

13 A: I just don't remember writing a report in the
14 way I remember writing documentation studies
15 for other clients.

16 Q: Okay. And of all of those reports, how many
17 involved a company performing a procurement
18 function?

19 A: Well, all the companies that I've worked for
20 had a procurement function, because ---

21 Q: I'm talking about, like where your study is
22 dealing with that.

23 A: I would say, most of the studies, the
24 procurement function would probably have been
25 embedded somewhere in a broader range of



1 functions that the particular taxpayer
2 performed.

3 Q: Okay.

4 A: So, for example, a manufacturer is selling to
5 a distributor, if I'm benchmarking the returns
6 of the manufacturer ---

7 Q: Yeah.

8 A: --- the manufacturer's procuring parts that it
9 then assembles into a finished product. So
10 there is probably -- there is gonna be some
11 procurement embedded in there, but my task is
12 to benchmark the returns that it should be
13 earning as this integrated manufacturer without
14 separating out that procurement function.

15 Q: Okay.

16 A: There are some that I recall -- well, I --
17 there was a -- I don't want to call it a
18 dispute proceeding, but an issue that arose on
19 audit in an international context that involved
20 a headquarters' function more broadly and
21 procurement was part of that. And their -- the
22 dispute, I mentioned earlier, was with regard
23 to, kind of, the allocation of costs and
24 whether -- and the deductibility of certain
25 headquarters' costs that had been allocated



1 down to a foreign subsidiary.

2 Q: Okay.

3 A: I have -- I testified recently in the Purdue
4 bankruptcy and that involved work on transfer
5 pricing matters. I believe there were some --
6 there may have been some procurement involved
7 in some of those trade flows, but the scope of
8 the charge was different than in a, a tax
9 related case. So this ---

10 Q: Yeah.

11 A: --- was a non-tax- ---

12 Q: I guess ---

13 A: --- proceeding.

14 Q: --- what I'm -- I'm sorry. Are you done?

15 A: Yes.

16 Q: I didn't mean to interrupt you.

17 I guess, what I was trying to get is -- in
18 the cases where you did the full-blown studies,
19 were any of those involving where you needed
20 value a procurement transaction between related
21 entities?

22 A: Well, I will say the issue came up in the --
23 that audit -- that foreign audit that I
24 mentioned. In terms of valuing that
25 transaction, we had to establish, to the



1 satisfaction of the foreign tax authorities,
2 that the function was being performed. I had
3 to review contracts that the, that the party --
4 that the parent company had entered into to.

5 Q: Okay.

6 A: Looked -- I had to trace through the supply of
7 the, of the product to see where it's coming
8 from third party vendors to the parent company
9 and then to the parent company down to the
10 subsidiary, or if it was simply signing a
11 master contract and the con- -- the vendor was
12 selling to the different parties. There was a
13 lot of, what I'll call due diligence and
14 ticking and tying of the information to then
15 present to the foreign tax authority, with
16 regard to who was performing what service and
17 the value that the foreign taxpayer was
18 receiving from that central service.

19 Q: Okay.

20 A: As part of that, I do recall, at some point,
21 there probably was an analysis of markups. I
22 mentioned before that the tax -- particularly,
23 the U.S. Code calls explicitly for markups to
24 be applied on certain types of services and
25 allows the taxpayer not to charge markups on



1 others. In a -- in dealing with foreign tax
2 authorities there's often a little bit of a
3 tension between the IRS's perspective and the
4 foreign tax authorities. So, we did look at
5 that -- or I did look at that in some detail,
6 but at the end of the day, most of the issues
7 in that case came down to the cost allocation
8 question.

9 Q: Okay. And when -- I, I apologize, I didn't
10 catch which case you were talking about. You
11 said the audit, what time period and which
12 matter are you referring to?

13 A: So this would be in the 2000s, and it would've
14 been a -- an audit by a foreign tax authority.

15 Q: And so, who were you performing work on behalf
16 of?

17 A: For the taxpayer.

18 Q: Okay.

19 A: For the, for the company at large.

20 Q: Okay.

21 A: Which would've been both, the foreign affiliate
22 and the U.S. headquarters.

23 Q: Okay. All right. And you've referenced a case
24 that you were involved in that I am not sure
25 how to pronounce. Is it Perrigo? Perrigo?

1 A: *Perrigo.*

2 Q: Okay. The *Perrigo* case. I think it's -- is it
3 *Perrigo Company and Subsidiaries versus United*
4 *States of America*, does that sound right?

5 A: You know, I should've memorized the case
6 caption.

7 Q: (Laughter.)

8 A: That sounds right.

9 Q: Okay. And I'm not sure if I heard this
10 correctly yesterday, so please, clar- --
11 clarify this for me. Did you say that you
12 provided testimony about economic substance in
13 that case?

14 A: So ... It was a highly nuanced issue ---

15 Q: Okay.

16 A: The whole issue of economic sens- -- substance,
17 simply because in that matter -- in that case
18 the government was asserting a tran- -- a sham
19 transaction theory ---

20 Q: Right.

21 A: --- but it also had alternative adjustments
22 that it was performing ---

23 Q: Okay.

24 A: --- or proposing -- other alternative theories,
25 rather. And I did analyze the economic



1 substance. My testimony was not with regard to
2 whether the transaction was, in fact, a sham,
3 which is a legal determination.

4 Q: Right.

5 A: I testified as to whether the transaction at
6 issue had any commercial effects or any
7 operational effects on the business. I
8 testified as to the presence or absence of
9 employees in the -- in one of the, the entities
10 created by the taxpayer.

11 Q: Uh-huh.

12 A: So, there was a, kind of, a wider range of
13 issues associated with that question of
14 commercial effects or ---

15 Q: Okay.

16 A: --- or economic effects ---

17 Q: Right.

18 A: --- or financial effects were at large. There
19 was a separate analysis that I then moved to.
20 I had a two-part analysis. I think on the
21 stand I referred to it as my A analysis versus
22 my B analysis.

23 Q: Yeah.

24 A: So the B analysis wa- -- the A analysis was
25 really on this broader question of commercial



1 effects ---

2 Q: Yep.

3 A: --- the B analysis was really on redoing the
4 company's transfer pricing to ---

5 Q: Okay.

6 A: --- be consistent with the arm's length
7 standard, i.e., if the Court were to determine
8 that it was not a sham, then what would be the
9 approach to -- that one would take to then
10 determine the -- an adjustment.

11 Q: Okay.

12 A: So in that analysis, I did analyze the economic
13 substance of what the -- of the transaction at
14 issue. I analyzed whether there was any change
15 ---

16 Q: Right.

17 A: --- from that time T-minus one, i.e., before
18 the, the assignment versus after the
19 assignment. And again, there's a -- I think
20 it's because there's -- the word economic
21 substance does appear in different statutes in
22 different ways ---

23 Q: Right. But your testimony was focused on those
24 underlying factual issues, you were not,
25 yourself, using the term economic substance in



1 your adjustment, right?

2 A: I believe I would have, because I -- again,
3 economic substance appears all over the place
4 in the §482 Regulations. So in that regard, as
5 an economist, you do need to wrestle with this
6 issue of form over substance because, as I said
7 yesterday, a taxpayer can write whatever it
8 wants into a related party contract and I need
9 to evaluate the actual conduct, or the
10 substance of the arrangement, what it -- to
11 ensure that what I'm pricing is consistent with
12 the actual transactions and the conduct of the
13 parties, as opposed to the forum.

14 Q: So you believe that you testified as to
15 economic substance, specifically, using that
16 term?

17 A: With regard to the, the analysis that I did in
18 that, what I'll call, my -- the B part of the
19 testimony, I would say I definitely didn't. I
20 don't recall, on the stand, the terms that I
21 used. I think their -- in that proceeding,
22 because it was -- it had this alternative
23 theory, it had two different theories being
24 brought by the government, I am not quite sure
25 the specific language I used on the stand ---



1 Q: Okay.

2 A: --- to avoid confusion, but economic sub- --
3 but I did review economic substance in pricing
4 the transaction. That was my affirmative
5 opinion with regard to the actual transfer
6 pricing, is that it should be priced in a way
7 consistent with what I considered to be the
8 actual substance of the transaction, i.e., at
9 the most a -- this is all in the public record,
10 so ---

11 Q: Yeah.

12 A: --- it's one of the -- one of the cases I'm
13 comfortable talking about. So, I had a
14 financing transaction, for example, so I said
15 I'm going to price this consistent with what I
16 think it more closely approximates, the
17 substance of the transaction being a financing
18 transaction. I just don't recall whether I, I
19 used the terms explicitly economic substance,
20 simply because of the nature of the different
21 theories that were being had -- that were being
22 presented in the case.

23 Q: All right. I also recall in your discussion --
24 and now I've already forgotten how you told me
25 to say it, Pear-igo?



1 A: Perrigo.

2 Q: Perrigo. I gotta write that down. Kind of
3 think of the fruit, pear. Pear-igo. All
4 right.

5 I also recall you discussing that and
6 somehow connecting it to why your opinion that
7 the 2001 restructuring is relevant to your
8 opinion, and I just can't -- I couldn't follow
9 what you -- how you were tying those two things
10 together.

11 A: Certainly. So, there are certain transactions,
12 related party transactions that a company has
13 been doing, effectively, since time immemorial.
14 And so as an analyst, you come in and you're
15 seeing a pattern of conduct that's been going
16 on for years, and so you're just evaluating the
17 -- and you can -- all you're evaluating is what
18 you have and what you know today, and that
19 history can inform your opinion. So, for
20 example, if a related party has for many, many
21 years been engaged in advertising and brand
22 development, and then you're trying to figure
23 out what the appropriate royalty is for a
24 trademark license in the years at issue, you'll
25 consider that longer history as part of that,



1 for example, in evaluating the level inves- --
2 of an investment that the company has done.

3 In other instances, you will have a
4 company that implements a change. So a --
5 what's -- and typically it will be either in
6 the inst- -- in the case of an operational
7 restructuring or, what I'll refer to as a tax
8 restructuring. Operational restructuring would
9 be something where the company is literally
10 changing the way it does business, on an
11 operational perspective. A tax restructuring
12 will generally be something that the company is
13 doing simply for -- to, to reduce its taxes, or
14 in some cases, to outright avoid tex- -- taxes.
15 In that instance, it's important to look at
16 what happened at that T-minus one and T-plus
17 one time period. So, to examine the state of
18 the world and the position of the related
19 parties and the way the parties were being
20 compensated, and the income they were earning
21 prior to the transaction versus after the
22 transaction. So this happens all the time in
23 things like, like R&D cost sharing, buy-in
24 agreements. So when there's a restructuring of
25 a company's international structure of their

1 R&D function where they may be moving
2 intangible assets from one tax jurisdiction to
3 another, that's critical to the analysis,
4 understanding what happened -- what the
5 situation was at time T-minus one and then what
6 the situation was at time T-plus one. That's
7 also -- that feeds into this question, the
8 broader question of, what are the realistic
9 alternatives that the taxpayer faced -- or that
10 the -- that -- the related party that was
11 engaged in that transaction, particularly, a
12 related party that was responsible for a
13 function, or that had a particular asset like
14 an intangible asset, what reasonable
15 alternatives did it have relative to the new
16 transaction that it was implementing, 'cause
17 it's a related party transaction, and relative
18 to the dollars that it was giving up, or that
19 it may have been receiving as part of that
20 transaction.

21 So, just as in *Perrigo*, there was an asset
22 assignment and it was important to look at the
23 activity and the position of the taxpayer,
24 meaning in the period up to the assignment, and
25 whether the assignment actually changed the

1 economic position of the parties after the
2 assignment. In an R&D and cost sharing
3 arrangement I will often look at how much money
4 the, the intangible owner -- so, maybe, a
5 patent holder, how much they were earning in
6 the time period leading up to the transfer of
7 that patent to a foreign subsidiary and then,
8 if that -- if the taxpayer is then paying a
9 royalty to its foreign subsidiary, how that
10 changes the position of the econ- -- of the
11 taxpayer.

12 Here, we have a ---

13 Q: Can I -- before you move on, can I ask you --
14 just so I'm -- we don't lose our train of
15 thought as to where you are, and then you can
16 go on to give the rest?

17 A: Certainly.

18 Q: So in *Perrigo*, what was the time period that
19 you were looking at, like T- -- the T-one and
20 the -- and what was the time period of the
21 issue you were looking at?

22 A: Sure. Sorry, the T-minus one period ---

23 Q: Yeah.

24 A: I ---

25 Q: T-minus one. Sorry.

1 A: So, the years -- I should, I should know this.
2 It was in the two-thou- -- mid-2000s. I don't
3 rememb- -- trying to remember the exact year.
4 I believe it was the 2005 to 2008 time period.

5 Q: Okay.

6 A: And the -- there was a dispute -- or I should
7 say, still is a dispute, with regard to when
8 the assignment actually occurred.

9 Q: Okay.

10 A: And -- so, I would say that the time period I
11 looked at was from, effectively, the time when
12 the taxpayer initially began development work
13 on the product at issue, a product called
14 Omeprazole. And the -- so, that would've been
15 long before the asserted assignment.

16 Q: Okay.

17 A: And then -- so I looked at it from the
18 initiation, and even before the initiation,
19 probably, when it was produced by the original
20 company who developed the product, Astra-
21 Zeneca.

22 Q: Okay.

23 A: And then -- so this is a private label product.
24 So the focus of my analysis begins in earnest
25 then, when the taxpayer begins development work



1 on their product, which would've been several
2 years before the assignment ---

3 Q: Right.

4 A: --- and then all the way through to the
5 present.

6 Q: Okay.

7 A: I think I was in the middle of my responses ---

8 Q: Oh, yeah ---

9 A: --- to why I ---

10 Q: --- I'm sorry.

11 A: --- looked at this ---

12 Q: Yep. This slide here.

13 A: Here, yes.

14 Q: (Laughter.)

15 A: So, here -- so just as I've done that in other
16 cases -- because I think it is very important
17 in help- -- in, in assessing the reasonableness
18 of a particular structure, and in terms of the
19 compensation that the different parties
20 receive, pre and post to that, that change,
21 here, we also have a -- an event period, 2001,
22 where the company was previously this
23 integrated company and, and the company decided
24 to split itself up and create Texas and
25 Michigan as distinct legal entities. And so,



1 at -- part of my analysis, the at-issue is --
2 there is a license agreement here, even though
3 there's not an explicit royalty being paid for
4 that license. As the auditor stated, it is
5 referenced in the inventory agreement, and I
6 believe it's a -- kind of, a condition of the,
7 the license is that the parent company only has
8 a right to use the license if it continues to
9 procure inventory from Texas. So it is very
10 much implicated, and because of that I need to
11 look at the tim- -- at, okay, who owned the
12 intangibles, what are these intangibles, would
13 a party in, in -- would a related party -- I'm
14 sorry, the third party give up an asset that it
15 owns, presumably a potentially valuable asset,
16 it's trademarks, to a third party for no
17 compensation, and also thereby assume a
18 liability, i.e., a -- an obligation to purchase
19 inventory at ultimately, what I consider, to be
20 an inflated price. And I consider that to be
21 consist- -- inconsistent with TSC's available
22 alternatives -- or realistic alternatives.

23 So, it's important in that, in that
24 regard. And it's also important in assessing
25 that broader question of, is this an integrated

1 enterprise? Did the restructuring change
2 anything? Were there any benefits that the
3 company was able to obtain as a result of the
4 restructuring other than the reduction of tax?

5 Q: I've run out of clean paper, so I'm gonna grab
6 a piece of paper real quick (laughter).

7 **THE COURT:** Then we'll just take a clean paper
8 break.

9 **MS. GEER:** I don't have any more legal pads. I've
10 gone through all my legal pads.

11 **THE COURT:** Although, I don't know. If she runs out
12 of paper that may be a benefit for y'all.

13 *(Laughter.)*

14 **MS. GEER:** Well, he's talk -- usually it's kind of a
15 question and answer where I can follow, and I
16 don't have to write down everything.

17 **THE COURT:** Oh, okay. Well, then we're gonna --
18 we're just ---

19 **MS. GEER:** You wanna take a break?

20 **THE COURT:** --- gonna take a quick break. Yeah.

21 **MS. GEER:** Yeah. Okay.

22 **(Off the record from 11:13 a.m. until 11:21 a.m.)**

23 **THE COURT:** Okay. Have we acquired more paper?

24 **MS. GEER:** Yes. For just -- actually ... More
25 paper and a bathroom break.



1 **THE COURT:** I might create a new rule.

2 **MS. GEER:** No paper?

3 **THE COURT:** No. Anybody that's doing cross-
4 examination from now on cannot go on a bathroom
5 break.

6 *(Laughter.)*

7 **MS. GEER:** That's not gonna be pretty, Your Honor.

8 **THE COURT:** It would assist in the efficiency of a
9 cross-examination.

10 *(Laughter.)*

11 **MS. GEER:** Oh, my goodness. That could be bad for
12 me.

13 **THE COURT:** Go ahead.

14 **MS. GEER:** Thank you, Your Honor.

15 Q: All right. All right. So moving on to talking
16 about some of the same issues we've been
17 talking about, but just -- I'm leaving *Perrigo*
18 for now.

19 So in this case, I think you're connecting
20 that the 2001 restructuring is relevant to your
21 opinions about the PwC transfer study. Am I
22 understanding that correctly?

23 A: Yes, but more importantly, it's relevant to the
24 transfer prices that the company actually
25 implemented.



1 Q: Okay.

2 A: And ---

3 Q: During the time period?

4 A: During the time period, yes. And the contracts
5 that govern those were all executed as a result
6 of the restructuring.

7 Q: Okay. And I think you said something about it
8 being a tax transaction or a tax restructure,
9 or a tax driven transaction, all, all, kind of,
10 terms I've heard you use about the restructure.
11 Is that -- do you, first of all, do you recall
12 saying that?

13 A: Yes, I do.

14 Q: Okay. And then, second of all, is that a -- is
15 any of that like a -- is there a defined term
16 in economics principles or is that just like a
17 term you're using generically?

18 A: I would say it's probably more a term I'm using
19 generically, just to distinguish a transaction
20 that has economic consequences from a -- and/or
21 commercial consequences for a transaction that
22 is largely, if not entirely driven by tax.

23 Q: Okay. But there -- there is no economic
24 principles or transfer pricing regulations that
25 defines what a tax restructure is?



1 A: I know that there are certain areas of transfer
2 pricing that do look at, at the term economic
3 substance. Some of those are not in the
4 transfer pricing regulations, but in the other
5 -- in other tax regulations. So I would say
6 the concepts are pretty much embedded in
7 transfer pricing as well, because you do need
8 to look at how things change. And there is an
9 entire section in the, in the regs for,
10 effectively -- I think what -- it encompasses
11 restructurings, they often talk about asset
12 transfers. Actually, there are sections that
13 refer to restructuring, and the OECD
14 Regulations also talk about restructurings.
15 And the analysis would be similar to the
16 analysis I've done here.

17 Q: Okay. So, OECD Regulations, you think, def- --
18 would they define what a tax restructure is?

19 A: I don't know if they, they explicitly talk
20 about that as a defining term. I know they --
21 there's an entire section that analyzes what
22 kind of transfer prices should be paid upon a
23 restructuring and what, what the, the tax
24 consequences should be, or should not be of a
25 restructuring. So there is a lot of analysis

1 in that that goes to the operational effects.
2 But again, I don't, I don't recall there being
3 a specific term called "tax restructuring" ---

4 Q: Okay.

5 A: --- versus operational restructuring
6 quote/unquote.

7 Q: And that regulation that you just referred to,
8 which regulation is that?

9 A: I'm thi- -- it's a -- I'm thinking primarily of
10 the, the OECD Regulation, simply because I had
11 an engagement that involved applying those
12 regulations, that specific portion of the, of
13 the OECD ---

14 Q: Yeah.

15 A: --- Regulations ---

16 Q: Which specific regulation, is what I'm ---

17 A: Oh, I'm sorry.

18 Q: --- asking.

19 A: I said regulations, I should've said
20 guidelines.

21 Q: Okay.

22 A: The -- this is the Organization of Economic
23 Cooperation and Development, so it is a -- an
24 association, I guess, of ---

25 Q: Okay.



1 A: --- of countries ---

2 Q: Okay.

3 A: --- and there are guidelines that different --

4 that the members generally follow, but they

5 implement their own, obviously, their own tax

6 statutes. That's why §482 governs the U.S.

7 entities. But U.S. ---

8 Q: Okay. So this ---

9 A: --- entities ---

10 Q: --- is more a -- I'm sorry, were you finished?

11 A: Yea- -- I finished enough ---

12 Q: Okay.

13 A: --- that's fine.

14 Q: So -- all right. Is OECD a international

15 guidelines equivalent to §482? Is it somehow

16 similar, or -- explain that to me.

17 A: It's not equivalent because it's not a statute.

18 Q: Yeah.

19 A: But it -- they are guidelines that the members

20 generally follow.

21 Q: Okay.

22 A: The members have input. So the IRS had, had

23 and has input into those guidelines.

24 Q: Okay.

25 A: So, those guidelines reflect, kind of, the



1 broad principles that the different member
2 states generally apply ---

3 Q: Okay.

4 A: --- through their own specific statutes.

5 Q: And are the guidelines such that the section
6 you're speaking of is numbered in some way?

7 A: It is, but I can't recall -- if you look up
8 OECD Guidelines Restructuring, or OECD
9 Restructuring Guidelines ---

10 Q: Okay.

11 A: --- it -- they're -- because I recall
12 referencing them when a company was going
13 through a restructuring.

14 Q: But are you referencing them in this case? Did
15 you use them in this case?

16 A: No. I just ---

17 Q: Okay.

18 A: --- meant that -- you, you asked me whether
19 anybody refers to tax versus operational
20 restructuring ---

21 Q: Okay.

22 A: That's where I said, in the §482 Guidelines
23 there are guidelines with regard to -- or
24 discussion, obviously, with regard to asset
25 transfers. A lot of those asset transfers



1 occur in restructuring. I don't recall doing
2 a word search in the guideline -- in the §482
3 Regulations to see whether the term
4 restructuring appears in that.

5 Q: Okay.

6 A: In the ---

7 Q: So you don't -- oh, sorry.

8 A: In, in the OECD Guidelines, I know that term
9 does apply, 'cause I've used those specific
10 provisions in my previous work.

11 Q: Okay. So you -- today, you are not aware of
12 whether the Federal Regulations use the term
13 tax restructure?

14 A: I do not know.

15 Q: Okay.

16 A: And not with regard to the 482 guideline -- the
17 §482 Regulations.

18 Q: All right. Your transfer pricing testimony in
19 this case is based on the §482 Regulations,
20 correct?

21 A: That's correct.

22 Q: Okay. And you concluded that PwC's transfer
23 pricing study dated July 11th, 2014, hereafter
24 I'm just gonna say the PwC transfer pricing
25 study, failed to meet the arm's length standard



1 with respect to the procurement functions
2 performed by TSC of Texas, correct?

3 A: Yes. I think that's correct.

4 Q: Okay. Are you familiar with Treasury
5 Regulation §1.482-1?

6 A: Yes.

7 Q: Okay.

8 **MS. GEER:** Bobby, are you able to -- (to Ms.
9 Buckner) would we be able to put something up
10 on the screen?

11 **MS. BUCKNER:** Yeah.

12 **MS. GEER:** Thank you.

13 Q: Okay. All right. Is this Regulation what
14 you're referring to when you talk about the
15 arm's length standard under the §482
16 Regulations?

17 A: It's where the -- I, I believe it's the section
18 where the -- they define the arm's length
19 standard. If you'll go -- there we go. Yes.

20 Q: Yes. Okay. And do you agree that the
21 procurement function that's addressed in the
22 PwC study is a controlled transaction?

23 A: Yes, it is.

24 Q: And the PwC transfer pricing study was
25 addressing that controlled transaction, right?



1 A: (No audible response.)

2 Q: And the controlled transaction of licensing?

3 A: Effectively, yes. But, again, I -- I think I
4 discussed this at length. I thought the PwC
5 study mischaracterized that transaction. It
6 does talk about the provision of wholesale
7 distribution. They kind of lumped it into --
8 and I believe that the terms were procurement,
9 merchandising and distribution. So they were
10 ---

11 Q: Okay.

12 A: --- defining it -- at -- that broadly, where I
13 ---

14 Q: So you ---

15 A: --- consider it -- that the real transaction at
16 issue is a procurement service.

17 Q: Okay. So you think they, maybe, added
18 something in it that it wasn't, but you believe
19 that the procurement function should be the
20 controlled transaction in that Study?

21 A: I believe that they mischaracterized the
22 transaction, and so that fundamentally -- that,
23 that leads to a fundamental flaw in their
24 entire analysis, but I do consider the, the
25 appropriately defined transaction to be a



1 procurement service ---

2 Q: Okay.

3 A: --- correct.

4 Q: All right. Can you please read the first

5 sentence of -- will you know what I'm saying if

6 I just say dash one and then the numbers?

7 A: Yes.

8 Q: Okay.

9 A: But the one thing I've always hated about the

10 regs is the ---

11 Q: Is the dashes?

12 A: Is finding what specific provision -- how you

13 have to trace it up to ---

14 Q: Yeah.

15 A: --- all the other letters and numbers.

16 Q: All right. I would like you to read dash one,

17 subsection (b)(1).

18 A: Okay. In general? You jus- ---

19 Q: I -- just the first sentence.

20 A: Just the first ---

21 Q: Yes, In general.

22 A: --- sentence?

23 Q: I'm sorry. In determining ---

24 A: (Laughter.)

25 Q: (Laughter.)



1 A: Okay. So, I'm -- now I'm reading from the
2 text.

3 Q: Yes.

4 A: "In determining the true taxable income of a
5 controlled taxpayer, the standard to be applied
6 in every case is that of a taxpayer dealing at
7 arm's length with an uncontrolled taxpayer."

8 Q: Okay. An uncontrolled taxpayer means,
9 essentially, an unrelated third party, correct?

10 A: Correct.

11 Q: Okay. All right. Now, can you read -1(b)(1)
12 the next sentence?

13 A: "A controlled transaction meets the arm's
14 length standard if the results of the
15 transaction are consistent with the results
16 that would have been realized if uncontrolled
17 taxpayers had engaged in the same transaction
18 under the same circumstances (arm's length
19 result)."

20 Q: Now, do you agree that procurement functions
21 are being performed in 2014 through 2016?

22 A: Yes. Procurement functions are being
23 performed.

24 Q: Okay. And do you agree that the arm's length
25 standard does not look at whether unrelated



1 parties would engage in the transaction, but
2 instead tries to determine the price that would
3 be agreed to between two unrelated parties
4 engaged in the same transaction under the same
5 circumstances?

6 A: Generally, but I think you need to cross-
7 reference that to other statements. But I
8 think, with regard to this notion of -- i.e.,
9 this goes to the economic substance question,
10 because sometimes a taxpayer can assert that
11 the transaction is one thing and upon further
12 review, the economist, or the commissioner, can
13 determine that the transaction is something
14 else entirely different.

15 Q: Okay.

16 A: So -- but, setting that aside ---

17 Q: Yeah.

18 A: --- ultimately, once you figure out what the
19 transaction is, you generally take the
20 transaction, as given, and then try and
21 determine what the price -- the arm's length
22 price is.

23 Q: Okay. So you would want to determine in that
24 transaction whether the functions that are
25 being valued are the functions that are being



1 performed?

2 A: That's correct.

3 Q: Okay. I feel like I just passed an economic
4 exam (laughter).

5 All right. Let's see. Do you agree that
6 when trying to determine the arm's length price
7 for procurement functions being provided in
8 2014 through 2016, and envisioning this tran-
9 -- controlled transaction as being a
10 transaction between unrelated parties engaged
11 in the same transaction, under the same
12 circumstances as is required under the arm's
13 length standard, that there would be no basis
14 under this Regulation for looking at the
15 restructuring that occurred back in 2001?

16 A: No. I still think that there is -- it is an
17 important data point in assessing the --
18 particularly, this notion of realistic
19 alternatives, which is another term that
20 appears elsewhere in the regs. So, I think
21 that helps to give the analyst a greater
22 understanding of -- i.e., analyzing the
23 restructuring and assessing what went on at the
24 time of the restructuring, it very much helps
25 inform that opinion of what the company's



1 realistic alternatives, not only were back in
2 2001, but continue to be in 2014 and 2016.
3 Namely, this is a function that the company
4 previously performed, it's -- the people are
5 actually still there in the headquarters, and
6 there is nothing that would prevent the company
7 from, effectively, canceling the contract --
8 the procurement contract and taking over those
9 functions, other than the fact that it's
10 entered into a related party trademark
11 agreement that says, we hereby obligate
12 ourselves to continue to procure from Texas.
13 Which, again, is this -- another arm's len- --
14 entirely, related party agreement.

15 Q: So, the language of this Regulation says you
16 want to look at two -- what third parties would
17 do if they were engaging in the same
18 transaction in 2014. So where in this
19 Regulation does it give you authority to look
20 back to 2001, if you're just trying determine
21 what value would a third party pay for the
22 procurement function that is being provided?

23 A: Because the past is a reasonable guide to the
24 present, and it -- particularly, in this
25 circumstance. The -- often in transfer



1 pricing, you will analyze data from even years
2 that are closed, because that, that sheds in --
3 i.e., that are no longer at issue in a
4 particular audit. And because that, that
5 earlier time period sheds light into -- to the
6 prices that, at arm's length, parties would pay
7 in the current -- during the current period.
8 Like I said, it tells me something about the
9 available alternatives. It says to me that
10 there's nothing unique that Texas qua Texas has
11 developed over this time period that, that TSC
12 the headquarters -- that the parent company
13 couldn't replicate, or couldn't procure at
14 substantially lower prices from third parties.

15 Q: So, why -- if I'm trying to value what that
16 procurement function is providing, why do I
17 need to look at anything other than what that
18 tran- -- what that function is -- a third party
19 would pay for it?

20 A: Like I said, there are certain circumstances
21 when you don't have a change over time, you
22 simply have -- you know, think of a different
23 company that would've had -- in a -- it's like
24 literally people located in Texas from time
25 immemorial performing those functions, and

1 those individuals would have developed their
2 vendor relationships over time and then, at
3 some point in time, you come up to the years at
4 issue, and then you're evaluating that
5 transaction. So, I still think, at the end of
6 the day, you could analyze the transactions
7 similarly, in terms of it being a service, it's
8 a procurement service in that, that alternative
9 world where Texas had people located in Texas,
10 where it always had the people -- the
11 procurement function was always hived off from
12 the headquarters, it was always being performed
13 independently. And then, that -- that's one
14 set of facts in which you can simply say, okay,
15 I'm going to then evaluate that service during
16 the years at issue, given that set of facts.
17 And I think, at the end of the day, you can
18 still evaluate it with a similar approach that
19 I've done here, except here, I do have a
20 different set of facts. I do have the fact
21 that it's part of the, the people who are
22 performing the function are literally sitting
23 in Tennessee, and that they were previously
24 employed by TSC, they interact on a daily basis
25 with all these other individuals and that does



1 give me additional insight into what the
2 company's other alternatives are.

3 I would say it, kind of, ups the ante, in
4 terms of the factual basis I have for my
5 conclusion that says, the 9.7 percent is
6 inconsistent with the company's available
7 alternatives. I would say, even if we've been
8 in this hypothetical, where the purchasing had
9 been in Texas and, and there was an above arm's
10 length price being paid by TSC for that, I
11 would still think there'd be -- there's always
12 the alternative for a company to develop a
13 capability in-house, or to procure it from
14 third parties. Here, I know it to be the case.
15 I know that they had that capability because
16 they had cability -- capability, they had those
17 vendor relationships as of 2001, prior to the,
18 prior to the restructuring. So it's an
19 additional piece of -- from my, from my view,
20 it's a -- it's factual evidence that I use to
21 help build my opinion as to, what is the
22 reasonable alternative of the company during,
23 during the tax years at issue, as well as to
24 help assess, was there a real change in the
25 operations of the company, the way the

1 company's asserted with regard to that -- both
2 the restructuring, and with regard to the
3 alleged value add of that procurement service.

4 Q: Let me ask you a different way. Assume for me
5 that day one is a company performing all the
6 procurement activities, let's just say -- let's
7 use our, our company's. Let's say day one,
8 Tractor Supply is formed, TSC is formed,
9 Michigan is formed. That, that was -- that's
10 the initial structure.

11 A: Okay.

12 Q: Okay. And TSC of Texas is providing -- all the
13 facts are the same, as far as what the
14 procurement activities that they are providing
15 to TSC and Michigan are, they're all the exact
16 same, but we're just on day one. It's a new
17 group of entities versus a restructure ---

18 A: Okay. And on day one, in your hypothetical,
19 are those individuals located in Texas and
20 being supervised by other Texas employees, or
21 are they sitting in Tennessee and being
22 supervised by the employees of -- and
23 interacting with the employees of TSC?

24 Q: Let's assume that a pandemic hit and they're
25 tired of being in -- they don't like being in



1 Texas anymore and they've moved to Tennessee.
2 So they're in, they're in Texas, but they're
3 sitting in Tennessee with all the Tennessee
4 folks.

5 A: Okay. But the -- the issue for me is there's
6 also one of control -- of, of ---

7 Q: Okay.

8 A: --- manage -- management control.

9 Q: Yeah.

10 A: So I need to know in your hypothetical whether
11 you are posing a hypothetical in which this
12 purchasing function is operating truly
13 independently of the headquarters ---

14 Q: Yep.

15 A: --- or whether it's integrated into
16 headquarters the way it is ---

17 Q: It's a ---

18 A: --- for the Taxpayer.

19 Q: Exact same facts.

20 A: Exact same facts.

21 Q: Yeah.

22 A: So it would be fully integrated, though, assume
23 the -- from the get-go when the company was
24 established ---

25 Q: Yep.



1 A: --- they structure their operations exactly the
2 same way ---

3 Q: Yes.

4 A: Okay. And they hav- -- except they had
5 established these legal entities back in the
6 day?

7 Q: Yeah.

8 A: Okay.

9 Q: And they've come to you and they've said, Dr.
10 DeRamus, can you please tell us what the arm's
11 length price would be for this transaction,
12 could you do it?

13 A: I would say -- but, yes. My conclusion would
14 be no different than it is today.

15 Q: Okay. And, and tell me why?

16 A: Well, because you've already posited that
17 they're part of the headquarters' function.
18 The headquarters has established already that
19 it has the capability to develop a broader
20 range of functions, i.e ---

21 Q: That they're a new entity.

22 A: Right. Well ---

23 Q: In the hypo.

24 A: So, what I meant was, as of today -- as of the
25 years at issue -- as of 2014. We're in 2014,



1 the company had been established years ago, the

2 ---

3 Q: Yeah, yeah. But ---

4 A: --- headquarters ---

5 Q: I -- I -- and I'll letting you talk about the
6 facts, but I want you to start with my question
7 and then you can move to something else if you
8 need to. But, I want you to answer my hypo of,
9 new company, started today, organized exactly
10 the same and all of the functions are exactly
11 the same, and I'm asking, can you price that
12 transaction?

13 A: A new organ- -- a new company organized today
14 and I'm trying to practice -- trying to price
15 the transaction, today?

16 Q: Yes.

17 A: Yes.

18 Q: Okay. And so, is your conclusion going to be
19 the same as it is for the facts in this case or
20 is it gonna be different?

21 A: It'll be the same. I will say, I will have one
22 less data point, in terms of the ability of the
23 headquarters to replicate that function, i.e.,
24 if it has not developed other functions. For
25 example, the advertising function, so it has



1 not -- it's literally just starting today, and
2 I have no idea what the capabilities of the
3 com- -- the headquarters is ---

4 Q: Right.

5 A: --- to develop that function?

6 Q: Yep.

7 A: Then, I -- so I have fewer data points to, to
8 point to, but I -- still, in terms of the, you
9 know, what I understand about the purchasing
10 function, effectively, this is a more or less
11 routine function that every manufacturer, every
12 retailer has to perform, there's a free labor
13 market out there, so those people can be hired
14 -- the company actually hires people ---

15 Q: Right.

16 A: --- from other competitors. So, that is -- all
17 those tell me that the, that the company could
18 replicate that function and therefore it
19 wouldn't pay substantially more to a -- an
20 unrelated party for the same function that it
21 can either recreate itself, or that it could
22 purchase from -- the service that it could
23 purchase from a third party.

24 Q: All right. So, the 2001 transaction doesn't
25 actually add anything to your analysis other



1 than -- I think you're saying, it might give me
2 one more data point level of comfort in my
3 opinions -- my -- your opinions are gonna be
4 the same regardless of what happened in 2001.

5 A: Well, I still think it's an important data
6 point, but it -- it is -- I, I could've come to
7 -- I would've come to the same, the same
8 conclusion even absent the restructuring, but
9 nonetheless, I do consider ---

10 Q: Okay.

11 A: --- it to be important -- also because of the
12 intertwining of the, of the different
13 agreements. The licensing agreements,
14 particularly, the licensing and the, and the
15 inventory agreement. Recall the -- the
16 trademark is still sitting out there as a bit
17 of an elephant in the room, even though the
18 company's not charging a royalty, it's
19 nevertheless implicated by the related party
20 contracts and it's what obligates TSC to
21 purchase from TSCT. And so, in terms of
22 whether a royalty should be paid for the use of
23 the trademarks will depend very much on
24 history. It will depend on whether TSC was the
25 one that has been investing in advertising in



1 the past. It will depend on the extent to
2 which TS- -- in the contract, I believe it says
3 TSCT wa- -- in the licensing contract it says
4 something to the effect that TSCT will assist
5 TSC with advertising, or something of that
6 nature, which, as I've reviewed it, TSCT does
7 not do, does not have anybody in the
8 advertising function. So, there's -- there are
9 a lot of other implications for the
10 restructuring for the sum -- for the totality
11 of the related party transactions that are at
12 issue here.

13 Q: Okay. But for the procurement piece of it,
14 nothing would change about your conclusions if
15 we were on day one versus if we looked back to
16 the ti- -- if we're considering the restructure
17 as being another factor, the conclusion is
18 gonna be the same in both cases?

19 A: Of the net conclusion, yes. But I would say
20 that the, kind of, the basis for the conclusion
21 would change, 'cause I did- -- I wouldn't have
22 that basis, right.

23 Q: Okay.

24 A: And, and that -- and, again, just simply
25 because that royalty is hanging out there and



1 that royalty -- I would have to think further
2 about the implications of that royalty.

3 Q: Is there anything in the §482 Regulations that
4 requires related parties to maximize their
5 taxes?

6 A: No.

7 Q: Is there anything in that requires -- or,
8 sorry, that prohibits related parties from
9 minimizing taxes?

10 A: Other than compliance with the Regulations and
11 the applicable laws, no.

12 Q: Okay. Is there anything in the Regulations
13 that says tax motivations are relevant to
14 determining the arm's length price between
15 related parties?

16 A: In the §482 Regulations?

17 Q: Yes.

18 A: I don't recall.

19 Q: Is there anything in the Regulations that
20 allows you to ignore a transaction that has
21 occurred?

22 A: Not as I think you're talking about ignoring.

23 Q: Okay.

24 A: Yeah, so you don't -- you don't ignore actual
25 transactions.



1 Q: Okay.

2 A: That's correct. In the §482 Regulations.

3 Q: Right. Is there anything in the §482
4 Regulations that would allow you to say that
5 TSC of Texas does not own the intellectual
6 property that it received in 2001?

7 A: There's noth- -- nothing in the §482
8 Regulations that would allow me to challenge
9 the legal ownership of those.

10 Q: Okay.

11 A: I think there are other provisions of the
12 Regulations that talk about the difference
13 between a legal owner and a part of it may have
14 developed those intangibles. But it -- it has
15 to go -- as to the legal ownership, those are
16 legal issues, not issues that I can opine on as
17 a ---

18 Q: Right.

19 A: --- as an economist.

20 Q: Is there anything in the Regulations that would
21 allow you to disregard TSC of Texas as being a
22 separate and distinct entity from Tractor
23 Supply?

24 A: Not within the confines of the §482
25 Regulations, correct.



1 Q: Is there anything in the Regulations that would
2 allow you to pierce the corporate veil and
3 treat TSC of Texas and Tractor Supply as one in
4 the same?

5 A: Well, the short answer is, I don't recall
6 whether there's any specific corporate veil
7 piercing language. The part I'm -- so, I would
8 expect there's not. I don't recall ever seeing
9 that term in there. I think there's a
10 different question with regard to, kind of, a
11 consolidation of transaction among entities,
12 where there are instances in which entities
13 involving different ent- -- different related
14 parties can be consolidated, but at the end of
15 the day, you're not necessarily disregarding
16 the legal existence of a, of a specific legal
17 entity ---

18 Q: Okay.

19 A: --- the way you would in a sham transaction-
20 type theory, for ---

21 Q: Okay.

22 A: --- example.

23 Q: And I assume your answers will be the same if
24 I asked you about TSC of Michigan ---

25 A: Yes.



1 Q: --- as TSC of Texas? Okay.

2 A: Maybe -- I should say, the one -- you know, I
3 haven't really looked at that many entities
4 like Michigan, where it -- where all the
5 employees are located in a different -- or are
6 employed differently. So the facts here are
7 very different than I've ever seen in an
8 international context.

9 Q: Well, the question was the law, not the, not
10 the facts. The question was whether there's
11 anything in the Regulations that would allow
12 you?

13 A: Correct. But, I -- I guess, the -- there is a
14 -- well, there's a substantial discussion in,
15 I believe, it's -- I don't know if it's in the
16 Regulations or more in the commentary about the
17 Regulations, about so-called empty boxes, i.e.,
18 companies that are set up so that they just --
19 they don't have people in them, they don't have
20 assets in them -- or they do or don't, so ---

21 Q: Are you saying TSC of Michigan doesn't have
22 people in it?

23 A: It does not have people in it. It has --
24 Michigan has assets, it doesn't have people.
25 As I understand it, all of the employees are



1 part of ---

2 Q: Are being leased to it.

3 A: Being leased to it, correct, from, from TSC.
4 And that's not a, a fact pattern that I would
5 see in an international context, whereas --
6 that's why I'm trying to con- -- I'm ---

7 Q: Okay.

8 A: --- sorry. I'm just trying to piece together
9 the parts in the regs that reference other
10 types of entities that don't have people. But,
11 I guess, the bottom line is, I, I don't think
12 there's anything that I can think of off the
13 top of my head in the §482 Regs that would call
14 for one to disregard an entity like Michigan,
15 if Michigan were a -- in a, a cross-border
16 transaction.

17 Q: Okay. Which -- and it -- you would agree that
18 it does own and operate retail stores in
19 Michigan?

20 A: Correct.

21 Q: Okay.

22 A: It owns those retail -- those assets. And, I
23 guess, ultimately, it operates them, although
24 the people that it leases are the ones that I
25 would think actually operate them, but.



1 Q: All right. And you would agree that TSC of
2 Texas was formed in 2001 and that it exists
3 today, and is an existing legal entity?

4 A: That's my understanding.

5 Q: Okay. And you would agree that it has owned
6 retail stores and trademarks since 2001?

7 A: Correct.

8 Q: Okay. And TSC of Michigan, would you agree,
9 that it was formed in 2001, that it still
10 exists today, and that it is an existing legal
11 entity?

12 A: I'm sorry, TSC or TSC of Michigan?

13 Q: Sorry. TSC of Michigan.

14 A: Correct.

15 Q: Okay.

16 A: That's my understanding, at least.

17 Q: Okay. All right. And that it has owned retail
18 stores since 2001?

19 A: Correct.

20 Q: All right. So, I think you agreed with -- you
21 agreed with me a minute ago that there was no
22 -- nothing in the Regulations that allows you
23 to disregard the occurrence of the 2001
24 restructuring. Are there any economic
25 principles outside of the Regulations that



1 you're relying on to disregard this 2001
2 restructuring?

3 A: I'm not disregarding the 2001 restructuring.

4 Q: Okay. So you believe it happened?

5 A: Correct. It's a ---

6 Q: Okay.

7 A: It was implemented by the company. I'm not
8 challenging the fact that the company
9 implemented a restructuring and created those
10 legal entities at that time.

11 Q: Okay. All right. And would you agree that
12 there's no economic principle outside the regs
13 that would allow you to disregard the separate
14 legal existence of the three entities?

15 A: Correct. I -- it's a -- ultimately, that's a,
16 a legal issue.

17 Q: Okay. Now, if I transfer assets to an entity
18 and I take back an ownership interest in that
19 entity, would you say, from an economic
20 perspective, that I have gifted those assets to
21 that entity, or would you say I've exchanged
22 them for an interest in that entity?

23 A: Generally, I would say you've exchanged it for
24 an interest in that entity.

25 Q: And so, why, in this case, do you keep saying



1 that Tractor Supply has gifted its assets to
2 other entities?

3 A: So, so whether it was -- I haven't seen the
4 exact form in which those org- -- those company
5 organization documents occurred, i.e., whether
6 there was a -- it was part of the capital
7 contribution or simply a nominal assignment.
8 So, at the end of the da- -- I could, I could
9 see it being one of -- either way, either way
10 but the bottom line is that I, as an economist,
11 I'm looking to see whether there was any
12 compensation paid to TSC, some explicit
13 compensation that would then justify a future
14 royalty payment by TSC -- to the parent company
15 back to TSCT. So this is typically how you see
16 transactions in an international context, if
17 you're going to move a patent portfolio or
18 potentially, I guess, a brand intangible
19 overseas, there will be a -- often referred to
20 as a buy-in payment, or a, kind of, a payment
21 for the asset itself from one entity to the
22 other. And then the other entity that
23 previously owned it may license it back, and
24 actually might be -- might enter it into a
25 license with the related party to whom it



1 previously sold the asset, and then pay a
2 royalty. So that's typically where, where the
3 transfer pricing analysis comes in, is to
4 evaluate both the consideration paid for the
5 asset, as well as the -- from the initial
6 transfer and then the royalty that's paid back.
7 Here, I don't observe that set of
8 circumstances.

9 Q: So, if TSC puts its assets in Texas -- so this
10 transaction, you under- -- is your
11 understanding that it all happened in 2001 at
12 the same time?

13 A: That's correct.

14 Q: Okay. All right. So, if at that time, TSC
15 puts its assets -- puts some of its assets into
16 TSC of Texas and it gets a interest -- a one
17 percent interest back, but at the same time,
18 Michigan is created and it gets a 100 percent
19 interest in Michigan, has it not received value
20 in the form of ownership from its contributions
21 to the other entities?

22 A: Well, as the ultimate parent company, its own-
23 -- it owns everything, right.

24 Q: Right.

25 A: So, I think there is a distinction between what



1 happens down below as a shareholder and
2 shareholder returns and, kind of, the returns
3 of dividends, versus what happens up above in
4 more of an operating level -- or the operating
5 income level. So that's where the, kind of,
6 these asset transfers and royalty arrangements
7 that you observe in international transactions,
8 they're happ- -- even though these are related
9 parties often owned by the same company, that
10 if there's going to be related party contracts
11 that impact, the operations, those are the ones
12 that need to have this consistent payment of a
13 -- (coughing) -- excuse me, of an upfront
14 payment for the asset, and then a continuing
15 royalty payment that is -- that would be no
16 higher -- that would have to be consistent with
17 that upfront payment. You can't have a
18 structure where a U.S. subsidiary just simply
19 grants a valuable patent to a Cayman Islands
20 company and then starts paying massive
21 royalties, even if that asset is really, really
22 valuable, you can't do that simply because it
23 owns that Cayman Islands company and that -- it
24 -- it's making a capital contribution and then
25 receiving something in return, namely, an

1 ownership interest in that capital con- -- in
2 that, in that company.

3 Q: Okay.

4 A: The -- I think that type of transaction would
5 be challenged in a heartbeat as resulting in
6 deductions from U.S. income for those royalty
7 payments that would be inconsistent with the
8 arm's length standard. So, that's where I
9 think there is a, a sense in which you can have
10 a contribution of an asset, of any kind of
11 asset by an owner, in return for an ownership
12 interest, and for dividends that you receive,
13 but I think -- and it's, it's really important
14 not to confound that with the implications that
15 it has for the transfer prices at an operating
16 level. It doesn't imply that contribution of
17 that, of that -- whether it's a gift, i.e., it
18 was never -- there was no compensa- -- it was
19 actually one of these transaction where it's
20 literally, here's an assignment, we're
21 assigning this asset for no compensation ---

22 Q: Right.

23 A: --- a structure I've seen in my other work, or
24 for nominal consideration versus an actual
25 contribution of, like a contribution of



1 capital. You know, either way, you can't
2 simply say, okay, because the parent company
3 contributed, now the parent company needs to be
4 bound -- or would be bound in arm's length
5 parties to an arm -- above arm's length
6 procurement agreement with this same related
7 party. And furthermore, that it, that it would
8 owe some compensation for the very asset that
9 it just contributed. So that's the part -- at
10 an operating level ---

11 Q: Okay.

12 A: --- through -- in a way that cre- -- that would
13 create a deduction for tax purpose. That's the
14 part where it kind of veers off the rail
15 really, really quickly.

16 Q: But you haven't seen the underlying facts of
17 this transaction to know, one way or the other,
18 what happened here?

19 A: So, I have not seen anything in the documents
20 that I've reviewed in the restructuring
21 documents I reviewed, that talked about how
22 the, the -- whether that was treated as a
23 contribution of capital ---

24 Q: Okay.

25 A: Whether that, meaning, the licens- -- whether



1 the -- any intangibles were considered as a
2 contribution of capital, whether it was
3 assigned for zero value, i.e., it was simply,
4 either asserted or simply assigned or, kind of
5 -- it just pops up in a licensing transaction
6 that says it's hereby property of Texas ---

7 Q: Right.

8 A: Or whether it was done that way, or whether it
9 was actually through a formal contribution, it
10 wouldn't change my opinion, namely, that at
11 arm's length parties that TSCT -- TSC, the
12 original owner of the asset, wouldn't obligate
13 itself to, effectively, a liability, either an
14 obligation to pay a royalty payment or an
15 obligation to make -- to stay in a procurement
16 arrangement or to stay in the -- particularly,
17 a procurement arrangement with an above arm's
18 length price as a result of that transfer.
19 That's inconsistent with the company's
20 available alternatives at the time.

21 Q: You said in your testimony that, I'm gonna call
22 it CUE, but I think you know I'm referring to
23 consumables, usables and edibles?

24 A: Yes.

25 Q: Okay. You said in your testimony that CUE,



1 which is kind of the bread and butter items
2 like dog food, is really what's bringing people
3 in the stores.

4 A: That -- that's my understanding. That they're
5 ---

6 Q: Okay.

7 A: That -- I should say it, maybe, more broadly.
8 It's -- what's bringing ---

9 Q: It's one of the things that's bringing people
10 in the stores?

11 A: Correct. It is important ---

12 Q: Yeah.

13 A: It's an important part of what keeps people
14 coming back. And these are large, fairly
15 bulky, bulky products, yes.

16 Q: Okay. And I think you also said that the mix
17 of products that are in the stores is also
18 keeping customers returning?

19 A: That's correct.

20 Q: Okay. And which entity is in charge of those
21 two functions?

22 A: Those two functions. I think, you're talking
23 about -- in terms of the procurement function,
24 with regard to procuring the individual items
25 that are being sold, is going to be within that



1 procure- -- the individuals in Tennessee that
2 are employed by Texas.

3 Q: Okay.

4 A: The -- I think it's broadly a reflection of the
5 company's broader corporate strategy, which I,
6 I think is a, pretty much, a shared
7 responsibility among the executive team and,
8 probably, a wide variety of individuals in the
9 firm. The specific mix -- so, it's a --
10 basically, there's a broader format question,
11 right, that says what kind of company -- if
12 you're gonna be a retailer, let's call it
13 Tractor Supply, what kind of products are we
14 gonna be selling, what's our general format,
15 are we gonna be a big box store, or a medium
16 box store? So a lot of these are high level
17 executive decisions about corporate strategy.

18 So those, I think, a lot of those strategy
19 decisions are at a paygrade above the
20 individuals who are in the procurement
21 functions itself. The people who are actually
22 negotiating the contracts with the vendors.

23 There's a -- then, you have a lot of
24 detailed questions that flow from that. Once
25 you define the format the product -- the



1 general product mix, you're going to be
2 providing this CUE type of category plus the
3 clothing and the hardware, they're -- at some
4 point, you are -- you do get into the nitty-
5 gritty of, somebody's gotta execute the
6 contracts with vendors, you have to identify
7 con- -- vendors, you gotta execute those
8 contracts, those are going to be the
9 procurement folks. There are other people in
10 the firm who are gonna be responsible for the
11 display of those products, or the specific
12 layout. So again, these are other functions
13 that appear to be, generally, what I would
14 consider a -- popping up on the, the Tennessee
15 side -- I'm sorry, on the, the corporate parent
16 side of the headquarters ---

17 Q: Uh-huh.

18 A: --- but because they have the word
19 merchandising in the title of some of the
20 employees in -- that are doing procurement, I'm
21 not sure how much of this is a shared
22 responsibility among them.

23 Q: Okay.

24 A: But there's a, kind of, a broader range of
25 things that go into deciding strategy and then

1 getting the product, and then shipping and
2 monitoring it, and that -- then you've got
3 inventory people and local store people, as
4 well ---

5 Q: Right.

6 A: --- who have a certain amount of discretion
7 about their -- and regional managers who have
8 discretion, as well.

9 Q: Okay. Well, I'm not gonna make you speculate
10 as to who's doing what because we have a
11 witness later that's gonna tell us all about
12 that. So, that's -- your answer is perfectly
13 good, for now.

14 A: I would say, I wasn't speculating so much as I
15 was referring back to the documents I reviewed,
16 including the, the -- not just the descriptions
17 that PwC provided of those functions, but also
18 the individual employment records and their --
19 and the job descriptions.

20 Q: Okay. Well, that's fair enough. I was mainly
21 trying to refer to the fact that you thought
22 that there was some shared responsibilities and
23 I wasn't gonna make you speculate as to how
24 it's shared. And that we'll get some
25 information on that later.



1 All right ---

2 A: I -- even that, I would still say, there was
3 information that I've seen in the documents
4 that refer to a sharing of responsibility, but
5 I'll ---

6 Q: Okay.

7 A: --- leave it ---

8 Q: Okay.

9 A: I don't wanna fight you on it ---

10 Q: No, no, no. Yeah ---

11 A: I'm just saying, there is a different factual
12 basis that I have for that statement.

13 Q: Well, maybe, maybe I will. And I'll, I'll just
14 ask you some specifics and then you can tell me
15 if you know which one -- which entity, and if
16 you don't know, you can just say you don't
17 know.

18 A: Sure.

19 Q: All right. So, which -- and just for being
20 more concise, instead of talking about
21 employees each time, we're just gonna say which
22 entity, which entity is performing the
23 following tasks, so ---

24 A: Okay.

25 Q: --- I would mean the employees in the -- each



1 of those entities performing those tasks. Is
2 that ---

3 A: Correct.

4 Q: --- fair? Okay.

5 All right. Which entity is following the
6 trends and styles and looking for new products,
7 and determining the types, brands, amounts of
8 products for the stores?

9 A: That's a pretty broad categorization. I would
10 say it's a shared responsibility. I would say
11 the procurement people have a -- that's
12 probably a significant part of what they do,
13 but I think there's also a fair amount that
14 occurs on the TSC side of, side of the business
15 as well.

16 Q: And what, what side of the -- when you talk
17 about TSC, which parts are you saying are
18 performed by TSC?

19 A: I would say lar- -- I'm sorry, you packed it a
20 lot there. I would say, primarily, I'm
21 thinking of it as a headquarters' function.

22 Q: Okay.

23 A: It -- there may be a -- I know their -- I think
24 their regional manager's as well. And so --
25 and I know there is a process of localization



1 for some of the stores. So there is a, a
2 difference in the, in the stock, the inventory
3 carried by, carried by different stores ---

4 Q: Got to my next bullet point. Who's doing that
5 product localization?

6 A: So, I would say it's, again, probably a mix --
7 or, I just meant, probably -- based on the
8 information I've reviewed, it appears to be a
9 mix.

10 Q: Okay.

11 A: But there is significant activity, or at least,
12 I -- this is -- some of it I'm -- in terms of
13 the level of significance, I'm basing some of
14 this based on the 30(b)(6) witness' testimony.

15 Q: Right.

16 A: So there appears to be some significant amount
17 that the procurement folks do. Based on the
18 other information that I've reviewed, I would
19 expect there also to be some amount that's also
20 done by the planning people, the planogram
21 people, so these are people that are going to
22 be on the TSC side of the business, by the
23 executive folks. Probably, not -- the
24 executives probably wouldn't get into too much
25 level of detail, I would think, they're



1 supervising the work of others.

2 Q: Right.

3 A: But, it -- and I would think there would be
4 some level of input, at least, or involvement
5 by the regional managers, and maybe even the
6 store managers. There is -- to some extent,
7 it's also derived from data that's being pulled
8 -- their -- the company's made significant
9 investments in data infrastructure, collecting
10 data on consumer -- kind of, like consumer
11 buying patterns through like the neighbor --
12 their, their customer loyalty program, but also
13 in terms of what stock moves. All that data
14 infra- -- infrastructure and a lot of that data
15 analysis happens on the TSC side of the house,
16 even though I've -- I understand there are
17 people within the procurement function that
18 also have a data title, and so there is a, I
19 would say, a shared data analysis function.

20 Q: All right.

21 A: So with regard to assessing, like you've said,
22 regional changes or differences, a lot of
23 that's going to be a function of that broader
24 data -- infrastructure/data analysis, which is
25 going to be shared -- the analysis is gonna be



1 a shared responsibility. The infrastructure is
2 definitely going to be a TSC side of the house
3 activity.

4 Q: Okay. So reviewing that data, which entity do
5 you believe is looking at the skew level
6 detailed data and evaluating it, and trying to
7 decide what product mix to get? Which
8 employees do you think are actually reviewing
9 and analyzing the data?

10 A: Based on my review of the job descriptions, it
11 would appear that there are people on both
12 sides that are doing it ---

13 Q: Okay.

14 A: --- i.e, doing that review and ana- -- analysis
15 of the data of ---

16 Q: Okay.

17 A: --- inventory data, of -- you actually need it
18 to perform an inventory. So you've got the
19 people who are doing the inventory and
20 distribution, and those are largely people who
21 are, kind of, managing that physical inventory.
22 And that -- and the distribution in the
23 warehouses, those are all in the TSC side of
24 the house. There are -- the people who
25 ultimately are choosing which things to buy ---



1 Q: Yeah.

2 A: --- those are gonna be people on the
3 procurement side, that's what ---

4 Q: Okay.

5 A: --- procurement does.

6 Q: Right. All right.

7 A: And I -- but I would say, ultimately, they're
8 reporting up to Mr. Barbarick, who is on the
9 TSC side of the house.

10 Q: Okay. And who would be -- which entity would
11 be determining the volume at the -- inventory
12 for each store?

13 A: Well, again, I would consider that to be a
14 shared responsibility. There's a strategic
15 issue, in terms of how much inventory,
16 generally, you would wanna have on-hand.
17 There's a, kind of, a finance function, a CFL
18 function that goes into that. There is a
19 inventory management/distribution function that
20 goes into that. This -- that's all on the TSC
21 side of the house. And there's also, I would
22 expect, going to be some involvement by the
23 procurement individuals because those are the
24 ones who are, who are, I would assume, are
25 entering in the specific purchase orders for a



1 specific quantity from a vendor.

2 Q: What about who's evaluating and analyzing how
3 products interact and like making decisions,
4 like, if you have this product, it's gonna go
5 well with this product, and you wanna make sure
6 you have this product if you've got this one,
7 that kind of decision, who's looking at that
8 data and figuring that out?

9 A: So, in general, I -- my understanding based on
10 the documents I've reviewed, is that there is
11 -- that it is largely a procurement function on
12 the Texas side of the house.

13 Q: Okay.

14 A: Although, I still think that there's a lot of
15 integration of that with the things that are
16 being done on the TSC side of the house with
17 regard to, like I said, strategy issues, and a
18 lot -- broader strategy issues, planning,
19 there's -- like I said, even just the physical
20 placement of the product. So there are people
21 whose job is to implement a particular
22 planogram in a -- i.e., you have to have
23 Product A next to Product B on the shelf. So,
24 that -- I would -- I think that occurs on the
25 TSC side of the, the house, so.



1 Q: What about who's responsible for tailoring the
2 inventory to the geographic location of each
3 store? And, just as an example, you know, you
4 might want more snow blowers and generators in
5 Colorado, where it's cold, and you might want
6 some beekeeping stuff in Oregon, where that's
7 popular. That type of thing. Who would be
8 responsible for that?

9 A: So based on the testimony of the 30(b)(6)
10 witness, I -- it sounded like that was a
11 respon- -- a responsibility of the procurement
12 folks of Texas. But based on, kind of --
13 again, my analysis of the, kind of, the
14 employment records and the job descriptions, I
15 would consider it more of a shared
16 responsibility, simply because there is -- like
17 I said, first you have to have that data
18 infrastructure, people are analyzing that data
19 to see what com- -- which products are doing
20 well in a particular location, versus not. So
21 there's a broader analysis function. There's
22 a CFO function somewhere embedded in there.
23 So, I think, ultimately, that's why I think the
24 -- at the end of the day, so many of these are
25 highly integrated ---

1 Q: Right.

2 A: --- type of activities, even if the day-to-day
3 responsibility for saying, I want to buy 3000
4 snow blowers for this particular store, may
5 well rest with the procurement individual.

6 Q: And I thought you agreed with me earlier, that
7 the data analysis itself was primarily
8 procurement.

9 A: No, I said I saw data analysis throughout the
10 company. I thi- -- I expect there, there is a
11 lot of data analysis of -- in -- at the -- on
12 the procurement side ---

13 Q: Okay.

14 A: --- in Texas. I think I even observe a, a job
15 title. And I observe other people on the TSC
16 side of the house that appear to have similar
17 responsibilities for data analysis, all the way
18 up to the CFO, obviously.

19 Q: Okay. And what about developing the exclusive
20 brands, which entity is responsible for that?

21 A: So, to be, to be clear, the exclusive brands
22 are something the company has had since before
23 the restructuring, since 2000. So it's not a
24 new development. So many of those brands are
25 long-lived brands. So those have -- would have



1 been developed initially, or at least a
2 significant number of them would've been
3 developed initially by TSC.

4 Q: How many were developed already at the time of
5 the restructure?

6 A: I believe something like -- well, it was -- I'm
7 looking at the -- I was looking at the 10-K,
8 and I believe it was something like seven,
9 eight. I'm not quite sure. It was a -- not
10 insignificant number. The 10-K talked about
11 the extensive sale of, what's called private
12 label products. It's not unusual at all in the
13 retail industry for retailers to have their own
14 brands that they sell to customers. They
15 generally can make higher margins on those
16 because they're selling it at a little bit of
17 a discount to the national brand. In fact,
18 that's what the *Perrigo* case was all about.
19 So, so there was a significant amount of that
20 that was being done back in 2000 and 2001 by
21 TSC. Then, as we moved to the years at issue,
22 that's a function that went over to Texas as
23 part of the -- that procurement function embeds
24 some folks who are responsible for product
25 development, which is largely -- not R&D, or

1 engineering the way you might think of with the
2 word product development, but as I understand,
3 it is largely working with vendors to make
4 private level -- label versions or their own --
5 I should say, their own branded versions of
6 other products available from national
7 manufacturers.

8 Q: And is it your understanding -- you know, there
9 can be different levels of private label, label
10 and some people might, you know, get a vendor
11 to get them a, you know, a jar of something and
12 just put their -- slap their label on it, so
13 it's just the label that's it. And then,
14 another situation might be more like design and
15 development and, you know, actually create
16 something new, and put their label on it.
17 Which is your understanding of the situation
18 with Tractor Supply's private -- exclusive
19 brands?

20 A: Well, there is some -- I would say, my general
21 understanding is that it would likely be a mix
22 of the two. I know that they do their ow- --
23 based on my review of the information, there
24 was an indication that they do work on product
25 development, i.e., if there's a particular



1 product that's not quite meeting the needs of
2 their customers, they -- and they have an
3 engineer on staff, one engineer, who -- or I
4 would assume, then -- or I could conclude, that
5 they are involved in a product design element.
6 There's reference in the 10-Ks to private
7 label. Private label does generally tend to be
8 one of, almost, a me too product, but I
9 shouldn't -- I wouldn't underestimate the work
10 that other companies do, or even that Tractor
11 Supply goes -- undergoes, with regard to those
12 products that are repackaged or reformulated --
13 I don't wanna say copies, but reformulated
14 types of products of the national brand.
15 Again, the whole *Perrigo* case was about the
16 sale of private label store brand products.
17 And there's a lot that goes into the marketing,
18 the design, the pricing of those products.

19 Q: It can be very valuable.

20 A: It can -- they'll -- they can be very -- they,
21 they generally contribute a lot to a company's
22 bottom line because of the higher price -- the
23 higher margins that the, that the retailers can
24 earn because they can price a little bit
25 underneath the national brand and they're

1 procuring it from manufacturers at less than
2 what a national brand would sell them at. So,
3 there -- I would expect there to be involvement
4 of the marketing people, this is a, is a
5 marketing function, i.e., how do we advertise
6 our in-house brands? You know, the, the era of
7 the true generic, I think, has long since
8 passed, where you had -- literally, had -- I
9 don't know if you remember the generic beer
10 brand, it was literally a white can with a
11 black label ---

12 Q: I do not remember ---

13 A: --- proudly ---

14 Q: --- that (laughter).

15 A: It proudly said, generic beer, back in the day.
16 And this is -- okay, I'm dating myself
17 (laughter). Might've been in the '70s, before
18 I was at the legal age.

19 Q: (Laughter.)

20 A: But the -- increasingly, the -- all retailers
21 go these days with, what they would call store
22 brands. So they have their specific branding,
23 which is a -- heavily an advertising function.
24 And also -- and a -- literally a placement
25 function in the store. You wanna place it



1 right next to the national brands so that
2 customers see that they have a choice, and more
3 price-sensitive customers -- or customers that
4 have done more of their own homework, will
5 choose the cheaper than -- the cheaper product
6 than going with the national brand.

7 Q: Right. And did you say you did or did not know
8 what percentage of Tractor Supply's exclusive
9 brands are the slap-on label model versus the
10 design and develop model?

11 A: So, I wouldn't characterize any of it as slap-
12 on label, but in terms of -- but I, I would
13 say, in terms of the design develop intellect
14 ---

15 Q: Right.

16 A: --- label versus the more packaging, re-
17 branding, of a ---

18 Q: Right.

19 A: --- of something that they can buy from a
20 manufacturer as opposed to a national
21 manufacturer from their own manufacturing
22 relationship ---

23 Q: Yes.

24 A: I don't.

25 Q: Okay. All right. You've mentioned Li and



1 Fung. I feel like that's the main name I
2 remember in this case. Li and Fung, I wanna,
3 I wanna ask you if my understanding of what
4 they do is correct. Are they -- do they go in
5 -- like, would I go to them and say, I have a
6 business, I need -- I've run out of women's
7 clothing, I need some more women's clothing in
8 my shop and here's the, you know, price point
9 I wanna hit, and here's the type of clothing I
10 want to have in there, the style, and here's,
11 you know, the volume that I need. And then,
12 they will go out and find vendors and source
13 those items for me?

14 A: Generally. It wouldn't simply -- it would not
15 be simply the scenario in which you run out of
16 stock. Li ---

17 Q: No, no. I'm talking about, like, you know, I
18 was creating a business -- or maybe I was
19 running out of stock, but -- I think I did say
20 running out of stock, actually (laughter).

21 All right. So, you just elaborate on
22 that.

23 A: So, I -- the short answer is yes.

24 Q: Yeah.

25 A: That would be the type of company you would go



1 to, but this is a company that large retailers
2 often rely on ---

3 Q: Okay.

4 A: --- to source a lot of their, their products
5 that -- the products that are manufactured
6 overseas. Generally, it's going to be apparel
7 focused.

8 Q: Okay.

9 A: That's where a lot of the, kind of, the
10 outsourcing model has kind of gravitated.

11 Q: Okay.

12 A: Although, there -- I, I expect it also pops up
13 in other types of manufactured products.

14 Q: So my example is bad because it sounded like a
15 one-time thing. You're saying people would
16 typically use them for repeat help?

17 A: Correct. And, and in large volumes. It's not
18 just a, kind of, a -- an individual starting up
19 a new business, or an individual that has a
20 difficulty. You have large, multinational
21 retailers that rely on Li and Fung, or
22 companies like Li and Fung ---

23 Q: Right.

24 A: --- for substantial amounts of there purchases,
25 even though those retailers also have a --



1 their own in-house procurement function, they
2 still go to Li and Fung because -- both,
3 because Li and Fung has their relationships
4 with manufacturers ---

5 Q: Right.

6 A: --- many of whom are in Mainland China. And it
7 also has a fairly sophisticated in-house design
8 capabilities as well, it's not simply a, a
9 middleman as it were, in that arrangement.

10 Q: And have they always had that design
11 capability, or is that something that developed
12 over time? How, how long have they been
13 around?

14 A: Well, the first time I analyzed them was back
15 in the late '90s ---

16 Q: Okay.

17 A: --- or, I would say, it was while I was at KPMG
18 so it was probably '97. So they were in
19 business then and they were publicly traded, so
20 they were a sizable business at the time. I
21 believe they had a design capability back then,
22 but it's -- just because I recall there being
23 -- they were never simply, kind of, the
24 middleman.

25 Q: Okay.



1 A: They were, they were a -- more of a, kind of,
2 a full service procurement slash broader
3 service company. As you'd expect a company in
4 that situation.

5 Q: And they're in Southeast Asia, is that right?

6 A: I believe their headquartered in Hong Kong.

7 Q: Okay.

8 A: But they are -- I think they have offices
9 throughout Southeast Asia. They're, they're a
10 very large company.

11 Q: And I think you agreed with me that that would
12 not be ideal to have your comps be a Southeast
13 Asia company versus a U.S. company. Can you
14 elaborate on that?

15 A: Well, I mean, it could be, it depends -- it's
16 all a facts and circumstances issue, right.
17 Their -- it depends on the function you are
18 trying to benchmark and if your -- if the, kind
19 of, the best comparables you have, from a
20 functional perspective, or even a product
21 perspective, are overseas companies, then it's
22 reasonable to use those. I think there are --
23 you know, generally, if you're benchmarking a
24 U.S. function -- or a function performed by a,
25 by a U.S. company, you'll look to U.S.



1 comparables, or particularly for something like
2 procurement. And a company that is -- and I'll
3 say at first, heavily reliant on imports like
4 Tractor Supply, it is, I think, reasonable to
5 focus on Asian procurement companies. And I
6 realize when I say that, that's -- is a
7 difference in, kind of, how I have seen the,
8 kind of, the information and what the 30(b)(6)
9 witness testified through -- are the fraction
10 of imports.

11 But, nonetheless, it's -- I -- the
12 information I've reviewed suggests that there's
13 actually a fairly substantial amount of imports
14 that they rely on.

15 Q: Okay.

16 *(Whispering.)*

17 **MS. GEER:** (To the Court) My apologies.

18 Q: All right. I wanna ask you about the
19 comparable profits method. And I wanna talk
20 about the tested party issue.

21 So, if you've got two related entities
22 with an intercompany transaction and you wanna
23 price it, and -- my understanding is you wanna
24 look at the routine versus the non-routine
25 business activities among the related parties.

1 Is that one of the steps in the comparable
2 profits method?

3 A: Just to avoid giving you a very long answer ---

4 Q: Yeah.

5 A: I would say, generally, you're on the right
6 track.

7 Q: Okay. Okay. I'm gonna keep -- I have some
8 follow-ups so you can clarify ---

9 A: Okay.

10 Q: --- as we go along. And is it the purpose of
11 looking at those routine and non-routine
12 business activities to try to figure out which
13 party should be the tested party?

14 A: Correct. That's part of the analysis ---

15 Q: Okay.

16 A: It's not gonna be the, the end, but generally
17 you will go to -- gravitate towards the, the
18 party that performs, kind of, a more narrow
19 range of functions -- a range of functions that
20 are easier to benchmark ---

21 Q: Right.

22 A: --- relative to another one, particularly, if
23 there are intangibles involved. And, maybe,
24 that's were this issue of routine versus non-
25 routine crops up.



1 Q: Right.

2 A: So if a company is contributing a lot of
3 intangible assets -- so you'll generally pick
4 the party that is -- does not have intangible
5 assets and that is doing that benchmarkable
6 function.

7 Q: Okay. And is the reason that you're wanting to
8 pick the least complex party and not the most
9 complex is because, if you've got an entity
10 that's performing more unique things, it's
11 harder to find comparables that match-up with
12 that without having to like, take a bunch of
13 comparables out that don't have that same
14 unique piece?

15 A: Again, I would say ---

16 Q: Or a more complex -- sorry.

17 A: I would say, generally, that's correct.

18 Q: Okay.

19 A: I would say -- yes. I'll just leave it at
20 that. There's a -- there's language -- very
21 explicit language in the §482 Regulations that
22 talk about this notion of, you know,
23 reliability and the need for the comparables to
24 really be reliable ---

25 Q: Right.



1 A: --- even in applying the method.

2 Q: Right.

3 A: So if you can't reliably benchmark a company,
4 CPM may not be the best

5 Q: Okay.

6 A: Even, even if that tested party shows it is the
7 simpler of the two parties.

8 Q: And does the IRS or the regs require you to use
9 the simpler party as the tested party, or is
10 there an occasion where you're authorized to
11 use the more complex party?

12 A: Again, you're testing my memory on the, the
13 specific language. I would say, that would be
14 the default, that's generally the guidance.

15 Q: Okay.

16 A: But I -- I'm sure there are -- ultimately, the
17 broader catchall language that the regs talk
18 to, is about the reliability of the results.
19 So you really just wanna get a reliable answer
20 of what the arm's length result is going to be.
21 So there's a fair amount of digression that the
22 regs, I think, actually provide someone in
23 doing that.

24 Q: You mentioned the Neighbor's Club and, I think,
25 we were talking about the value that a



1 Neighbor's Club, which is a loyalty program,
2 would bring. Do you remember that testimony?

3 A: Yes, I do.

4 Q: Okay. Once a company starts that type of
5 loyalty program, is the value in it related
6 primarily to the valuable feedback that you get
7 from customers and that you can then figure
8 out, what are they buying, what are they
9 interested in, and being able to track their
10 purchases and help you in making future
11 decisions, and also that you're getting some
12 customer loyalty? Are there, are there any
13 other reasons beyond those?

14 A: Sure. I think there's a, kind of, a name
15 recognition factor ---

16 Q: Okay.

17 A: --- that happens every day.

18 Q: Yeah.

19 A: I, I get e-mails every day from the Neighbor's
20 Club ---

21 Q: Yeah.

22 A: I went into a Tractor Supply and I signed up
23 for their program, and every day I get that,
24 that e-mail and it tells me the things that
25 they -- that are on sale, or that I might wanna



1 buy.

2 Q: So, we have ---

3 A: I think that ---

4 Q: --- a loyal customer testifying against them?

5 *(Laughter.)*

6 A: I, I wouldn't say I'm necessarily a loyal
7 customer. I said -- I did sign up for their
8 program, so I have a sense of how it works, and
9 for the frequency of the communication.

10 Q: Okay.

11 A: And I -- 'cause I was interested in the
12 frequency of the communication. And I think
13 that does have a -- an impact on consumer
14 behavior.

15 Q: Okay.

16 A: So, it's more than simply collecting data about
17 purchases, but it's also about that constant
18 nagging reminder that says, oh, you -- you're
19 out of dog food, or you're out of horse feed --
20 -

21 Q: Right.

22 A: --- why don't, why don't I go to Tractor Supply
23 ---

24 Q: You get ---

25 A: --- because I remembered then ---



1 Q: --- \$10 off.

2 A: Indeed. Yes.

3 Q: Yeah. Okay. All right.

4 And so, if I -- if a company starts a
5 loyalty program, how long does it take once
6 you've rolled it out for you to start seeing
7 the benefits of that in a financially
8 meaningful way? I assume there's some lag
9 time.

10 A: Generally, but I think in a, a program like
11 that, I think, it's pretty quick.

12 Q: Okay.

13 A: In terms of -- I've done other work on loyalty
14 programs for a retailer, and -- so this was in
15 the context of a -- I think I can -- yeah, I
16 can talk about it without talking ---

17 Q: All right.

18 A: --- about the taxpayer. So this is about the
19 use of credit card programs.

20 Q: Yeah.

21 A: And credit card programs, retail -- retailers
22 will often issue their own brand in credit
23 cards, and those have a phenomenal ROI, or at
24 least, for the -- my analysis, in terms of --
25 it will get people to spend a lot more money,



1 very quickly, even within that first year of
2 issuance.

3 Q: Is there a credit card in this situation?

4 A: No, but if -- well, I'm not -- I don't know if
5 Tractor Supply has it's own branded credit
6 card. But I, I put it in the same bucket of
7 the -- of a consumer loyalty programs. These
8 things that are done to, to give that, that
9 customer a sense of connection and a way of
10 communicating, and a way of hearing that
11 they're still there in ways that often you
12 can't get through print media. So, doing
13 circular, circular advertising in newspapers,
14 those -- the newspapers are -- circulations
15 have dropped a lot. Internet advertising is a
16 bit of a shot in the dark. So, I think the
17 programs like their -- the loyalty program are
18 very effective in instantly developing that
19 communication channel with the customer in ways
20 that -- I think there are very few alternatives
21 of -- like I said, either credit card programs
22 or points-type or rewards programs, or simply,
23 a we're gonna let you know what's on sale
24 tomorrow.

25 Q: All right. So, I can -- I'll go at it again,



1 in similar granular detail. I'm assuming that
2 means you don't have, like an estimate of how
3 long it would take to get to sub- --
4 substantial financial returns on that program?

5 A: Well, I think the financial returns are pretty
6 much immediate, as soon as they start rolling
7 it out. And I think there were some
8 discussions during the years at issue about the
9 importance of that neighbor's club program. It
10 was in some of the analy- -- you know, the
11 analyst reports ---

12 Q: I don't ---

13 A: --- or the company ---

14 Q: Hold on.

15 A: I'm sorry.

16 Q: Those did not come into evidence.

17 **MS. WOOTEN:** Your Honor, he's allowed to rely on
18 evidence ---

19 **THE COURT:** Yeah.

20 **MS. GEER:** Oh, yeah, yeah.

21 **MS. WOOTEN:** --- that's not in ---

22 **MS. GEER:** You're right.

23 **THE COURT:** You're asking him about it ---

24 **MS. GEER:** I'm wrong.

25 **THE COURT:** --- he can ---



1 **MS. GEER:** I apologize. I'm wrong. You are allowed
2 to rely on those.

3 A: So, so that there references to those ---

4 Q: Yeah.

5 A: --- either in the analyst reports or the ---

6 Q: Yeah.

7 A: --- company's statements about the Neighbor's
8 program -- the ---

9 Q: Yeah.

10 A: --- Neighbor's Club Program. I believe, it was
11 also mentioned in the company's 10-K, at some
12 point.

13 Q: Yep.

14 A: So, that's why -- I think there's a question
15 of, during the years at issue ---

16 Q: Yeah.

17 A: --- is this -- appear to be an important
18 initiative? I think the answer for me as an
19 economist, is yes, it's an important
20 initiative.

21 Q: Yes.

22 A: There's a different question, which is, did it
23 actually provide traction to the company, did
24 the company get benefits during the years at
25 issue? I think, definitely yes, otherwise the



1 company would not have touted that program.
2 And it's also consistent with my understanding
3 of how effective these programs are. There may
4 be a different question, in terms of the return
5 on investment, i.e. ---

6 Q: Right.

7 A: --- it costs something to develop these
8 programs. So somebody in the TSC side of the
9 house had to invest money in developing it, and
10 I just don't -- I have not done the analysis to
11 know, did they earn that back immediately? Did
12 it cost a lot to develop, or did it take a
13 couple years to earn it back?

14 Q: Well -- and let -- so let's talk about some of
15 the, some of the -- where you -- we think the
16 value is in that. So, one of them is impacting
17 consumer behavior. That's a big one that kind
18 of hov- -- is an umbrella over a number of the
19 things that you just talked about.

20 A: Yes.

21 Q: And so, if I roll it out on day one, it's gonna
22 take, I'm assuming, some amount of time for
23 people to start going into the stores and
24 getting those loyalty cards, right?

25 A: Correct. There's gonna be a -- people have to



1 sign up for it to ---

2 Q: Right.

3 A: --- effective, yes.

4 Q: So, I would, I would think that there's gonna
5 be some lag time, in terms of seeing the
6 benefits of the loyalty program, because you
7 have to get enough people signed up and that's
8 not happening on day one.

9 A: Well, people are signing up on day one. I --
10 you walk up to register, and if you're not a
11 member they'll invite you to sign up right
12 then.

13 Q: Right.

14 A: So it's a question of, I think, measurability
15 ---

16 Q: Okay.

17 A: --- if you're trying to analyze the data ---

18 Q: Yep.

19 A: --- and you're saying, okay, we've rolled out
20 this program, how many incremental sales have
21 we been able to earn from the first day?

22 Q: Right.

23 A: You probably aren't gonna see it on day one.
24 I think you probably could've seen it in -- at
25 the end of the first year.



1 Q: Do you know when this loyalty program began?

2 A: I wanna say it was 2015, but I'm -- I think it
3 was during the years at issue.

4 Q: Okay.

5 A: So, I believe 2015.

6 Q: Do you know the exact time period in 2015?

7 A: Now, you're really testing my memory.

8 Q: (Laughter.)

9 A: No, I don't.

10 Q: Okay.

11 A: Not as I sit here today.

12 Q: And do you know whether it began as a pilot
13 project?

14 A: Yes, that's generally my recollection.

15 Q: Okay. Do you know how many states it started
16 out in?

17 A: No, I don't.

18 Q: Okay. Do you know when it was rolled out as a
19 -- to everyone everywhere program?

20 A: No.

21 Q: Okay. All right. Do you agree that it is very
22 common for multistate businesses to have
23 subsidiaries?

24 A: Yes. Well -- I keep thinking in terms of an
25 international business. In terms of a purely



1 domestic business, I don't know. But,
2 certainly, in the international context, it's
3 very common for companies to have subsidiaries.

4 Q: What about, like, the Fortune 50 companies, do
5 you think most of those are -- have
6 subsidiaries?

7 A: Yes.

8 Q: What about Fortune 500?

9 A: Yes.

10 Q: Pretty common, right?

11 A: Yes. The use of subsidiaries is very common.

12 Q: Okay.

13 A: I just don't know the frequency with which a
14 purely domestic company, particularly one that
15 has, kind of, a single business line -- or a
16 single business activity, would necessarily use
17 subsidiaries.

18 Q: You talked about the other cases that you're
19 involved in with the South Carolina Department
20 of Revenue, and I think you said that all of
21 them involved subsidiaries, correct?

22 A: The ones that I have analyzed, yes.

23 Q: Okay. Were any of those -- were, were all of
24 those domestic entities?

25 A: No. I mean -- what I -- well, I'm sorry. When



1 you say, were all of those domestic entities,
2 not all of the cases that I've worked on, to
3 date, have involved companies that are only
4 selling and operating in the United States,
5 some have involved international transactions.

6 Q: And some have been domestic?

7 A: I don't recall. I don't recall if there were
8 some that were only domestic. I mean, the
9 issues are ultimately about domestic taxation,
10 state taxation. But I think the question goes
11 to whether the cases that I've worked on
12 involved U.S.-only retailers, and I think
13 that's, maybe, that's the substance of your
14 question versus international ones.

15 Q: Right.

16 A: I just, I just don't recall.

17 Q: Okay.

18 A: Like, I -- I'm sorry. I recall that there are
19 -- there's at least one that had international
20 operations. I don't recall if there was one
21 that was a U.S.-only company.

22 Q: Do you agree that it's common to have one
23 entity provide procurement functions for the
24 group?

25 A: It's common for the procurement function to be



1 centralized.

2 Q: Okay.

3 A: I think, whether it's providing the procurement
4 function for the group really depends on, kind
5 of, the broader structure of the company and
6 where it's operated. I have -- again, for
7 large multinationals you will often have a
8 central purchasing function for -- in typically
9 the headquarters location, but a lot of
10 regional purchasing, as well. So you might
11 have a local purchasing arm in a different
12 location if they're buying, particularly, if
13 they're buying locally some supplies, which,
14 typically, a manufacturer will.

15 Q: If ... hold on.

16 Do you agree that if I have my assets in
17 two business entities versus one business
18 entity, that that would protect the assets of
19 Business A from a lawsuit against Business B?

20 A: So, I'm not a legal expert, but based on the
21 cases I've worked on involving, kind of,
22 corporate veil piercing type issues,
23 particularly, in the area of product liability,
24 I would say that the -- holding assets in two
25 different entities does not necessarily protect



1 you, by a long shot, from liabilities ---

2 Q: Let's ---

3 A: It would depend on -- a lot on the facts and
4 circumstances ---

5 Q: Okay.

6 A: --- of how you held them ---

7 Q: And if there was fraud situation or anything
8 like that, what -- can we just set that to
9 side, if there is no fraud or piercing type
10 facts, would you agree that having two separate
11 companies can provide some asset liability
12 protection for the companies?

13 A: Again, I -- the circumstances I was thinking of
14 were not simply fraud issues, like a fraudulent
15 transfer, but even for environmental
16 liabilities, those have gone up the chain of a
17 lot of companies that had products in very --
18 in subsidiaries that were far removed from the
19 parent company, and some of those have brought
20 down the parent company, notwithstanding the
21 -- them being held in separate entities. So --
22 -

23 Q: And ---

24 A: --- it's a, very much of facts and
25 circumstances issue about the -- and it depends



1 on each states statute, with regard to whether
2 a company can successfully limit veil piercing
3 type arguments.

4 Q: Right. And this is our problem. My question
5 isn't, is it all -- does it always. My
6 question is, can it?

7 A: Yes, in circ- -- in some circumstances it can.

8 Q: Okay.

9 A: Yes.

10 Q: All right. Let's say today I decide that I
11 wanna start -- I wanna open a business in South
12 Carolina and I wanna open a business in North
13 Carolina, is there any -- and they're both
14 doing the exact same thing, just in two
15 different, two different states ---

16 A: Okay.

17 Q: --- and two different business entities. Is
18 there any 482 reg or economic principle that
19 would say that I shouldn't be allowed to do
20 that?

21 A: No.

22 Q: Okay. And what about, I've owned a single
23 business entity for decades and they're both --
24 it is a -- it has retail stores and they're in
25 South Carolina and North Carolina, but it's



1 just one entity this time, and I hear -- I have
2 a friend that has a store and I hear that he's
3 having a lot of slip and falls in his stores,
4 and he's like, gah, I'm -- every time, I'm just
5 getting hit by these slip and falls. And I,
6 and I decide, gosh, I wonder, I wonder if I
7 would be better off having one entity in South
8 Carolina and one entity in North Carolina, and
9 a slip in fall then won't impact my North
10 Carolina assets. Could it provide me asset
11 protection -- I'm -- we already got -- let me,
12 let me, let me take that back.

13 Is there any economic principle or §482
14 Regulation that would say that there was
15 something improper about me doing that?

16 A: No.

17 Q: Okay. Is there any economic principle or
18 regulation that says that one cannot select a
19 structure if one of the reasons for the
20 restructure is tax savings?

21 A: No.

22 Q: What if I've been operating my business as --
23 oh, sorry, I lost my place.

24 What if I've been operating as an LLC for
25 a long time, and I learn that in my state as an

1 LLC I'm paying seven percent in corporate tax
2 -- income tax, but if I change to a
3 corporation, I'm only gonna get taxed at five
4 percent, can I change my business structure, or
5 is there anything -- economic principles or 482
6 regs that would say I can't do that?

7 A: Well, there's nothing in the 482 regs that say
8 you can't do that. In the 482 regs -- again,
9 as an economist, I'm not -- I'm never saying
10 somebody cannot do something. I'm not a ---

11 Q: Right.

12 A: I'm not an enforcer. I am an analyst. So, I
13 would probably apply that to all your
14 questions.

15 Q: Uh-huh.

16 A: That an economist doesn't say -- economics
17 doesn't say don't do a restructuring, for
18 example.

19 Q: Well, in this case you're using economic
20 principles to say that Tractor Supply should
21 not have done the restructure in 2001, right?

22 A: No. I'm saying the comp- -- not at all. I'll
23 ---

24 Q: Okay.

25 A: --- leave it ...



1 Q: And -- well, clarify how ...

2 A: Sure. I'm not saying the company should do or
3 shouldn't do a particular structure, I am
4 saying that the restructuring had no ec- -- no
5 operating impact, no commercial effect on the
6 company. I did not see any other financial
7 benefits to the company other than the saving
8 of taxes, or avoidance of taxes in certain
9 circumstances. The, the -- it is important as
10 an economist in evaluating the transfer prices
11 today to evaluate that transaction, because it
12 helps me to understand the reasonable
13 alternatives and then to ensure that the --
14 whatever pricing is implemented after the
15 restructuring, it's consistent with those
16 available alternatives.

17 Q: Okay.

18 A: And to be -- just, maybe, to make your life
19 easier ---

20 Q: Yeah.

21 A: --- I'll give you an example.

22 Q: Yeah.

23 A: If the company had done the restructuring, had
24 set up Texas, had set up -- and Michigan,
25 implemented even with their procurement



1 agreement, and simply used the procurement
2 agreement to allocate as a, kind of, a cost
3 reimbursement and a cost allocation, the same
4 way it did for the, the -- admin- -- in the
5 administrative services that the other --
6 administrative services that headquarters
7 provides, and the way that the headquarters is
8 compensated for the, for the employees, if all
9 those had simply been allocated at cost, their
10 -- basically, that's -- there's -- I don't
11 think we'd be here today. The income that
12 would be showing in South Carolina is what you
13 would get under a combined entity apportionment
14 method.

15 Q: So ---

16 A: And in the sa- -- as I said before, it's also
17 the same -- if the company had decided to
18 charge a modest markup on the actual cost of
19 those services, 13 million dollars in annual
20 expenses for the procurement function, the 80
21 some odd million dollars of the central
22 headquarters' expenses, the 20 million dollars
23 -- 20-something million dollars of the payroll
24 for Michigan, apply a markup to all those
25 services, a net amount, I think you're pretty

1 much in the same position if you do it on
2 costs, except there's probably a little bit
3 more income in TSC in that scenario, simply
4 because the proportions in which those costs
5 are being borne. But, that's where the sh- --
6 I'm, I'm not saying the transaction should
7 never have been done, it's a question of, you
8 analy- -- of analyzing that transaction ---

9 Q: Okay.

10 A: --- and then determining what the appropriate
11 prices would be based on standard economic
12 transfer economic principles as applied to
13 transfer pricing, in particular, as consistent
14 with the arm's length principle and based on
15 this notion of a realistic alternative that the
16 company actually had when it went into that
17 transaction.

18 Q: And so, what you're saying, I think, is that if
19 the transaction had been priced differently,
20 you would not be needing to look at what
21 happened in 2001? You wouldn't car- -- or are
22 you saying there wouldn't -- hold on, let me
23 think about this.

24 All right. I might come back to this.
25 I'm gonna think about it. You -- I wanna -- I

1 think I'm on the same page with you, so I don't
2 wanna duplicate.

3 A: Okay.

4 Q: If I decide to restructure my business, for
5 what we would all agree is a valid business
6 reason, and there are a number of structures
7 that could address that concern, but some of
8 them result in more tax savings, is there any
9 economic principle or 482 reg that would
10 suggest that I cannot pick the structure with
11 the most tax benefits?

12 A: No.

13 Q: Okay. All right. And you have criticized that
14 the fact that the TSC Texas employees are
15 sitting in Tennessee versus Texas ---

16 A: Just to be clear, I've not criticized it. I
17 say as a matter of fact, that they are sitting
18 there ---

19 Q: Okay.

20 A: --- and that that has implications for the
21 appropriate analysis of the transfer prices.

22 Q: Okay. So are you saying that to do your
23 analysis of the appropriate prices, that if a
24 business is incorporated in a particular state,
25 then all of the employees of that business need



1 to be in that state?

2 A: No.

3 Q: Okay. Explain to me how that works?

4 A: Well, you have -- for a while I believe -- I
5 think we were -- my company was a California
6 LLC at one point. I'm not ---

7 Q: Right.

8 A: --- quite sure what it is today, whether it's
9 a D.C. LLC. But for a while we had employees
10 in, in Boston, so in different parts of the
11 country and in -- obviously, in D.C., as well.
12 So ---

13 Q: So how does that play in to your analysis?

14 A: So, here, it's the -- the fact that the, kind
15 of, the core function ---

16 Q: Yeah.

17 A: --- the -- I'm sorry. The function that's at
18 issue here is this procurement function.

19 Q: Right.

20 A: And the question is, what should the
21 appropriate third party -- or arm's length
22 pricing for that procurement function. That
23 function is being -- is not being performed in
24 a separate location from the headquarters. It
25 is being performed by individuals who are



1 located cheek by jowl with the broader
2 headquarters operations. And it is a fairly
3 extensive amount of stuff that goes on at the
4 headquarters.

5 Q: Right.

6 A: I think there's even a, like a demonstration
7 store, maybe, where they test out certain
8 things right there ---

9 Q: Right.

10 A: --- and a lot of stuff that happens at the
11 headquarters. So, first of all, that
12 integration of that, of that procurement
13 function within the headquarters is helpful in
14 assessing what is the -- an appropriate arm's
15 length price ---

16 Q: Right.

17 A: --- as opposed to an alternative fact pattern
18 where that procurement function might've been
19 performed in Texas or in Oklahoma, or in some
20 place distinct.

21 Q: Okay.

22 A: So, there is a, kind of, a -- so it goes to
23 this notion of the integration of the services,
24 the extent to which any of this is really
25 separable. And it also goes to the, kind of,



1 the reliability of a method, 'cause once you
2 have this intertwining of stuff across entities
3 -- or an intertwining of activities across
4 entities, you're having a hard time snipping
5 between the two.

6 Q: Okay.

7 A: Whereas in your typical cross-border
8 transaction, internationally, you'll have the
9 manufacturer, the assets are in, say, the
10 United States, it's got facilities in a foreign
11 country called Mexico, and it's distributing
12 the products that the manufacturer sells in
13 Mexico, and you can snip between those two
14 entities really easily. You have separate
15 treasury functions in Mexico, separate treasury
16 functions in the United States. You have
17 different vendor relationships, different
18 people. All the people are located within
19 those same jurisdictions that are performing
20 those functions, or generally. So that's a
21 very different fact pattern than we have here.
22 This is additional complexity, which in turn
23 then calls into question, why? Why is the
24 procurement function embedded there, and why at
25 the time of the restructuring didn't they pull



1 it out? And it's -- I, as an economist, I
2 conclude it's because there would've been
3 enormous inefficiency associated with pulling
4 it out. There are efficiencies that the
5 company gains from having that embedded
6 function because, one, they have to report up
7 to the executive team. And those executives
8 are sitting in Tennessee. And two, they're
9 working on a daily basis with all of the other
10 people in -- or all the other people with
11 different teams depending on the needs of the
12 day of the people in the headquarters'
13 function.

14 Q: Okay. I follow you now. We kind of referenced
15 this earlier, but I don't think I asked this
16 specific question, talking about separate and
17 combined reporting. So you understand that
18 some states have chosen to have separate entity
19 reporting as their required filing method,
20 while other states choose to have combined
21 unitary reporting as their required filing
22 method, right?

23 A: Correct.

24 Q: Okay. And is it your opinion that if you have
25 an in- -- a unitary business with intercompany



1 transactions, that the combined unitary
2 reporting method is always going to be the best
3 method?

4 A: I'm sorry. Could you say it one ---

5 Q: Yeah.

6 A: --- more time?

7 Q: Yeah. Is it your belief or opinion, that when
8 you have a unitary business with intercompany
9 transactions, that combined unitary reporting
10 is always gonna be the best method? Coming
11 from your economic perspective.

12 A: Not necessarily, no. I think the -- and some
13 of it kind of depends on a hypothetical. I'm
14 just thinking through what a, kind of, a
15 combined entity -- when you're -- as you were
16 thinking about, or that unitary business, that
17 you're ---

18 Q: Right.

19 A: --- thinking of. I can see how -- well, it
20 would be a facts and circumstances case. And
21 by best, I think, that's the biggest -- the
22 other thing would -- that maybe I'm struggling
23 with. So, I'll lea- -- I'll just leave my
24 prior answer as is.

25 Q: Okay.



1 **MS. GEER:** Your Honor, I just need to look -- I
2 think I -- I'm almost done. Could I have five
3 minutes to look ---

4 **THE COURT:** Yep.

5 **MS. GEER:** --- at my notes and ---

6 **THE COURT:** Yeah.

7 **MS. GEER:** --- make sure?

8 *(Whispering.)*

9 **THE COURT:** Off the record.

10 **(Off the record from 12:53 p.m. until 12:59 p.m.)**

11 Q: All right. Dr. DeRamus, I'm almost done.
12 Earlier you said something to the effect that
13 you're not aware of the §482 Regulations
14 talking about tax motivations. So I'm not
15 gonna as- -- I'm not asking you about the §482
16 Regulations, specifically, right now.

17 A: I -- I'm sorry, you said, you're not talking
18 about tax motivations. I think -- I'd refer
19 you back to my -- the, the previous question
20 and answer to make sure it wasn't about tax
21 motivations as opposed to tax restructuring, I
22 said ---

23 Q: Okay.

24 A: So ---

25 Q: Let me just ---



1 A: Okay.

2 Q: That, that is what it is. She's got it for us

3 ---

4 A: Okay.

5 Q: So I'll just ask you the new question.

6 A: Right.

7 Q: When you're determining the arm's length
8 standard, as referenced in the -1(b)(1) that we
9 had up there earlier.

10 A: Yes.

11 Q: For a controlled transaction, are the tax
12 motivations of the parties actually involved in
13 the controlled transaction being evaluated,
14 relevant to determining the arm's length
15 standard?

16 A: Not explicitly, in the way I think you're
17 asking the question. You're just -- you're
18 looking at the transaction, period. So, what
19 if the transaction -- what's the con- -- actual
20 conduct of the party ---

21 Q: Right.

22 A: And it may involve recharacterizing the
23 transaction, to be consistent with the economic
24 substance, but you're not typically saying, oh,
25 wait a second, I need to make an adjustment



1 because of the tax motivation.

2 Q: Okay. And yesterday you had a lengthy des- --
3 demonstrative that was ultimately put into
4 evidence. And so, I nee- -- I have a question
5 following up on that. Let's see.

6 I think you agreed with me earlier that
7 the restructuring occurred in 2001, correct?

8 A: Correct.

9 Q: Okay. Let's assume that there was no evidence
10 in this case, we just didn't know, about the
11 2001 restructuring. No documents. No
12 witnesses. Nobody knows about that at all.
13 Everything else that happened is the same. Are
14 any of the opinions that you expressed
15 yesterday different?

16 A: No, not fundamentally. I -- the bases of --
17 like I said, the bases ---

18 Q: Right.

19 A: --- would change, obviously, a little bit ---

20 Q: Right.

21 A: --- but the fundamental opinions are still the
22 same.

23 Q: Okay. And earlier when you were discussing
24 per- -- per-igo---

25 A: *Perrigo.*



1 Q: Or *Perrigo*. I can't get it (laughter).

2 I believe you said something to the effect
3 of you, you may not have used the phrase
4 economic substance in your testimony because of
5 the claims in that case. Is that because it
6 would've been a legal conclusion in that case,
7 because of the claims made?

8 A: I think there -- just because there were very
9 -- there's a clean separation between my A and
10 B ---

11 Q: Right.

12 A: --- side, and there was very clear language
13 about what pertained to the economic -- to the
14 sham transaction theory ---

15 Q: Right.

16 A: --- that it was, you know, within the bounds of
17 this commercial effects, and that I was not
18 testifying as to the ultimate issue, as to
19 whether there was or was not economic substance
20 on that side.

21 Q: Right.

22 A: The -- you know, I may have not used it in the
23 explicit discussion of what I was doing in the
24 -- on the other side, but I talked about the
25 analysis that I performed, which was to price



1 the transaction consistent with the actual
2 substance of the transaction. I'd -- like I
3 said, I haven't downloaded my transcript ---

4 Q: Right.

5 A: --- to see whether I inadvertently said
6 economic substance, but I was, I was sensitive
7 to the issue that the Court had a legal
8 determination to make ---

9 Q: Right.

10 A: --- and I was -- as the expert, I was not
11 trying to step into the role of the Court in
12 rendering that decision of law.

13 Q: Okay. All right. Thank you very much.

14 **THE COURT:** All right. It's -- or actually past
15 1:00.

16 **MS. GEER:** I apologize, Your Honor.

17 **THE COURT:** No, I'm just saying I'm gonna --
18 redirect's gonna happen after lunch.

19 **MS. WOOTEN:** Thank you, Your Honor.

20 **THE COURT:** So, that's all right. So, thank y'all.
21 Let's be back at 2:15.

22 **MS. WOOTEN:** Thank you.

23 **THE COURT:** And I'll try to be here.

24 **(Off the record from 1:03 p.m. until 2:19 p.m.)**

25 **THE COURT:** Redirect?



1 **MS. WOOTEN:** Yes, Your Honor.

2 **THE COURT:** Okay.

3 **DR. DERAMUS - RE-DIRECT EXAMINATION BY MS. WOOTEN:**

4 Q: Good afternoon, Dr. DeRamus ---

5 **THE COURT:** Just to -- to let all of y'all know,
6 whenever I ask re-direct or re-cross, or
7 anything cross, no is an acceptable answer.

8 *(Laughter.)*

9 **MS. WOOTEN:** We'll take that queue.

10 Q: Good afternoon, Dr. DeRamus.

11 A: Good afternoon.

12 Q: During your cross examination, do you recall
13 being asked questions about the Department of
14 Revenue's engagements with you in litigation
15 matters?

16 A: Yes.

17 Q: Okay. I believe your testimony was that you
18 could recall four -- approximately, four
19 engagements at the retail -- dealing with
20 retailers, is that correct?

21 A: I think it was four -- was it four? I -- it
22 may have been -- I may have said four -- ones
23 that I actively reviewed.

24 Q: Okay.

25 A: That I've done substantive work on.



1 Q: All right.

2 A: It may have been five. I -- just, again, I'm
3 just trying to recall the number, but.

4 Q: Okay.

5 A: But four, I think is what I said earlier, yes.

6 Q: All right. So stepping back for just a second.
7 More broadly speaking, has the Department
8 engaged to you for a transfer pricing analysis
9 to be done at the audit level?

10 A: (No audible response.)

11 Q: Working with auditors versus a litigation
12 matter?

13 A: Not that I recall.

14 Q: Okay. So all of your engagements with the
15 Department have been in litigated mat- -- or
16 matters currently pending in litigation?

17 A: That's my understanding. I don't recall
18 whether there was actually a case filed in all
19 of them, but I -- it was my understanding that
20 they were headed towards an actual litigation.

21 Q: Okay.

22 A: And not actually -- actively in litigation.

23 Q: Okay. You were also asked questions about your
24 -- whether or not you ---

25 **MS. WOOTEN:** (Whispering.)



1 Q: Whether or not you had had any conversations or
2 research with specific company personnel, do
3 you recall those com- -- that dialogue with Ms.
4 Geer?

5 A: Yes, I do.

6 Q: Okay. And in that dialogue you noted that you
7 had reviewed notes from Dr. Andrade, is that
8 correct?

9 A: Correct.

10 Q: Okay. Do you recall the volume of those notes,
11 with regard to TSC personnel?

12 A: They were, what I would characterize, as
13 exceptionally brief, relative to the issues
14 that are before the Court.

15 Q: Okay. And after reviewing those notes, based
16 on -- or, describing TSC either operations,
17 business, etcetera, did any of those notes on
18 that page cause you to change your opinion in
19 this matter?

20 A: No.

21 Q: Okay. Do you also recall Ms. Geer asking you
22 if there was a defin- -- or -- let me back this
23 up.

24 There were conversations between you and
25 Ms. Geer about tax restructuring. Do you



1 recall, generally, those conversa- -- or that
2 dialogue?

3 A: Yes.

4 Q: Okay. And Ms. Geer asked what your definition
5 of tax restructuring was, do you recall that?

6 A: Yes.

7 Q: Okay. Do you know if the company has
8 characterized -- how the company has
9 characterized its reorganization?

10 A: As I sit here, I don't recall specifically. I
11 just recall reviewing documents where they
12 talked about the lack of operational impact of
13 the, of the restructuring.

14 **MS. WOOTEN:** Ms. Buckner, may we have the computer,
15 please?

16 **MS. BUCKNER:** Uh-huh.

17 **MS. WOOTEN:** Thank you.

18 Q: I'm gonna refer you to Responden- -- or, excuse
19 me. Yeah, Respondent's Exhibit 12. These are
20 documents in evidence.

21 **(Respondent's Exhibit Number 12 was referenced at**
22 **this time.)**

23 **OBJECTION:**

24 **MS. GEER:** Your Honor, I'm gonna object to leading.

25 **THE COURT:** She hasn't asked the question, yet.



1 **MS. GEER:** Okay. Sorry. Well, I mean, if it --
2 once it gets up there, it's -- it can't be
3 cured.

4 **THE COURT:** Well, is this in ---

5 **MS. WOOTEN:** It's in ---

6 **THE COURT:** --- evidence?

7 **MS. WOOTEN:** --- evidence.

8 **THE COURT:** Yeah. She can ---

9 **MS. WOOTEN:** It's already been admitted.

10 **MS. GEER:** I, I know, but if she's trying to -- if
11 she's wanting him to give an answer of what it
12 says, then -- and she shows it to him, then --
13 anyway.

14 **THE COURT:** Well, actually ---

15 **MS. GEER:** That was the objection.

16 **THE COURT:** --- if she wants to, she could put it up
17 there and publish it.

18 **MS. GEER:** Okay.

19 **THE COURT:** So.

20 **MS. GEER:** All right.

21 Q: Dr. DeRamus, if you will look at Respondent's
22 Exhibit 12.

23 A: Yes.

24 Q: And there is a paragraph in the middle that
25 starts with, the Board. And then, there is an



1 indented paragraph below that.

2 A: Yes.

3 Q: Could you please read that paragraph?

4 A: Whereas the corporation has established a
5 strategy for reduction of state income taxes,
6 the details of which were previously presented
7 to the Board (the "tax restructuring"). And,
8 and then it goes further.

9 Q: All right. Thank you. Also, during your cross
10 examination, Ms. Geer referred to your analysis
11 as quote litigation analysis, so I'm gonna keep
12 that terminology for purposes of this. So, in
13 discussing your litigation analysis of the nine
14 and a half or 9.7 inventory markup, your
15 testimony was that you updated the PwC comps,
16 is that correct?

17 A: That's correct. I brought them up to date,
18 i.e., assuming one were to use those
19 comparables, I obtained the financial
20 information during the years at issue to
21 calculate the financial ratios.

22 Q: Okay. And based on your experience and that
23 analysis that you went through in this case,
24 what did you determine should be the
25 approximate markup of that inventory?



1 A: The markup of the inventory itself should be
2 negligible. Simply because the inventory, as
3 I saw it, was never really purchased and then
4 resold by the company, in terms of, literally,
5 paying the vendors and then selling it on.
6 That there should be a modest markup to the
7 purchasing function as a service. So, at that
8 -- at most, there would be a markup no greater
9 than, I would say, approximately, 10 percent on
10 the cost of providing those services. So that
11 would be, rough justice, 10 percent times the
12 12 million -- or 13 million dollars of, of
13 expense for the purchasing function. I believe
14 I said before it is -- so approximately, 1.2
15 million dollars of which TSC has -- or
16 represents 80 percent of the company's
17 purchases, would then bear 80 percent of that
18 number, and then there would be some netting of
19 that amount against charges that would go the
20 other way for the administrative services that
21 TSC provides to both Texas and Michigan. And
22 then, likewise the additional markup that TSC
23 should earn for the provision of the, the labor
24 services for Michigan.

25 Q: All right. During cross you were also asked



1 whether ... Just bear with me. (Reviews
2 documents.)

3 You were also asked questions regarding
4 other reasons a business may form a legal
5 entity, and that also -- Ms. Geer also asked
6 you questions about liability. Do you recall
7 that dialogue?

8 A: Yes.

9 Q: Okay. In your prior economic consulting and
10 work have you analyzed issues to corporate
11 organizational forms and limited liability
12 protection?

13 A: Yes, I have.

14 Q: Okay. And could you describe that for us?

15 A: Sure. So, most of that has been in the context
16 of two different types of cases. The first
17 type of case would be a ---

18 *(Slamming noise.)*

19 **MS. GEER:** Sorry. I didn't realize that was me.
20 Apologies.

21 *(Laughter.)*

22 A: The first type of case would be an alleged
23 fraudulent transfer case. So, where a company
24 effectively may have been seeking Chapter 11
25 protection and the question is, in the time



1 period leading up to the bankruptcy, did the
2 company fraudulently transfer certain assets
3 either to other subsidiaries or to the
4 shareholders of the company -- or the owners of
5 the company, and the question would be whether
6 the organizational structure of the company
7 would have -- would prevent plaintiffs from
8 pursuing causes of action to recover those
9 transferred funds.

10 The other type of case would've been in
11 the context of product liability cases. So,
12 generally, the ones that are, that are precious
13 to my mind are asbestos liability cases, where
14 -- this is the instance which I referred to
15 where lar- -- a large company might have bought
16 a very small subsidiary many, many years ago,
17 that subsidiary may have manufactured asbestos
18 containing products and then, as time marches
19 on, and litigants bring claims against the
20 company, then the issue was whether those claim
21 -- claimants were likely to be able to pierce
22 the corporate veil and attach the assets of the
23 parent company. And as I mentioned earlier,
24 there have been many such cases in which
25 litigants have successfully done so and in fa-

1 -- have in fact, bankrupted the parent
2 companies even though the, the liability is
3 ultimately attached to these very separate
4 smaller subsidiaries that were acquired in
5 transactions many years ago.

6 Q: So, turning back to this case, in all of the
7 documents that you've reviewed, have you seen
8 any indication that the restructuring improved
9 the limited, limited liability protection for
10 Tractor Supply Company?

11 A: Not based on my experience, no.

12 Q: You were also asked during cross examination,
13 is there any guidance out there to say that you
14 can't restructure if one of the reasons was tax
15 minimization? Do you recall that?

16 A: I recall the substance of the question.

17 Q: Okay. In this particular case, have you rev-
18 -- in the documents you reviewed, have you seen
19 anything other than tax savings as the rea- --
20 reason for the restructuring?

21 A: I've seen assertions, but they were other
22 reasons. The only, what I'll call hard
23 analysis I've ever seen, was with regard to the
24 tax savings where, I believe, it was PwC that
25 calculated those actual tax savings. But there



1 were some assertions in, in some of the
2 planning documents about that.

3 Q: Okay. And going back to that tax savings
4 analysis that you reviewed in PwC, do you
5 recall how much PwC calculated would be the
6 annual tax savings as a result of their
7 structure?

8 A: I believe it was approximately 1.5 million
9 dollars a year.

10 Q: Okay.

11 A: Which I consider an underestimate.

12 Q: Okay. And why do you consider it an
13 underestimate?

14 A: Because they based that calculation on the
15 initial markup that was used at the time of the
16 restructuring. The initial markup was 3.6
17 percent, I believe, and that markup has grown
18 to 9.7 percent. So, the -- and also, the sales
19 grew from 800 million to five or six billion
20 dollars during the time at issue, so you
21 multiply those together and you get a much
22 larger annual tax savings.

23 Q: Thank you, Your Honor.

24 **THE COURT:** Re-cross on new matter?

25 **MS. GEER:** One new matter.



DR. DERAMUS - RE-CROSS EXAMINATION BY MS. GEER:

Q: Dr. Andrade, you mentioned just now that you reviewed some of Dr. Andrade's notes.

A: I think you ought to -- you want -- you meant to say Dr. DeRamus. You called me Dr. Andrade, so I just wanna make sure the record is clear ---

Q: Did I?

A: --- who was answering.

MS. WOOTEN: You did.

Q: I mean ---

THE COURT: I know that Dr. Andrade reviewed Dr. Andrade's ---

(Laughter.)

MS. GEER: Yeah. I mean ...

THE COURT: Matter of fact, he drafted those.

MS. GEER: Sleep deprivation is getting the best of me. I apologize.

THE COURT: That's okay.

Q: Dr. DeRamus, you mentioned, just now, that you had reviewed Dr. Andrade's notes.

A: Yes. And I believe I referenced those in my -- in your original cross examination, right.

Q: Did you review anything else in his file?

A: Yes. I reviewed all of the materials that were

1 provided as part of that, frankly, what I
2 considered a relatively late production in
3 November and December, so there was a fair
4 amount of information provided at that time.

5 Q: And are you aware -- did, did reading --
6 reviewing that information impact your opinions
7 your opinions at all?

8 **OBJECTION:**

9 **MS. WOOTEN:** Your Honor, I'm gonna object to the
10 scope. I only asked her -- asked Dr. DeRamus
11 about the specific notes with -- related to TSC
12 personnel. I did not ask him about any other
13 information in Dr. Andrade's file, so.

14 **MS. GEER:** My recollection is that he did not talk
15 about taking -- giving any credence or reliance
16 to anything in his earlier testimony that, this
17 is the first time that he's talked about giving
18 credence to in reviewing Dr. Andrade's
19 materials, and that they made an impact on his
20 decision. So I would think, I would be
21 entitled to explore whether they impacted any
22 of his other opinions.

23 **THE COURT:** I remember the last you talked about ---

24 **MS. GEER:** I, I actually don't remember him
25 mentioning the notes, so if ---



1 **THE COURT:** When he ---

2 **MS. WOOTEN:** He -- well, he, he did mention the --
3 briefly the notes, and that was why I had asked
4 because of ---

5 **THE COURT:** Yeah.

6 **MS. WOOTEN:** --- the sheer nature ---

7 **THE COURT:** I know that ---

8 **MS. WOOTEN:** --- or the size of them. That was my
9 question, was for him to recall that, so. He
10 did mention that in his cross.

11 **THE COURT:** Okay.

12 **MS. GEER:** I did not hear him say that he analyzed
13 them or relied on them in any way.

14 **THE COURT:** He didn't say he relied on them, I think
15 he made the comment that Dr. Andrade and --
16 referred to -- actually, I don't have my notes
17 on that, so I can't recall specifically. I
18 remember him talking about them though. But --
19 -

20 **MS. GEER:** Right. And, and my point is just that
21 he, he didn't -- in my memory, which of course,
22 everyone's memory on this is not clear, but my
23 memory is that he did not say that he relied on
24 them for any purpose. And I think I'm entitled
25 to explore, if you relied on this did you not



1 rely on anything else in the file?

2 **THE COURT:** Do you have a response to that?

3 **MS. WOOTEN:** Sure. I mean, I -- th- -- I limited,
4 on re-direct, I limited my question to those
5 specific notes, and so on re-cross, it would be
6 opening up into another matter to talk about
7 other things outside of those notes. I didn't
8 ask about any other ---

9 **THE COURT:** Yeah, you ---

10 **MS. WOOTEN:** --- work analysis.

11 **THE COURT:** But what she's saying is, is when he made
12 the comment that he relied upon them, that
13 opened a door for her to ask questions about to
14 what extent he -- he really has relied upon the
15 notes.

16 **MS. WOOTEN:** I believe I asked him -- and, Your
17 Honor, wouldn't have a better recollection of
18 this than me, if he had reviewed them, and did
19 it change his opinion.

20 **THE COURT:** Yeah.

21 **MS. WOOTEN:** So ---

22 **THE COURT:** I agree with --- that was ---

23 **MS. WOOTEN:** Okay.

24 **THE COURT:** --- your question.

25 **MS. WOOTEN:** It was my question.



1 **THE COURT:** Okay. I will allow you to go into that
2 in a limited capacity ---

3 **MS. WOOTEN:** But that's the -- the other thing is,
4 those are notes that was not his analysis. I
5 asked him about the -- he was taking notes of
6 an interview with company personnel ---

7 **THE COURT:** Let ---

8 **MS. WOOTEN:** And so ---

9 **THE COURT:** Let me hear the question again.

10 **MS. WOOTEN:** Oh, I'm sorry.

11 **THE COURT:** No, I'm sorry ---

12 **MS. WOOTEN:** I apolog- ---

13 **THE COURT:** --- I -- I'm not, I'm not precluding you
14 ---

15 **MS. WOOTEN:** Sure.

16 **THE COURT:** I just wanted hear the question again,
17 for the ---

18 **MS. GEER:** He wants to hear the question, so he
19 knows whether ---

20 **MS. WOOTEN:** Okay.

21 **MS. GEER:** --- whether he should ---

22 **MS. WOOTEN:** Okay.

23 **MS. GEER:** --- allow it or not.

24 **MS. WOOTEN:** Okay.

25 **Q:** So, Dr. Andrade, you mentioned -- Dr. ---



1 A: You mean ---

2 Q: Ugh. I'm sorry. Gosh.

3 *(Laughter.)*

4 Q: Dr. DeRamus, you referenced earlier that you
5 reviewed Dr. Andrade's notes regarding
6 interviews with certain witnesses.

7 A: Correct.

8 Q: Okay. Did you review and evaluate also any of
9 his other notes, or did you disregard those?

10 **THE COURT:** I'll let her go into that one.

11 **MS. WOOTEN:** Okay.

12 **THE COURT:** That may be about it though, but
13 whatever.

14 A: So, I reviewed the entirety of the information
15 that was provided to me, so that would've
16 included -- along with his notes, there were
17 additional discovery documents, there were
18 additional files of the company that I did
19 review, and there were additional analyses that
20 he performed and that he summarized in those
21 materials that were provided at the time. So
22 I did review all of those.

23 **MS. GEER:** We're good, Your Honor.

24 **THE COURT:** Okay.

25 **MS. WOOTEN:** Thank you.



1 **THE COURT:** You may step down.

2 **DR. DERAMUS:** Thank you, Your Honor.

3 **THE COURT:** Dr. Andrade.

4 *(Laughter.)*

5 **ADMINISTRATIVE MATTERS:**

6 **MS. WOOTEN:** Oh, Your Honor, I'm sorry. There was
7 one other housekeeping matter. The
8 Demonstrative that we talked about yesterday,
9 I just want the record to be clear. Dr.
10 DeRamus' Demonstrative, there were two slides
11 that I don't think that we had come to an
12 official decision on, so.

13 **MS. GEER:** I think we're good with those.

14 **MS. WOOTEN:** Okay. So, just for the court reporter,
15 can I ---

16 **MS. GEER:** You tell them which ones ---

17 **MS. WOOTEN:** Okay.

18 **MS. GEER:** --- 'cause I can't identify them.

19 **MS. WOOTEN:** So, it's gonna be Respondent's Exhibit
20 33. And we have, at this time, removed slides
21 12, 14 ---

22 **THE COURT:** Can I stop you?

23 **MS. WOOTEN:** Sure.

24 **THE COURT:** Why don't you just come up here and
25 remove them from the ---



1 **MS. GEER:** Yeah, let's do that.

2 **MS. WOOTEN:** Okay. I, I just wanna make sure the
3 record was clear, but I'm happy to do that.

4 **THE COURT:** Oh, okay, well, go ahead and ---

5 **MS. WOOTEN:** For purposes of the ---

6 **THE COURT:** Yeah, yeah. For the record, okay.

7 **MS. WOOTEN:** --- transcript.

8 **THE COURT:** Yeah.

9 **MS. WOOTEN:** Okay. So, Respondent's Exhibit 33 we
10 are removing slides 12, 14, 15 and 20.

11 **THE COURT:** Okay.

12 **MS. WOOTEN:** Thank you. May I do that at this time?

13 **THE COURT:** Yeah.

14 **MS. WOOTEN:** Okay. Thank you.

15 **MS. GEER:** And, Nikki, do you mind if I put the
16 other housekeeping matter on the record?

17 **MS. WOOTEN:** Sure.

18 **MS. GEER:** Okay. Your Honor, we had some ---

19 **THE COURT:** Whoa, whoa, whoa. Are you ---

20 **MS. GEER:** Okay.

21 **THE COURT:** So you -- she's talking to the court
22 reporter ---

23 **MS. GEER:** I'll wait for you ---

24 **MS. WOOTEN:** Oh, I'm sorry. I was, I was talking to
25 myself; I did not mean to talk to the court



1 reporter.

2 **THE COURT:** Oh, okay. Okay. Go ahead now.

3 **MS. GEER:** Your Honor, we have some deposition
4 designations that we prepared ---

5 **THE COURT:** And ---

6 **MS. GEER:** --- prior to us knowing whether Mr.
7 Sharpe would testify. The Department put up
8 two 30(b)(6) witnesses. One is Rob King, who
9 did not testify. One is Orville Sharpe, who
10 did testify. And we have not had a chance to
11 look at those designations and compare them
12 with what came into the record already, so that
13 we could narrow that down. And so, just for --
14 to make sure that we don't lose our timing
15 opportunity to file them, what we would like to
16 do is file them today as they exist, but then
17 hold the Department's deadline to file
18 responsive designations and allow us time after
19 the trial to look at them and see if we can
20 narrow this down just so there's less into the
21 record, less for the Court to have to look at,
22 and then the Department could at that time do
23 their counter-designations and then we will
24 send them in to the Court.

25 **THE COURT:** Well, I don't mind y'all just holding it



1 all off.

2 **MS. GEER:** Okay. Well that's ---

3 **THE COURT:** So it ---

4 **MS. GEER:** That's great with me.

5 **THE COURT:** Well, as long as y'all are in agreement
6 in doing that.

7 **MS. GEER:** (To Ms. Wooten) I mean, you can keep my
8 copy.

9 **MS. WOOTEN:** That's fine, Your Honor.

10 **THE COURT:** Okay.

11 **MS. GEER:** Okay. Let's do that ---

12 **THE COURT:** Let's just ---

13 **MS. GEER:** --- then.

14 **THE COURT:** So, where the record will be clear,
15 we're just gonna hold the record open for the
16 determination of what Mr. Sharpe's 30(b)(6)
17 deposition will contain?

18 **MS. GEER:** Well, it's Mr. Sharpe and Mr. King, but
19 yeah ---

20 **THE COURT:** And Mr. King's?

21 **MS. GEER:** Right.

22 **THE COURT:** All right.

23 **MS. GEER:** (To Ms. Wooten) Is that better?

24 **MS. WOOTEN:** Yes.

25 **MS. GEER:** Okay.



1 **MS. WOOTEN:** Thank you.

2 **THE COURT:** Okie doke.

3 *(Whispering.)*

4 **THE COURT:** I'm waiting for something to happen.

5 **MS. WOOTEN:** Oh. My apologies. Your Honor, that's
6 all from the Department.

7 **THE COURT:** So you rest?

8 **MS. WOOTEN:** Yes, we rest.

9 **THE COURT:** Oh, okay.

10 **MS. WOOTEN:** Until rebuttal.

11 **THE COURT:** Yeah. All right.

12 **MS. WOOTEN:** We're just chatting.

13 **MR. LUTHER:** We're just resting over here, Your
14 Honor.

15 *(Laughter.)*

16 **THE COURT:** Y'all are doing it in actuality, I just
17 need the words to go with it (laughter).

18 **PETITIONER'S CASE IN CHIEF:**

19 **MS. GEER:** Your Honor, Tractor Supply would call
20 Marjorie McKoon -- McKeown to the stand.
21 Getting better.

22 **THE COURT:** I'll save the court reporter the trouble
23 and just say you're still under oath.

24 **MS. MCKEOWN:** Okay.

25 **MS. MCKEOWN - DIRECT EXAMINATION BY MS. GEER:**



1 Q: Do you mind if I call you Marjorie?

2 A: That is fine.

3 Q: Okay. All right. Marjorie, what is your
4 current position at Tractor Supply?

5 A: Director of Income Tax and Incentives -- or Tax
6 and Incentives.

7 Q: And tell us a little bit about your educational
8 background?

9 A: I went to UT Knoxville for undergrad, majored
10 in Japanese language and world business. I
11 stayed on at UT to get my Master's in
12 accountancy where I focused on tax, and then I
13 went to work for a local public accounting firm
14 right out of college, did a couple of those,
15 wasn't quite sure if I liked the whole churna
16 merna (ph) things and did a little stint in
17 retail and finished my CPA, and went to work
18 for a little bit bigger firm in Nashville for
19 a few years prior to Tractor Supply.

20 Q: All right. And are you also a CPA?

21 A: Yes.

22 Q: What year?

23 A: I believe -- I might've said in my deposition
24 it was 2005, but I think, actually, that
25 would've happened in 2003 because I got my



1 designation -- or my Ethic's test passed in
2 that fall and I joined Kraft CPAs in 2004,
3 where I stayed then for two years until Tractor
4 Supply.

5 Q: And tell us about your work experience after
6 you obtained your Master's degree?

7 A: My ---

8 Q: Did I -- I already covered that. Did I already
9 cover that?

10 A: Master's degree.

11 Q: All right. So Tractor Supply. I would -- let
12 me go back to it. What, what type of work did
13 you do at your public accounting firms?

14 A: So, I would've prepared initially, and then I
15 started to review different types of income tax
16 returns. Sometimes not income tax returns,
17 sometimes they were gift and estate tax
18 returns. Towards my -- end of the time at
19 Kraft CPAs, I would've been reviewing mostly
20 corporate income tax returns, most
21 predominantly, I guess, in banking or
22 multistate.

23 Q: And tell us about your job responsibilities and
24 positions since you've been at Tractor Supply?

25 A: So I was hired at Tractor Supply Company to, I



1 guess, be the first official income tax
2 position for the Tax Department, because the
3 Tax Department was created the year before I
4 started. At that time, they weren't quite sure
5 exactly what all my roles and responsibilities
6 would be, but initially, it was to bring the
7 outsourced preparation of income tax returns
8 back in-house, and so I did that for the first
9 time. I had to implement the new system which
10 was One Source Tax -- Income Tax and put the
11 returns into that system. From there, it
12 became largely around compliance, estimated tax
13 payment filings, resolution of notices, annual
14 report filings, a little bit of preparation
15 within the tax provision, and that was kind of
16 it for the first bit. And then, at some point,
17 I was given a team member to manage for payroll
18 tax. And then, from there -- and so that was
19 a senior income tax position. In 2010 I was
20 promoted to Manager of Income Tax and Payroll
21 Tax. I ended up getting another employee for
22 payroll tax. I was also allowed to hire
23 someone else who helped me, kind of, manage
24 some incentives -- tax incentives. We had
25 gotten some through some of our expansion work

1 with our distribution centers, wanted to make
2 sure that, you know, we complied with all the
3 requirements of those incentives, wanted to
4 make sure we could handle their annual
5 compliance with that, and so I had a team
6 member for that, and then ultimately, was able
7 to hire somebody to work directly for income
8 tax. So, I took a little bit more of a
9 reviewer role there and started preparing more
10 of the income tax provision. So that took me
11 through 2018 where ultimately, I became
12 Director, which I am now.

13 Q: Okay. And were you involved in the preparation
14 and filing of the Tractor Supply returns in
15 South Carolina that are at issue?

16 A: Yes. I would've been responsible for the rev-
17 -- part of the review.

18 Q: And what about the federal returns?

19 A: Yes, the same.

20 Q: And were you also involved in the audit process
21 once the Department issued a Notice of Audit?

22 A: Yes.

23 Q: And what would that -- tell, tell me about your
24 role in that process?

25 A: So, typically, when we get an audit notice, it



1 comes sometime -- it can come via telephone
2 call, an e-mail, I know there was some e-mails
3 in this case, but I'm not sure exactly if
4 that's how -- initially, how it happened.
5 Typically, we'll get a -- an IDR or an infor-
6 -- you know, and Information Document Request
7 that would request certain standard documents
8 to be presented before the auditor comes
9 onsite. So I, usually in conjunction with my
10 team member, would pull those documents and
11 send them over and coordinate a visit time for
12 them to come onsite.

13 Q: Tell us about the nature of the Tractor Supply
14 business?

15 A: We are a rural retailer of farm -- like, hobby
16 farm-type items. Basically, everything to
17 support the life -- out-here lifestyle, pet
18 food, pet feeds products, clothing.

19 Q: And tell us a little about, about the history,
20 how it started out?

21 A: Sure. So I obviously, wasn't there that -- all
22 the way back then, but evidently it was started
23 in 1938. Charles Schimdt -- E. Schimdt was, I
24 guess, the founder. It started on a kitchen
25 table in his house. I think his wife's name is



1 Dorothy. They worked together to do this mail
2 order catalog business, and then it kind of
3 continued to evolve. Lost it's way a little
4 bit, I guess, in the '50s and '60s, some
5 investment firms got involved, didn't do so
6 hot, and then in the '80s it started to turn
7 around a little bit.

8 Q: And how many stores has it grown to now?

9 A: A little over 2,000.

10 Q: And how many states?

11 A: In all states, but -- and, and you're talking
12 about the old Tractor Supply, not just the
13 parent in this case?

14 Q: Correct.

15 A: I think all states other than Alaska.

16 Q: And how many employees?

17 A: At this point in time, well over 50,000.

18 Q: And how many stores were there during the audit
19 period in South Carolina?

20 A: 42.

21 *(Whispering.)*

22 **MS. GEER:** (To Mr. Streisel) Are you not hooked in?

23 Ah.

24 Q: All right. I've pulled up Exhibit 4. Is this
25 an accurate depiction of the Tractor Supply



1 corporate structure as of 12/31/2016?

2 A: That is correct.

3 **(Joint Exhibit Number 4 was referenced at this time.)**

4 Q: And there are some pages that follow this that
5 give some descriptions of the entities. Are
6 they generally accurate?

7 A: The pages that follow this?

8 Q: Hold on.

9 **MR. STREISEL:** Do you wanna go through them?

10 **MS. GEER:** Just scan it.

11 A: Yes.

12 Q: Entity information?

13 A: Yeah.

14 Q: And which of these entities did the Department
15 attempt to combine in the audit?

16 A: Tractor Supply Company, Tractor Supply Company
17 of Texas, and Tractor Supply Company of
18 Michigan.

19 Q: And with respect to these three entities, how
20 long has this structure existed?

21 A: Since 2001.

22 Q: And prior to this audit, has the Department
23 ever attempted to combine these three entities?

24 A: No, it has not.

25 Q: And I wanted to ask you about the business



1 conducted by Tractor Supply, TSC of Texas and
2 TSC of Michigan during the audit period.

3 Let's start with Tractor Supply, does it
4 have retail stores?

5 A: It does.

6 Q: Approximately, what percentage of the overall
7 stores are in Tractor Supply?

8 A: I think it's around 80 percent.

9 Q: Did it also provide services to related
10 entities?

11 A: It did.

12 Q: Which ones?

13 A: Tractor Supply Company leased payroll to
14 Tractor Supply Company of Michigan, it also
15 provided back-office function administrative
16 man- -- administrative support to Tractor
17 Supply Company of Texas and Tractor Supply
18 Company of Michigan.

19 Q: And did it -- let's see ... All right. Does
20 Tractor Supply of Texas have retail stores?

21 A: It does.

22 Q: Did it also provide certain services to related
23 entities?

24 A: It did. Tractor Supply Company Tex- -- Texas
25 was the, you know, procurement operation or



1 procro- -- procured inventory on behalf of
2 Tractor Supply Company and Tractor Supply
3 Company of Michigan.

4 Q: Let's move on to TSC of Michigan. Does it have
5 retail stores?

6 A: It does.

7 Q: And ...

8 A: And it was just receiving the benefit -- or, I
9 guess, leasing its employees from Tractor
10 Supply Company.

11 Q: Okay. And which of these entities had
12 activities in South Carolina during the audit
13 period?

14 A: TSC, Tractor Supply Company.

15 Q: And what, what were those activities?

16 A: It was the retail sales either in its brick and
17 mortar or through e-commerce.

18 Q: What was the initial business structure of
19 Tractor Supply?

20 A: It was a single entity.

21 Q: Well, when did that structure change?

22 A: 2001.

23 Q: And tell us what was happening with the company
24 prior to that time period?

25 A: Sure. As I said -- or I was talking about --



1 I guess in the '60s, '50s, wasn't doing so
2 great. And in the '70s, they were, they were
3 still largely owned by investment companies and
4 they were able to buy back -- there were a
5 couple officers at that time, they were able to
6 buy back the company so it could be privately
7 held. In between, in between them, kind of,
8 just weren't quite sure about what was needed
9 to, you know, happen next. Some wanted to grow
10 a little bit more slowly, some wanted to grow
11 a little bit more fast or quickly. In the '90s
12 they formed what was, I think, it was called
13 the Gang of Five, and so there was a key, kind
14 of, officers that were hired at this point
15 that, I guess, really started to drive the
16 business in the next kind of -- in it's next
17 direction. In the '80s they saw some moderate
18 growth, but in the '90s they, you know, finally
19 took it public.

20 Q: Okay.

21 A: And at, at that point, I think mid-'90s, 57 --
22 I guess, 57 year -- years later from when it
23 was actually formed, they were at about a half
24 a billion dollars in sales. They weren't quite
25 sure, you know, at -- how to get bigger

1 quickly, their focus had really been just on
2 operating stores. They were starting to make
3 decisions on how do you, kind of, scale and
4 figure out how to get to the next level. So,
5 one of those things would've been an investment
6 in a -- in accounting systems like SAP to be
7 able to kind of support a structure if you were
8 to grow. There was a little bit more talk
9 about, like, how do you get around -- or, I
10 guess, how do you expand quicker. One of those
11 opportunities I guess came into play through
12 just, kind of, some of the nurturing of real
13 estate relationships as they moved into
14 different locations. One opportunity came from
15 Walmart. During the '90s we started cul- --
16 you know, kind of cultivating that relationship
17 and there was an opportunity I think in early
18 2000 for us to go and secure, I guess, ten
19 locations at once. And what we had determined
20 about these Walmart locations was that,
21 essentially, when they were moving out to these
22 bigger super centers, that, you know, the
23 vacancies that they left behind from their,
24 their older stores were in an ideal location
25 for us to kind of move into. So this

1 opportunity which happened to be in Florida,
2 this particular area was awesome, it -- we had
3 never done anything like that before, to be
4 able to move into, you know, ten locations just
5 like that. We, I think, were looking at maybe
6 15 to 20-ish stores a year, if that. And if
7 that was kind of the rate that we're opening
8 in, if you compare that to, like, today, we're
9 like, opening like 80 stores a year, so we're
10 still pretty small -- kind of small potatoes
11 when we're thinking about opening up businesses
12 -- or new locations. And -- but this kind of
13 gave us some, kind of, the impetus to do what
14 came next.

15 Also, at the same time, in the '90s, we
16 were struggling a little bit with our -- I
17 wouldn't say struggling, I guess, it wasn't as
18 ideal of a situation that I think that we
19 wanted on our procurement side, so we were
20 still buying a lot of, of our inventory through
21 third parties, third party distributors. And
22 we had, you know -- there's a lot of
23 efficiencies in that 'cause there's, there's
24 like multiple middlemen, obviously, some charge
25 into that, and so we wanted to be able to move



1 away from that. The other issue with that, is
2 that you could end up having a risk of reliance
3 and something could happen to that distributor
4 and then you're kind of, kind of, just, you
5 know, stuck, and that happened to us. So we
6 had a major tool and parts company go bankrupt,
7 I think, in 1998, and what do you do at that
8 point? And in 1999, I think, we lost a couple
9 more. And so, there was this desire to try to
10 move away from this third party way of doing
11 business. And -- or, I guess, additionally to
12 that, we had some private label goods at this
13 point in time, but at this point in time, it
14 was really no more than putting our name on
15 somebody else's product. There wasn't a whole
16 lot of, you know -- more to go into that. And
17 we wanted to, kind of, expand more into, I
18 guess, what we now call these exclusive brands,
19 where we do a lot more of the formulation that
20 goes into the product. But -- and there's a
21 reason for this, because it kind of overlaps
22 with this CUE that we've heard about, and if
23 you looked at our business at this time, we are
24 really seasonal. If we ended up predicting the
25 weather wrong, then we, you know -- I mean, if

1 we got snow blowers and it was really hot, then
2 we're not gonna sell the snow blowers, and so
3 this CUE kind of, I guess, flattened out some
4 of the seasonality and helped to make it not,
5 you know, just a, you know, a win or a loss
6 year, it would, you know, kind of smooth things
7 out for us. And so, we wanted to invest in
8 that for that reason, but also because there's
9 generally -- you know, there was some -- as we
10 heard earlier too, there's generally some
11 larger margins with, in going into your
12 exclusive brand products.

13 **COURT REPORTER:** Can you say that one more time,
14 please?

15 A: Sorry.

16 **COURT REPORTER:** And slow down just a little bit.

17 A: Sorry. Usually, there's a little bit more of
18 a margin with your exclusive brand products,
19 and so that was another reason in wanting to
20 focus on the CUE. The big problem was that we
21 didn't have the volume ourselves to go and
22 command that directly from the vendors at this
23 point, and that's why we had to go to these
24 third parties. They were kind of a vendor
25 consolidation for us, they would kind of bring



1 them in because they had other people that they
2 were, you know, helping out, or other companies
3 that they were helping out, but we could -- we
4 just didn't have the volume yet ourselves, so
5 we had this need to have to grow our business,
6 open more stores, and so that's kind of where
7 we were when we started working on the
8 restructuring.

9 Q: What about -- you mentioned taking over some
10 Walmart locations. Were there any other
11 acquisition opportunities that y'all were
12 considering in that time frame?

13 A: So what's interesting about this is that the
14 stores that we expanded into with Walmart,
15 there was another competitor at this time that
16 really wanted to move into this market,
17 Quality. And so, the rumor was at the time,
18 that they were a little miffed by our ability
19 to move into Florida so quickly, 'cause they
20 had been eyeing it. But over the next year,
21 starting in 2001, there were a couple other
22 opportunities to buy their -- or, I guess, buy
23 locations or take over locations from Quality.
24 They didn't go through at that point, so there
25 was one opportunity in Georgia where we

1 ultimately, I guess, made an offer, they
2 declined it, and then they came back and we
3 said no at that point. There was another
4 opportunity, I think where they had another 150
5 stores, I think it was on the west side of the
6 United States, but ultimately they didn't want
7 to give us an opportunity on that because they
8 didn't want to do so at their expense, 'cause,
9 you know, we're competing. And then, about
10 that time, I think, you know, I think our
11 restructuring actually went through. And then,
12 four months later -- or a few months later, I
13 think it was the end of November, Quality filed
14 for bankruptcy. And I think -- the intent was
15 that they were gonna try to buy themselves back
16 on the cheap, and we ended up walking away with
17 I think 87 of those stores.

18 Q: How big would the procurement division have
19 been pre-restructure?

20 A: Less than ten. And when I say procurement,
21 that's like everything that procurement does
22 today would've been less than ten people.

23 Q: And did the less than ten people that were
24 doing procurement then, what was the scope of
25 their procurement activities?

1 A: It would've been around mostly the, the buyer
2 function. I think there was a little bit of
3 that private label that we discussed.

4 Q: All right. How big would the legal department
5 have been then?

6 A: Maybe, a handful of people. And it would've
7 been focused on real estate?

8 Q: How big would the tax department have been?

9 A: We didn't have a tax department then.

10 Q: All right. So you had -- you've told us some
11 concerns and goals that you were facing prior
12 to the restructure. How did Tractor Supply
13 decide to address them?

14 A: So at this point, we wanted more stores. We,
15 we know we need to expand, we know that, you
16 know, we'd like to pull, you know, some cost,
17 have some better penetration when it comes to
18 the exclusive brands and have that ability to
19 kind of leverage what we talked about, those
20 benefits there. But, obviously, we didn't have
21 a legal team, we didn't have the tax team. And
22 so, at this point, we would've reached out to
23 consultants, especially if we were thinking
24 about doing something like an acquisition. I'm
25 sure there were considerations that, you know,



1 if we're gonna grow bigger, maybe we need to
2 add, you know, a subsidiary, there's got to be
3 a way to do this. And so, we wanted to buy
4 some of the things that we wouldn't've known
5 about.

6 Q: And why did you select PwC?

7 A: Because they're a -- are a reputable accounting
8 and consulting firm.

9 Q: All right. Once the company started talking to
10 PwC, did any additional concerns or goals come
11 up?

12 A: Sure. We were told that there was not, you
13 know -- we had told them that we would, you
14 know -- wanted to increase our earnings and
15 enhance our earnings, but they had mentioned
16 this might be a way for us to track our
17 performance, that, you know, maybe we'd have
18 some asset protection with this, and also that
19 there would be an opportunity to minimize our
20 taxes, not only future but current, which is
21 typically a pay-for for a lot of ideas that you
22 do.

23 Q: And what do you mean by that?

24 A: So, sometimes we'll look at doing things and
25 there's a greater goal of what we're trying to



1 achieve, but sometimes you look at the cost --
2 the initial cost in doing it, and going, oh, I
3 don't know if I wanna do that. But in this
4 case, we could look at, you know, where we
5 currently paying taxes and know that possibly
6 future state, we could look at that and know
7 that based on whatever the taxing regime is at
8 the time, it would have a different impact
9 post-restructuring, and so we could look at
10 those savings and say, oh, that would pay for
11 the fees of doing this, or the -- you know, the
12 change in doing that. And so, that's typically
13 looked at as a pay-for. And so, you know --
14 I'll, I'll stop there.

15 Q: Yeah.

16 A: I'm sorry.

17 Q: That's good. Had Tractor Supply Company been
18 sued prior to the restructure?

19 A: Yes.

20 Q: And post-restructure, have either Tractor
21 Supply, TSC of Michigan or TSC of Texas been
22 sued?

23 A: Yes.

24 Q: Have all of them been sued?

25 A: Yes.



1 Q: Okay. The Department has pulled up some Board
2 meeting minutes that refer to the restructure
3 as a tax restructure. What is your response to
4 that?

5 **(Respondent's Exhibit Number 12 was referenced at**
6 **this time.)**

7 A: I definitely would see them saying something
8 like that, because that's a way to say we're
9 gonna pay for something. It's the, the people
10 talking -- or I think, referenced in the
11 document, are the CFO and the Controller who
12 had had a vested interest in taxes and
13 accounting.

14 Q: All right. So let's talk about, what did PwC
15 -- what structure did PwC recommend -- or the
16 structure that we just talked ---

17 A: The, the structure that -- what was on the
18 screen, it was the far-left boxes, the TSC of
19 Texas, TSC of Michigan and, and parent
20 structure.

21 Q: Okay. And then, the -- you mentioned some
22 functions at the beginning of questions about
23 what each -- let me make sure I covered that
24 already.

25 **COURT REPORTER:** (Whispering) ma'am, would you mind



1 just sitting back a little bit from the mic.
2 I think that's good right there, yeah.

3 **MS. MCKWEOWN:** Okay.

4 Q: Actually let me just ask you. So at -- what
5 was the purpose of TSC going to be in that
6 structure? What would it do?

7 A: Well, TSC was -- TSC is selling -- still
8 selling goods.

9 Q: Uh-huh.

10 A: We didn't have a whole lot of distribution
11 centers at that time, so that -- there were
12 still distribution center activities occurring.
13 They're basically accounting tax, legal, you
14 know, whatever other real estate functions that
15 -- you know, back office, I think we've heard.
16 But, it would perform those on behalf of the
17 group for a charge.

18 Q: And did it provide any other services?

19 A: Oh, and it also leased payroll to, to Michigan.

20 Q: Okay. And what was the purpose of TSC of
21 Michigan in that structure?

22 A: They -- TSC of Michigan was going to hold its
23 -- the Michigan retail stores and make retail
24 sales.

25 Q: And what was the purpose of TSC of Texas in



1 that structure?

2 A: TSC of Texas was going to hold the Texas
3 stores, ultimately, have -- the distribution
4 center, I think, was under construction at that
5 point, and, and then hold the procurement
6 function.

7 Q: And did each of those entities perform those
8 functions after the restructure?

9 A: They did.

10 Q: Okay. And then, some of those goals that you
11 talked -- you mentioned earlier, I'm gonna ask
12 you how that changed.

13 A: Okay.

14 Q: So you talked about wanting to grow the
15 procurement function. Did that change after
16 the restructure?

17 A: It did.

18 Q: Can you explain how?

19 A: Sure. At the time of the restructure, I think
20 we had about ten -- I think, we indicated about
21 ten procurement individuals. At the time of
22 the audit, we had over 100. These groups
23 further expanded, so -- with the buyers. So,
24 what the buyers do is, they are responsible for
25 identifying the products that are in the



1 stores, they identify the vendors, they
2 negotiate the terms with those vendors, they
3 also negotiate any type of vendor funding that
4 comes in. That team has grown. That had
5 split-off into a special second team, which is
6 the inventory management team. That team
7 consists of two other teams -- or consists of
8 two teams. One of those teams is looking at
9 the trends, the data, the, the mix that we're
10 gonna offer in all those stores. Does it --
11 does a particular store get an assortment for
12 bee keeping versus another store who might
13 need, you know, more -- I don't know, fish --
14 you know, not fishing, 'cause we don't, you
15 know -- but maybe, they need more kayaks or
16 something like that, just, and do -- probably,
17 a sweater or a hor- -- a horse and equine. So
18 there's a team that does that, and they also do
19 the, the planning and the forecasting and
20 project out needs, as far as, how much of it
21 we're going to need for that particular season
22 to sell in each of those locations, and you
23 know, which locations can get so much of that
24 assortment and particular mix.

25 The other team, then, is the replenishment

1 team. And so, as that data comes through the
2 POS system automated, they are able to create
3 new PO's and order that merchandise, so that's
4 the next team. There is also ---

5 Q: And that was the inventory planning team?

6 A: Yes.

7 Q: Okay. Let me make sure -- do they deal with
8 shipping at all?

9 A: They would coordinate with the DCs ---

10 Q: Okay.

11 A: --- in order to get the shipping to the stores.

12 Q: Would they make any recommendations on whether
13 to buy or not buy particular products?

14 A: They would analy- -- or they would be able to
15 see the data to see how that data's trending.

16 Q: Would they have any role in determining
17 sourcing of products?

18 A: No, that's a different team.

19 Q: Okay.

20 A: So along those lines we also have the global
21 sourcing team that came on, came on after the
22 restructuring. This team would have looked at
23 where we can't get product in the U.S., they
24 would then have worked with agents that --
25 there is a team that works with those agents to



1 identify locations outside the U.S. in order to
2 source those goods.

3 Q: Okay.

4 A: In addition to that ---

5 Q: Wait, hold on. Can I ask you another question
6 ---

7 A: Sure.

8 Q: --- about that, global sourcing? What is
9 involved in what they do, as far as, once they
10 find a source, do they have any further role in
11 that?

12 A: As far as finding a source?

13 Q: No, like after they found an international
14 source, like do they have any role after that
15 part?

16 A: The global sourcing team?

17 Q: Yeah.

18 A: The global sourcing team would, you know,
19 again, work for that agent, but then -- the
20 agent kind of serves as more of a conduit to
21 getting to the manufacturers, so sometimes they
22 provide even translation services ---

23 Q: Okay.

24 A: --- just to be able to communicate.

25 Q: Well ---



1 A: Yeah.

2 Q: Which team would, would have anything to do
3 with, like quality controls, or foreign
4 products?

5 A: When we get into product development and that
6 global- ---

7 Q: And that would not ---

8 A: --- and in, in conjunction ---

9 Q: That would not be ---

10 A: It's the same time, but, but different teams.
11 They've got some overlap, I think, there was
12 some management overlaps there, but.

13 Q: Okay.

14 A: So, yes, we have a product development team and
15 that product development team at times does
16 have a contract manufacturing component to it
17 where there is quality con- -- quality control.
18 And, I guess, there would still be quality
19 control even with vendors with global sourcing,
20 just to make sure that you're buying ethically
21 made goods and that -- there's a lot that goes
22 into it, I can- -- I'm not an expert on that
23 piece of it. But the product development in
24 this particular case, sometimes lease ideas can
25 come either from the product development team



1 or they can come by from -- come from the buyer
2 team itself, but what they do is they look for
3 gaps in the market, they might go shop our
4 compe- -- competition and take a look to see
5 what's being offered from the different
6 vendors, and if they identify a niche or a
7 need, they would, you know, come up with an
8 idea and the product development team would
9 take it and develop an idea. They would then
10 work with an agent to come up with the
11 construction of kind of how that's gonna be
12 built, CAD drawings, that sort of thing. We
13 would come up with a formulation, and then we
14 would go out and find a contract manufacturer
15 to make that, make that product. Now,
16 ultimately, the buyer determines whether or not
17 that, that product can be put on the shelf, but
18 -- prior to telling that the product
19 development team comes up with the design, the
20 creation.

21 Q: And what are some of your exclusive brands?

22 A: For health, it's a DuMOR, CountyLine, it's C.E.
23 Schimdt.

24 Q: How, how many did you have of those before the
25 restructure?



1 A: Before the restructure, we had about eight
2 private labels.

3 Q: And ---

4 A: At the time of the audit, about 16 exclusive
5 brands.

6 Q: And how many do you have today?

7 A: More than that.

8 **COURT REPORTER:** I need you to back off of that mic
9 just a little.

10 **MS. MCKEOWN:** Sorry.

11 **COURT REPORTER:** Or, I'll tell you what, if you can
12 just push it forward any? Can you push it up
13 a little bit? It's just bogging down this ---

14 **MS. MCKEOWN:** Sorry.

15 **COURT REPORTER:** That's okay. It's all right.

16 Q: And what percentage -- do you know what
17 percentage of your total sales were from
18 exclusive brands during the audit period?

19 A: I think a third.

20 Q: And you told us a little bit about CUE. What
21 -- can you explain what the purpose of CUE is,
22 like, what are you hoping to accomplish with
23 that?

24 A: So CUE is like the bread and butter. It's the
25 things that the customers are gonna continue to



1 come into the store for, even though, you know,
2 they're -- that -- basically -- or, when --
3 weather indi- -- not dependent on the weather.
4 So, people are gonna still come in and buy, I
5 guess, mort- -- motor oil for their, you know,
6 zero-turn, or they're going to come in and buy
7 pet feed and pet food.

8 Q: And then, what are you, what are you -- what
9 are the types of products that would be in your
10 exclusive brand mix?

11 A: So pet feed and pet food.

12 Q: Yeah.

13 A: But that's for health, DuMOR.

14 Q: Okay.

15 A: Chicken feed ---

16 Q: Yeah.

17 A: --- horse feed, that's DuMOR. CountyLine, you
18 would, you would have tools and horse, like,
19 horse water, power tool -- I think there's some
20 type of power tools that like -- like, log
21 choppers type of things. But the -- like horse
22 troughs, those types of metal goods and tools.

23 Q: And what are the margins like?

24 A: For exclusive brands, bigger. Sometimes we'll
25 take a little bit of a cut on the margin, just



1 if we're getting some other benefit for it.
2 So, maybe, the transportation costs are better,
3 or maybe the -- well, they'll be a little bit
4 more put together, the product might come to
5 the customer a little bit put together just to
6 save on having -- the customer having to put
7 some- -- something together, so we're willing
8 to lose a little margin for that.

9 Q: All right. Can you talk about which entity
10 does the -- finds the vendors and negotiates
11 the contracts?

12 A: Tractor Supply Company of Texas.

13 Q: All right. Is that part of the procurement
14 function?

15 A: It is.

16 Q: And can you just talk a little bit about that?

17 A: Yes. Tractor Supply Company, the, the buyers
18 are responsible for finding the vendors. They
19 determine which vendors we work with, which
20 products that we're going to buy. Essentially,
21 the buyers own a shelf in a store, so they
22 determine what products can go on a shelf, just
23 not how they can be displayed. They also
24 negotiate the, the vendor funding, make sure
25 that all the vendors are setup correctly or



1 come into the system correctly. And they can
2 work with product development at times.

3 Q: What does the vendor maintenance team do?

4 A: So the vendor master data is kind of what they
5 are now ---

6 Q: Okay.

7 A: --- it's kind of evolved. But, they are
8 responsible for, within our ERP system,
9 tracking all the vendor data. So, you know,
10 vendor payment terms, vendor, you know,
11 specific data, you know, address, product
12 information, SKU information, pricing, and
13 making sure that that's all in the system
14 correctly.

15 Q: And you've mentioned DCs. Who -- which
16 entities hold the DCs?

17 A: So two entities hold the DCs. The -- most of
18 the DC's are in Tractor Supply Company.
19 Tractor Supply Company of Texas has the Waco
20 DC.

21 Q: And the mixing centers?

22 A: Tractor Supply Company of Texas has two owned
23 mixing centers, during the audit period, I
24 think there was a third, third party owned.

25 Q: And I know we've heard about these, but can you



1 tell us ---

2 A: What do they do?

3 Q: Yes.

4 A: So the distribution center, in general, is just
5 a big holding facility for inventory before
6 it's ready to go to the stores. It's just a
7 kind of consolidation point that, you know, are
8 interspersed throughout the, the United States
9 just to try to, you know, put the inventory
10 closer to the stores when they need it. The
11 mixing centers kind of bypass some of that,
12 especially for feed, in this case, is the
13 vendors will send directly to the mixing center
14 instead, and the mixing centers are closer than
15 the DCs, and it keeps from having to send, I
16 guess, like a full truckload or something, and
17 it allows for more frequent replenishment of
18 these stores with -- when you look at our
19 stores, we have two different types. We have
20 what's called a retrofit, and then we have a
21 prototype store, and generally they're all
22 about 19,000 square feet, but the retrofits can
23 vary. And our backrooms, traditionally, in
24 those prototypes are very, very small, so we
25 wouldn't want to overload the backrooms. It



1 would be -- you know, plus it'd still be
2 inventory.

3 Q: All right. So you've talked to us about what
4 -- the changes after the restructure with
5 procurement. Were there any changes with
6 regard to the goal you discussed of liability
7 protection?

8 A: Absolutely. Assets would've, you know -- the,
9 the assets from the parent that were
10 transferred are now in a different company, so.

11 Q: And one of the other goals you mentioned was
12 growing via expansions and acquisitions. Can
13 you tell what happened after ---

14 A: So as I'd indicated earlier, we acquired 87
15 stores, which is three times the normal amount
16 of stores that we were actually opening at that
17 point in time on an annual basis. So our -- I
18 think our sales were at about 850 million, I
19 think, right before this and I think it jumped
20 up to by like, by like another 300 and some odd
21 million dollars the next year, and largely
22 because we were able to open these additional
23 87 stores. So they referred to this year, or
24 right after that, as project 110, which was
25 basically opening up 110 stores, 87 of those



1 being the Quality conversions, and then the
2 rest that we had already intended to open
3 within 110 days. And that became kind of the
4 big launch and, and catalyst, because obviously
5 if you open those stores then you have to have
6 a support system to be able to support those
7 stores, so then that's the -- the Waco DC and
8 then, if you, you know, become good and adept
9 at doing that, then you can open even more
10 stores, so it -- that was a launching pad.

11 Q: And I don't think I asked you this, but I
12 haven't checked it off. Can you tell us how
13 many procurement employees you have today?

14 A: Over 200.

15 Q: And how many you had during the audit period?

16 A: Over 100. 120 or so.

17 Q: And in -- is there an agreement regarding the
18 procurement function?

19 A: There is.

20 Q: And what is it?

21 A: So there is a inventory procurement agreement
22 between Tractor Supply Company of Texas and
23 trac- -- and Tractor Supply Company of
24 Michigan, and one between Texas and parent.

25 Q: Give me one second. There's one more



1 procurement activity that I'm not 100 percent
2 -- I -- we keep hitting bits and pieces of
3 stuff, so I apologize if I'm asking you again.
4 But, in terms of who -- which team would be
5 involved with product selection in the stores?

6 A: Product selection in the stores would still be
7 the buyers. I mean, they, they determine which
8 products we're gonna sell. Now, of -- what
9 those -- which assortment of those products
10 that you want to sell would be the inventory
11 management team.

12 Q: Okay. So tell me a little bit more about the
13 buyer's piece of it versus the inventory
14 planners?

15 A: So the inventory planner would be looking at
16 what things are going to sell in a particular
17 location.

18 Q: Yep.

19 A: They were -- they would be looking at, you
20 know, that store's located in the south so it
21 needs this, you know, as far as seasonal goods,
22 you know. They're not gonna need snow blowers,
23 I believe I saw -- I said that before, but.
24 The -- and then, you know, in the north,
25 they're gonna want a different assortment



1 there. If you have bee keeping operations or
2 whatever, you're gonna want to do that. So
3 they look at, kind of, the customer and they
4 understand the sales that are coming through in
5 a particular location so they can make
6 recommendations as to, you know, what to buy,
7 what not to buy, but the buyer ultimately makes
8 that call. They make the call on whether or not
9 they want to bring that product in, but who
10 orders the POs is the inventory management
11 team.

12 Q: Okay. And who's -- and which entity's name is
13 on the contract with the vendors?

14 A: Tractor Supply Company of Texas.

15 Q: And which entity incurs the expense for the
16 inventory?

17 A: Tractor Supply Company of Texas.

18 Q: And which party disburses the funds for the
19 inventory?

20 A: Tractor Supply Company.

21 Q: And why would that be?

22 A: So Tractor Supply Company has what's called a
23 centralized cash management function,
24 centralized treasury ---

25 Q: Uh-huh.



1 A: --- and so it makes all payments on behalf of
2 the business.

3 Q: Okay. And then how is that expense for the
4 inventory booked?

5 A: It's booked on Texas.

6 Q: And where were the procurement team employees
7 located during the audit period?

8 A: They would've been in Tennessee.

9 Q: And why are they not in Texas?

10 A: Because they can do their job in Tennessee.

11 Q: Are you saying that there was no reason to move
12 them?

13 A: I think it might've even been disadvan- --
14 disadvantageous to move them. Some people
15 don't want to be re- -- relocated just to go
16 some place else when they can do their job from
17 where they are.

18 Q: What role do the retail stores play regarding
19 procurement?

20 A: Some, but I would say not a whole lot. They,
21 they can make recommendations at times to -- I
22 mean, most of, most of the stores communicate
23 about what they need automatically through the
24 system. That's -- and we have a -- you know,
25 an integrated system that can tell what's on-



1 hand and if they're getting low then that goes
2 up. The inventory management team can see it,
3 and they can replenish those orders. The store
4 itself obviously sees customers coming and, you
5 know, and going, they know what types of
6 products are being sold, and at times, you
7 know, our officers will do store visits and
8 they, you know, they get an opportunity to, to,
9 you know, to provide some of that feedback.
10 But they're not ordering goods to the extent
11 that, you know, this procurement team and
12 function are doing it, or sourcing goods or
13 developing products.

14 Q: Talk to me some more about the developing
15 products. Do you have any folks that are
16 involved in design or manufacture parts --
17 sorry, manufacturing process?

18 A: Yeah, absolutely.

19 Q: Can you describe that?

20 A: Sure. So a little bit what I was saying
21 before, our product development team, they're
22 always going out, they're taking a look at the
23 competition, they're looking to see what
24 vendors have up on those shelves. And if
25 there's a ---



1 Q: And I know you've already talked about that, so
2 I don't want ---

3 A: Oh, okay. I ---

4 Q: --- to make you repeat that part.

5 A: Okay. Yeah. So they, they do that, but then,
6 you know, what they will do, is they actually,
7 you know, they will get the -- or do prototypes
8 of the stuff, they will test it. For example,
9 during an R&D study that had, had been done at
10 one point in time, we got to see a video of
11 where we had wenchers that, that we built and we
12 tested, and this is the responsibility of this
13 particular team and it's function.

14 Q: How did they test the wench, I'm curious?

15 A: You -- they had a UTV that they basically
16 hauled up in a tree and hung from a tree with
17 this wench that -- I guess, test to make sure
18 it was gonna be durable enough for ---

19 Q: Was it?

20 *(Laughter.)*

21 A: Yes, it was. I saw the video.

22 Q: What about in -- is there -- has there been any
23 design or manufacturer in the bee area?

24 A: Yes. Essentially, we work through -- they come
25 up with the formulations of the product and



1 work with the contract manufacturer just to, to
2 make that product. We provide the formula.

3 Q: So you're coming up with the recipe?

4 A: We're coming up with the recipe.

5 **OBJECTION:**

6 **MS. WOOTEN:** Leading, Your Honor.

7 **MS. GEER:** I, I apologize, Your Honor.

8 Q: Do Tractor Supply executives play a role in
9 developing overall strategy or in procurement?

10 A: Yes, they have an overall vision of where they
11 would like the company to go, but they empower
12 the, the people that report to them to do their
13 functions and lead their areas.

14 Q: And which entity has the Chief Merchandising
15 Officer?

16 A: Tractor Supply Company.

17 Q: And what area is the Chief Merchandising
18 Officer over?

19 A: He's over the procurement functions.

20 Q: Okay. So, why is he in TSC?

21 A: He's in TSC with the rest of the C-suite. It's
22 a cost center.

23 Q: Does TSC of Texas charge Tractor Supply and --
24 sorry, yeah. Does TSC of Texas charge Tractor
25 Supply and TSC of Michigan for the inventory it



1 purchases for them?

2 A: It does.

3 Q: And how did TSC of Texas determine the amount
4 of the fee that should be charged?

5 A: Through a independent third party transfer
6 pricing study.

7 Q: And how often do you do those?

8 A: Every three years.

9 Q: And when was the one done for this time period?

10 A: 2013, I think is the date. I'm not sure of the
11 exact date, but it's ---

12 Q: Okay.

13 **MS. GEER:** (To Mr. Streisel) Do you -- can you pull
14 up the exhibit? There it is. All right.

15 A: I know we had one and we updated it, but it --
16 I don't know the exact date of the letter.

17 Q: So the one for the relevant time period, what
18 did it -- what conclusion did it reach
19 regarding the fee that should be charged?

20 A: Essentially, I think it had a charge that was
21 in the -- we, we landed at 9.7 as far -- but I
22 don't remember the range as to the end and the,
23 the beginning.

24 Q: What did you select?

25 A: 9.7.



1 Q: And how is that charge implemented?

2 A: It's booked through journal entries.

3 Q: And where would we see that?

4 A: In, in our legal entity trial balances.

5 Q: Okay. Did the report also give a range for the
6 expected profitability of Tractor Supply?

7 A: It did.

8 Q: And do you recall that range?

9 A: I think it was like one to five percent. I
10 know the -- I think, the target was like 3.1
11 percent, is like what it was supposed to be
12 targeting.

13 Q: And have you looked to see whether Tractor
14 Supply fell within that profitability range
15 during the audit period?

16 A: We did. We were at, I think, four percent.

17 Q: You mentioned earlier that Tractor Supply
18 provides certain su- -- overhead support
19 services for the other entities. Are -- is
20 there an intercompany -- or are there
21 intercompany agreements related to that?

22 A: Yes, there's an admin charge.

23 Q: And who are the agreements between?

24 A: That's TSC and -- between TSC and Tractor
25 Supply Company of Texas, and TSC and Tractor



1 Supply Company of Michigan.

2 Q: And can you summarize for us the services that
3 are provided under that agreement?

4 A: Sure. It's general accounting, legal, HR, real
5 estate, those types of functions. They are,
6 essentially, provided based on the expenses of
7 the year before, and we look at those at the
8 beginning of each year for the year prior, and
9 then we allocate out based on some pro rata
10 share based on the underlying expense that
11 we're allocating out. So if it was a store
12 operations cost -- we have a cost center that's
13 called store operations, then we might use
14 total store count and Texas would get its
15 portion of that share based on the stores in
16 Texas to the stores in -- everywhere.

17 Q: And how is that charge handled?

18 A: That is handled through that admin charge, and
19 it is booked in a journal entry on a monthly
20 basis.

21 Q: Could you send checks back and forth?

22 A: We could, but it's not needed in order to get
23 the, you know -- this -- to have the right
24 expenses reflected on the, on the books of the
25 entities.



1 Q: And where are the employees that perform these
2 overhead support services?

3 A: Store support center.

4 Q: What state, sorry?

5 A: Sorry. Tennessee.

6 Q: And where do they perform their job duties? I
7 assume -- or, I'm not gonna say what I think.

8 A: No.

9 Q: Where do they perform their job duties?

10 A: In Tennessee.

11 Q: Can you -- is there an intercompany agreement
12 related to Michigan leasing employees from
13 Tractor Supply?

14 A: Yes.

15 Q: And who are the entities that are a party to
16 that agreement?

17 A: TSC and TSC of Michigan.

18 Q: And what does Tractor Supply charge TSC of
19 Michigan for the leasing of employees?

20 A: It charges the cost to provide that service
21 plus a 10 percent markup.

22 Q: And when is that charged?

23 A: It's -- it is charged out monthly -- a month in
24 arrears.

25 Q: And how is that charge handled?



1 A: Through a journal entry.

2 Q: What is the Neighbor's Club?

3 A: So Neighbor's Club is our version of -- it's
4 actually the first version of a customer
5 loyalty program.

6 Q: And can you describe that program for us?

7 A: Sure. Essentially, it's a way to get to
8 understand your customers better, interact with
9 the customers, get insight in -- as to buying
10 trends, kind of, more so than what you'd
11 automatically see in -- inside of our inventory
12 management system. In this case, they might
13 see that a particular custom- -- customer has
14 a dog because they're always buying dog food,
15 so they might, you know, send them an e-mail
16 about buying doggy kennels or doggy toys or
17 something like that. So it's a way to interact
18 with those customers and get insights into the
19 types of products that they're, they're
20 selling.

21 Q: And when did that program start?

22 A: It was started as a pilot in 2015. So it meant
23 -- that was limited to a very small number of
24 stores relative to the, to the group.

25 Q: Okay. And then, when would it have been rolled



1 out to the group?

2 A: I think it was completely rolled out by the end
3 of 2016.

4 Q: And when do you believe -- how long did it take
5 after that program started for you all to see
6 some financial returns from that?

7 A: Well, we talked a little bit earlier -- or we
8 heard a little bit earlier about day one, and
9 day one would've been different for every store
10 that was brought onto this system, and then you
11 would have to wait for the customers to come in
12 and actually sign up for the Neighbor's Club,
13 so that didn't happen necessarily on day one,
14 that could happen whenever they decided to come
15 shop us. So over this period of time, yes, you
16 would've started to build a little bit of a
17 database, but you really probably wouldn't've
18 had a really good picture until you got, you
19 know, at least a year, you know, through it.
20 So if we started this at the end of -- and I
21 think it was closer to the end of 2015, then,
22 you know, it wouldn't've really started having
23 a whole lot of the information until, maybe,
24 the end of 2016 to be able to start influencing
25 any type of decisions of the products that we



1 would buy.

2 Q: Did you hear Dr. DeRamus's question about which
3 entities -- is -- my question in his testimony
4 regarding -- about which entities certain
5 departments belong to, and specifically, he was
6 talking about purchasing, accounts payable and
7 merchandise planning. I want to, I want to --
8 he seemed to be questioning why they would be
9 in TSC versus Texas, so I want you to speak to
10 each of those. Can we start with the
11 purchasing department?

12 A: So the purching -- purchasing department is a
13 little bit of a misnomer. It's not for
14 inventory, it's for non-inventory purchases, so
15 that would be for fixtures and supplies for,
16 you know, throughout the, you know, the
17 business.

18 Q: Okay. And so which entity is that in?

19 A: That's in TSC.

20 Q: Okay. And what about accounts payable?

21 A: So accounts payable is responsible for paying
22 all the bills of, of TSC and its subsidiaries,
23 so not just for inventory vendors but for real
24 estate and whatever else.

25 Q: What about merchandise planning?



1 A: Merchandise planning is responsible for the
2 inventory once we own it, so they have two
3 different teams. They're in TSC. One team is
4 responsible for the fixture design, how are
5 those products going to be displayed, you know,
6 and procurement of those fixtures. The -- or,
7 I guess -- or identifying those fixtures. The
8 other team is responsible for how those
9 products, once they're bought, are displayed
10 upon those shelves, so planogram.

11 Q: What about inventory control?

12 A: Inventory control is mostly focused around,
13 like, shrink, theft, counting of inventory,
14 sub-counts on inventory, you know, at the
15 stores.

16 Q: So of all of the ones we've just talked about,
17 which ones do -- would you say have a
18 connection -- let's see, with procurement?

19 A: Maybe, accounts payable. But definitely mixed,
20 as far as, you know, where they -- how they
21 provide their services, and accounts payable is
22 a part of that service admin charge that gets
23 charged out to, to Texas.

24 Q: Okay. Did you prepare the tax returns for
25 Tractor Supply?



1 A: I reviewed them.

2 Q: Who would've prepared them?

3 A: Possibly, Josh at this time. I think there was
4 was another staff that we had, but then Matt.
5 Matt Appelmann, which we've talked about.

6 Q: And would you have been involved in preparing
7 the -- I think I said it fast and generically.
8 Would that -- would you have done the same
9 thing for state and Federal, or is there a
10 difference?

11 A: I would've reviewed both.

12 Q: Okay.

13 **MS. GEER:** (To Mr. Streisel) Can you pull up one of
14 them? How about Exhibit 9.

15 *(Whispering.)*

16 **MS. GEER:** Your Honor, my team is requesting a
17 bathroom break, and I wouldn't mind ---

18 **THE COURT:** Okay.

19 **MS. GEER:** --- one either. Would now be a good time
20 for that?

21 **THE COURT:** Well, you're on direct, so that doesn't
22 fit with my cross theory, so.

23 **MS. GEER:** You're -- yeah.

24 **THE COURT:** So we'll take one.

25 **MS. GEER:** Okay. Thank you.



1 (Off the record from 3:41 p.m until 3:56 p.m.)

2 **THE COURT:** Alrighty.

3 **MS. GEER:** All right.

4 Q: Margie, can you see the screen? Is that -- or
5 is it too small?

6 A: No, I can see it, but I'm starting to guess my
7 glasses need to be changed though (laughing).

8 Q: Oh. Can you see it well enough to ---

9 A: Yes, I can.

10 Q: Okay. All right. So we have Exhibit 9 up,
11 which -- can you tell us what that is?

12 A: Sure. That is our South Carolina income tax
13 return for the 2014 tax year.

14 **(Joint Exhibit Number 9 was referenced at this time.)**

15 Q: And can you explain for us generally how -- I'm
16 just gonna ask you about 2014. If there are
17 any differences between the years, let us know,
18 but otherwise we'll use this as our sample.

19 A: Okay. So ---

20 Q: So just walk us through how you would've?

21 A: How, how would -- I would've prepared this ---

22 Q: Yes.

23 A: --- or Matt would've prepared this?

24 Q: Yes.

25 A: It would start with our, our audited financial



1 statements broken down by regarded legal entity
2 trial balances. That would be the starting
3 port -- point for the federal consolidated
4 return. We would then apply modifications for,
5 for gap to -- the tax differences to arrive at
6 a federal taxable income. We would've then
7 used the pro forma column, or entity amount,
8 for the federal taxable income of Tractor
9 Supply Company as the starting point for South
10 Carolina. We would've applied any South
11 Carolina to fit tax modifications to that
12 amount, and this would be the taxable base.
13 And then, from there we would've applied a
14 apportionment factor, which would've consisted
15 of a factor which would apprise South
16 Carolina's activity for that -- for the parent
17 entity, and that would've been South Carolina
18 sales for its retail customers over a
19 denominator, which would've been sales
20 everywhere for the parent entity. And then,
21 that would've been subject to the tax rate
22 which we see here, that's five percent.

23 Q: Okay. And ---

24 A: And then we took a credit. We have a small
25 credit that we were getting for TC-31 there and

1 that comes to our tax.

2 Q: Had you also made any prior payments?

3 A: We had. According to this, it looks like we
4 had a -- quite the carry-over. In this
5 particular case, I think -- it looks like we
6 had rolled forward -- must've made tax payments
7 where we had been filing unitary for a period.

8 Q: Okay. And you mentioned at the beginning that
9 you, that you used financial statements to
10 start with, are you those audited?

11 A: Yes. Our fin- -- financial statements are
12 audited by E&Y.

13 Q: All right. And so, you've described for us how
14 you filed. Why do you file that way?

15 A: Because we're required to do so by law, so.
16 Our entity -- or South Carolina filing starts
17 with the income of the parent.

18 Q: Does Tractor Supply file using the combined
19 unitary reporting filing method in some states?

20 A: We do, and that's because we're required to.

21 Q: Why are you -- what do you mean by we are
22 required to?

23 A: Because their laws require that we file under
24 the unitary combined method.

25 Q: Okay. Does Tractor Supply use the separate



1 entity filing method in any states besides
2 South Carolina?

3 A: We do. And we do that because those states
4 require us to file on a separate filing method
5 basis.

6 Q: Do you know approximately how many states
7 Tractor Supply files a separate entity return
8 in?

9 A: I think it's like 13 or 14.

10 Q: Has any other separate entity state besides
11 South Carolina invoked -- let me -- hold on.
12 What other states besides South Carolina have
13 invoked alternative apportionment and required
14 you to file on a combined unitary basis?

15 **OBJECTION:**

16 **MS. WOOTEN:** Objection, it's not relevant for this
17 proceeding.

18 **THE COURT:** All right. You want to respond to that?

19 **MS. GEER:** I think it's relevant if the statutes are
20 similar and they have never been required to
21 file using this method in another state that
22 has the same statute.

23 **THE COURT:** All right.

24 **MS. WOOTEN:** Oh, I'm sorry.

25 **THE COURT:** Go ahead.



1 **MS. WOOTEN:** I don't believe Ms. McKeown ---

2 A: McKeown.

3 **MS. WOOTEN:** --- McKeown ---

4 A: You're th- --- that's good.

5 **MS. WOOTEN:** --- isn't an attorney. The other state
6 statutes are not relevant to this matter, we're
7 not applying those ---

8 **THE COURT:** Yeah, I think ---

9 **MS. WOOTEN:** --- statutes.

10 **THE COURT:** I sustain that objection.

11 Q: What is Tractor Supply's business activity in
12 South Carolina?

13 A: Its retail sales through its business stores
14 and e-commerce.

15 Q: And after you filed the original returns for
16 Tractor Supply Company, did you receive a
17 Notice of Audit?

18 A: We did.

19 Q: And what happened next?

20 A: We would've scheduled that audit, provided the
21 documentation requested for that audit,
22 scheduled an audit appointment, they would've
23 come onsite, we would've been available to
24 answer any questions that they would've had
25 while going through those work papers. We were



1 given a brochure, I believe, of 15-5, and --
2 explaining that a 482 study wasn't good enough,
3 I think, to suf- -- show that unitary did not
4 need to be applied. We were told that they
5 were going to propose or likely -- they were
6 looking at combined unitary reporting.

7 Q: And did you provide all of the information that
8 was requested by the auditors?

9 A: Yes. Well, to the best of my knowledge.

10 Q: What was the Department's position on the
11 audit?

12 A: That we should be forced combined unitary
13 reporting.

14 Q: And which entities did they combine?

15 A: Michigan -- Tractor Supply Company of Michigan,
16 Tractor Supply Company of Texas and Tractor
17 Supply.

18 Q: From a factual basis, does the standard
19 apportionment method fairly represent the
20 business activities of Tractor Supply in South
21 Carolina?

22 **OBJECTION:**

23 **MS. WOOTEN:** Objection. Legal conclusion.

24 **MS. GEER:** I started with, from a factual basis.

25 **MS. WOOTEN:** I wasn't ...



1 **THE COURT:** Go ahead.

2 **MS. WOOTEN:** I still think it's a, a legal
3 conclusion. That's the, the issue the
4 Department has raised in this case.

5 **THE COURT:** I think ... When you asked, from a
6 factual basis ---

7 **MS. GEER:** Yeah.

8 **THE COURT:** --- the only fact that would be relevant
9 to would be the -- because of the legal
10 requirement under the Statute.

11 **MS. GEER:** Well, I mean, Dr. DeRamus ---

12 **THE COURT:** And what, what other fact ---

13 **MS. GEER:** --- got to speak to it as ---

14 **THE COURT:** What if ---

15 **MS. GEER:** --- to an economic perspective.

16 **THE COURT:** Well, if she -- if you want to have her
17 qualified as an economist, she could testify
18 from that perspective, but ---

19 **MS. GEER:** I'm just asking what -- okay. Let me,
20 let me see if I can ask a different way.

21 **MS. WOOTEN:** Okay.

22 Q: What facts does Tractor Supply rely on in this
23 matter to support its position?

24 A: The ---

25 **OBJECTION:**



1 **MS. WOOTEN:** Objection. I don't -- what position is
2 she talking about?

3 **MS. GEER:** Our position in the case. I -- I'm not
4 a- -- I'm not asking her for an interpretation
5 of the law at all, I'm saying what facts do we
6 support our case with.

7 *(Whispering.)*

8 **THE COURT:** I think I'm gonna overrule that one.

9 **MS. WOOTEN:** Okay.

10 **THE COURT:** Just -- I mean, you're getting close,
11 but I ---

12 **MS. GEER:** I'll, I'll, be limited.

13 **THE COURT:** Okay.

14 **MS. WOOTEN:** Thank you.

15 A: Bryson, I apologize. I'm not sure I understand
16 the question (laughing).

17 *(Laughter.)*

18 **MS. GEER:** I got tanked by my own witness.

19 **MS. WOOTEN:** I just wanted to make sure I understood
20 her.

21 **MS. GEER:** Okay.

22 **THE COURT:** I sus- -- sustain your comment.

23 *(Laughter.)*

24 Q: What facts did you rely on in your discussions
25 -- and I -- what facts did you rel- -- did



1 Tractor Supply rely on -- ah -- hold on.

2 I'm gonna come back to this one, and maybe
3 it'll cl- -- my head will clear out in a minute
4 and I'll come up with a different way to ask
5 it.

6 All right. What percent of Tractor
7 Supply's business activity is in South
8 Carolina?

9 A: Based on the apportionment factor, I think it's
10 about three percent.

11 Q: And how much income -- how much of Tractor
12 Supply's income would that tax?

13 A: Three percent of the income.

14 Q: Okay. And under combined unitary reporting,
15 what percent of the Taxpayer's income is taxed?

16 A: About eight percent.

17 Q: Did the Department challenge the transfer
18 pricing study performed by PwC or otherwise
19 challenge the calculation of the procurement
20 fee paid by Tractor Supply during the audit --
21 or in the audit report?

22 A: It did not.

23 Q: And did they question anything about your
24 business structure or the -- or say that the
25 intercompany transactions lat- -- lacked



1 economic substance during either the audit or
2 in the audit report?

3 A: It did not.

4 Q: What did you do after you received the audit
5 report?

6 A: We filed a protest.

7 Q: Has the Department audited any of the Tractor
8 Supply entities prior to this audit?

9 A: They did.

10 Q: How many times?

11 A: At least two, to my knowledge.

12 Q: Can you tell us -- well, let's start with the
13 first audit. When was that ---

14 A: The first ---

15 Q: --- approximately?

16 A: The first audit was for the period 2001 through
17 2004, and it was done in 2006 I bel- -- if I
18 recall.

19 Q: And when was the second audit?

20 A: It was for 2008 through 2010, and I'm not
21 exactly sure when it was done.

22 Q: Okay. Sometime after 2010?

23 A: Yes.

24 Q: Okay. All right. Let's talk about the 2006
25 audit. Would this have covered the period



1 during which the restructuring occurred?

2 A: It would've?

3 Q: And what happened during this audit?

4 A: I don't know the substance of, you know, how
5 the proceedings went or how the audit went
6 while they were onsite because it was prior to
7 my time, but I do have records of what the
8 results were from ---

9 Q: Okay.

10 A: --- that audit.

11 Q: What was the result?

12 A: And the result was that Tractor Supply Company
13 -- I, I think there was not an issue with the
14 Tractor Supply Company filing, but Tractor
15 Supply Company of Texas was required to file,
16 but moving forward, using a factor that
17 included the markup for South Carolina sales as
18 a numerator, and the denominator was the
19 everywhere sales I believe of Texas. And so we
20 agreed to file that way and continued to file
21 that way up until the next audit.

22 Q: Okay.

23 A: And at that point in time, South Carolina
24 decided that they no longer wanted us to file
25 that way anymore. In this case our facts



1 hadn't changed really at all as far as they
2 number of legal entities or the types of
3 businesses that we were, you know -- the type
4 of business, we're still selling goods. But in
5 this particular instance, they requested that
6 we file combined -- TSC file combined with only
7 Tractor Supply Company of Texas.

8 Q: Okay. And so, they told you that position,
9 what happened after they told you that
10 position?

11 A: So after that position, we were given an -- a
12 preliminary assessment and we ultimately
13 settled at something less than that assessment,
14 and that was based on a methodology of Tractor
15 Supply Company of Texas filing separate, but
16 instead of using the markup -- South Carolina
17 markup as the numerator, it was the entire sale
18 -- inter-company sale to South Carolina as the
19 numerator, and this basically produced a bigger
20 result in the tax from this -- for the Tractor
21 Supply Company of Texas. From the -- also at
22 that point in time, we agreed -- not in a
23 formal agreement, but had agreed that we would
24 file combined moving forward. So in 2011, we
25 had already filed that tax return so that one

1 had gotten through, and then 2012 we filed
2 unitary, and then we had the *CarMax* case, and
3 so at that point in time, we -- since we didn't
4 have a binding agreement and we reviewed the
5 facts, we did not agree with South Carolina's
6 position that, you know, that we -- how we were
7 filing was unfair, and so we stopped filing for
8 Tractor Supply Company of Texas at that point.

9 Q: We -- you mentioned *CarMax*. How did that play
10 into your decision?

11 A: So be- -- and I'm gonna butcher this, so I
12 apologize. But, when we looked at that, it
13 looked that -- as though the person who had an
14 objection, you know, had to bear the burden of
15 proof to show that first, the, the -- that it
16 was unfair, the taxpayer's, I guess, nature or
17 business activities was unfair, or it was not
18 being fairly represented. And so we didn't
19 feel that that -- South Carolina had gotten to
20 that point in -- with that previous audit, so
21 therefore we didn't feel like we had to change
22 our filing position.

23 Q: Okay. Thank you.

24 **MS. GEER:** One minute, Your Honor.

25 Q: Thank you, Marjorie. Those are all the

