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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 IV**

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*

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1 questions I have, but please answer any that
2 Ms. Wooten has.

3 **MS. WOOTEN:** Your Honor, may we take a brief five-
4 minute break before cross?

5 **THE COURT:** Yeah.

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

7 **(Off the record from 4:11 p.m. until 4:23 p.m.)**

8 **THE COURT:** Be seated, thank you. Alrighty, Ms.
9 Wooten?

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

11 **MS. MCKEOWN - CROSS EXAMINATION BY MS. WOOTEN:**

12 Q: Ms. McKeown?

13 A: McKeown.

14 Q: May I please call you Marjorie?

15 A: Yes, you may.

16 Q: Thank you, I appreciate that. Okay. I'm gonna
17 have a few -- more than a few questions. All
18 right.

19 If you will refer to Respondent's Exhibit
20 5.

21 A: It's not ---

22 Q: I believe it's the one right there on top.

23 A: Oh, okay.

24 Q: Do you recall earlier in this trial we had a
25 discussion about Respondent's Exhibit 5 and



1 earnings calls?

2 A: I believe so, yes.

3 **(Respondent's Exhibit Number 5 was referenced at this**
4 **time.)**

5 Q: Okay. And I asked you to identify certain
6 individuals that had made statements in those
7 earnings calls, do you recall that?

8 A: Yes, reading from -- or no, that was a
9 different spot. But yes, I think so.

10 Q: Okay. For Respondent's Exhibit 5 we have
11 identified -- on page three, I'm sorry, we'll
12 do this again -- Mr. Barbarick?

13 A: Yes.

14 Q: Yes. And he is an executive of Tractor Supply
15 Company ---

16 A: Correct.

17 Q: --- correct? Okay. If you will flip to page
18 21, and it's Bates stamped SCDOR 004783.

19 A: Okay.

20 Q: Okay. Mr. Barbarick's statement begins on that
21 page, do you see that?

22 A: I do.

23 Q: Okay. About halfway down there's a sentence
24 that begins; the other.

25 **MS. GEER:** Your Honor? Or -- I'm fine. Sorry.



1 Yes, I'm good.

2 **MS. WOOTEN:** Okay. All right.

3 Q: There's a sentence that begins, the other. The
4 other is on the very far right side of the
5 page.

6 A: Oh.

7 Q: And it's halfway down.

8 A: Am I on the right page? The other -- okay.
9 I'm, I'm there now.

10 Q: Are we there?

11 A: Yes.

12 Q: Okay. The sentence is, the other thing I will
13 tell you is that our customers use our site for
14 a variety of reasons and our web businesses
15 last year were up 20 percent, which is
16 exciting. Do you see that statement?

17 A: I do.

18 Q: Okay. Do you ag- -- does TSC agree with that
19 statement?

20 A: If he said it, then I would assume that -- I
21 agree with that statement, yes.

22 Q: All right. The next sentence, and the other
23 exciting thing is our store locator activity
24 was up over 20 percent. Do you agree with that
25 statement?



1 A: If he said it.

2 Q: I'm sorry, does TSC agree with that statement?

3 A: If he said it, TSC agrees.

4 Q: Yes, okay. So not only are customers finding
5 us through the site, but there are actually
6 many new customers using that store locator to
7 come into our brick and mortar space. Does TSC
8 agree with that statement?

9 A: The same answer. You know, if he said it, then
10 we agree with that answer.

11 Q: Okay. I'm happy to keep going through each
12 sentence through the end of that statement, if
13 counsel would like for me to, but do you have
14 -- does TSC disagree with any statement in that
15 paragraph beginning with, the other thing I
16 would tell you, down to the last sentence which
17 ends in, we have to over them?

18 A: Okay. Give me a second, please. (Reviews
19 document.)

20 Q: Actually, we'll just go through them one-by-one
21 and have them, have them read, and you can tell
22 me if you agree or not.

23 Our sales online continue to grow. Does
24 TSC agree with that statement?

25 A: TSC agrees with that statement.



1 Q: Okay. While they're still less than one
2 percent of our sales, we're very encouraged
3 with the growth rate that we're seeing. Does
4 ...

5 A: TSC agrees with that statement.

6 Q: Thank you. We've doubled the amount of drop-
7 ship vendors we have from year over year.

8 A: TSC agrees with that statement.

9 Q: We've got 75,000-plus SK- -- SKUs now that you,
10 you have access to online compared to about
11 15,000 to 20,000 inside the store.

12 A: Not sure about the SKU count, but if he said
13 it, TSC agrees.

14 Q: And what's also exciting is about half of our
15 sales online are from products that you can't
16 find in one of our stores.

17 A: TSC agrees with that statement.

18 Q: So we see that as a growth opportunity for
19 incremental comp store sales as we continue to
20 expand that out.

21 A: TSC agrees with that statement.

22 Q: So that's kind of an overview and an update,
23 and I would tell you that our customers are
24 responding very favorably to what we have to
25 offer them.



1 A: TSC agrees with that statement.

2 Q: All right. If you'll flip to page 24.
3 Actually, just flip to page 23. At the bottom
4 of the page ---

5 A: Where's, where's page 23?

6 **MS. GEER:** Yeah, it's ---

7 Q: Here, I'll show for identification. I didn't
8 include it in the exhibit because of other
9 statements.

10 **MS. WOOTEN:** (To Ms. Geer) Would you like to? Okay.

11 **MS. GEER:** (Whispering.)

12 Q: 23 begins with Mr. Barbarick's statement ---

13 A: Okay.

14 Q: --- and it continues over to 24 ---

15 A: Okay.

16 Q: --- and 24's the page that you have.

17 A: Okay.

18 Q: All right. So we're looking at page 24, SCDOR
19 004786, and if you'll look in the middle of
20 that first paragraph there's a sentence that
21 begins, as you look into 2017. Are you with
22 me?

23 A: Yes.

24 Q: Okay. Great. As you look into 2017, I think
25 you will continue to see an evolution of where



1 we're putting our marketing dollars.

2 Does TSC agree with that statement?

3 A: TSC agrees with that statement.

4 Q: We'll be spending more of those dollars on
5 things that are more digital.

6 Does TSC agree with that statement?

7 A: TSC agrees with that statement.

8 Q: We will be taking advantage of our Neighbor's
9 Club Program as we continue to scale that out
10 and talking to our customers.

11 A: TSC agrees with that statement.

12 Q: And we'll continue to evolve based on what
13 they're wanting from us.

14 A: TSC agrees from that, that -- TSC agrees with
15 that statement.

16 Q: And we can measure that through the response
17 rates in a lot of what we do.

18 A: TSC agrees with that statement.

19 Q: So we've always said the customer drives where
20 we want to go in this case, and we're going to
21 get in the backseat and let them take us for a
22 ride.

23 A: TSC agrees with that statement.

24 Q: Thank you, very much. All right. There's also
25 another Respondent's Exhibit, it's Exhibit



1 Number 6. And this is similar to the other --
2 we -- do you recall reviewing this document in
3 your prior testimony in this case?

4 A: Yes, I do.

5 **(Respondent's Exhibit Number 6 was referenced at this**
6 **time.)**

7 Q: Okay.

8 **MS. WOOTEN:** May I approach the witness, Your Honor?

9 Q: Well, first let me ask you. On -- do you have
10 page three ---

11 A: No.

12 Q: --- in this document?

13 A: I do not.

14 Q: Okay. Do we have the same document?

15 A: I think so, yes.

16 Q: Okay. I'm gonna flip to page three. Do you
17 recall Mr. Gregory Sandfort?

18 A: Yeah, Greg Sandfort, yes.

19 Q: Sandfort.

20 A: Uh-huh.

21 Q: Okay. Who is he?

22 A: He was our CEO, at one point was President.

23 Q: Okay. All right. I'm going to turn to page
24 five. I apologize, page four.

25 A: Uh-huh.



- 1 Q: Mr. Sandfort's statement begins on page four?
- 2 A: Yes.
- 3 Q: Okay. And it continues onto page five?
- 4 A: I -- right. I assume so, yes. Okay.
- 5 Q: Okay. And now we're on page six.
- 6 A: Yes.
- 7 Q: And you, and you have page six?
- 8 A: I do.
- 9 Q: Okay. All right. If you'll look at the bottom
- 10 paragraph.
- 11 A: Yes.
- 12 Q: It begins with, as we better understand our
- 13 markets?
- 14 A: Yes.
- 15 Q: Okay. We're gonna start with the sentence that
- 16 begins, one of the things.
- 17 A: Yes.
- 18 Q: Okay. Great. One of the things that we're
- 19 focused on today is what we call localization,
- 20 understanding that local Tractor Supply in that
- 21 small town and what are the needs in that store
- 22 versus the store that maybe loced- -- located
- 23 40 or 50 miles away.
- 24 A: TSC agrees with that statement.
- 25 Q: It's difficult to do.



1 A: TSC agrees with that statement.

2 Q: It takes a lot of talent and a lot of system's
3 work.

4 A: TSC agrees with that statement.

5 Q: But we understand it is -- we understand it
6 better today than we have.

7 A: TSC agrees with that statement.

8 Q: And we continue to work on it?

9 A: TSC agrees with that statement.

10 Q: But localization is important.

11 A: TSC agrees with that statement.

12 Q: Having the right mix in that store in that
13 market is what Tractor is about?

14 A: TSC agrees with that statement.

15 Q: Thank you. Is TSC a unitary business?

16 **OBJECTION:**

17 **MS. GEER:** Objection, Your Honor. Calls for a legal
18 conclusion.

19 Q: Does TSC file a unitary return?

20 A: It does.

21 Q: Could TSC file a unitary return if it was not
22 a unitary business?

23 A: I guess it all depends on ---

24 **OBJECTION:**

25 **MS. GEER:** Objection. Calls for a legal conclusion



1 as well.

2 **MS. WOOTEN:** I asked her if she filed unitary
3 returns, she said yes.

4 **THE COURT:** No, you said could -- and could she file
5 a unitary return if she was not a unitary
6 business.

7 **MS. WOOTEN:** Right.

8 **MS. GEER:** That would require interpretation of the
9 law to see if ---

10 **THE COURT:** Yeah.

11 **MS. GEER:** --- she could.

12 **THE COURT:** I think it would.

13 **MS. WOOTEN:** Okay. It was a good try though.

14 **THE COURT:** I think it's a good try.

15 *(Laughter.)*

16 **THE COURT:** I actually was gonna say that.

17 **MS. WOOTEN:** I appreciate that.

18 **THE COURT:** Okay. Yeah.

19 **MS. WOOTEN:** All right.

20 **THE COURT:** Luther's rubbing off on you, I'm just
21 telling you.

22 **MS. WOOTEN:** Mr. Luther's rubbing off?

23 **THE COURT:** Yeah.

24 **MS. WOOTEN:** *(Laughter.)*

25 **Q:** Okay. All right. During your direct



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ROA_001310

1 testimony, you discussed the Board meetings
2 surrounding the 2001 restructuring, correct?

3 A: Correct.

4 Q: And you were not there at that time ---

5 A: No.

6 Q: --- correct? Okay. And nobody is at Tractor
7 Supply currently that was at those Board
8 meetings, correct?

9 A: Correct.

10 Q: Okay. So you have no way to know whether or
11 not what was said and what was meant during
12 those Board meetings?

13 A: Not from physically being in those meetings.

14 Q: Okay. And the only, the only documents that we
15 have to record any intent by TSC regarding that
16 restructuring is in those Board meetings,
17 correct?

18 A: The only doc- -- can you repeat the question,
19 please?

20 Q: Sure. The only document -- or the only
21 statements from TSC documenting the intent of
22 the restructuring is con- -- contained in those
23 Board minutes, correct?

24 **THE COURT:** I think you said meetings last time.

25 **MS. WOOTEN:** Okay.



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ROA_001311

1 **THE COURT:** Minutes, yeah. That makes ...

2 **MS. WOOTEN:** Minutes.

3 A: The only min- -- say it one more time, please,
4 I'm sorry.

5 **MS. WOOTEN:** Can I get the court reporter to repeat
6 that, please?

7 *(Laughter.)*

8 **MS. WOOTEN:** Sorry. I thought it was a little bit
9 easier.

10 **COURT REPORTER:** It's coming.

11 **(The question was played back at this time.)**

12 Q: Okay. All right. During your, direct
13 testimony, you discussed the Board
14 meetings surrounding the 2001
15 restructuring, correct?

16 A: Correct.

17 Q: And you were not there at that time ---

18 A: No.

19 Q: --- correct? Okay. And nobody is at
20 Tractor Supply currently that was at those
21 Board meetings, correct?

22 A: Correct.

23 Q: Okay. So you have no way to know whether
24 or not what was said and what was meant
25 during those Board meetings?



1 A: Not from physically being in those
2 meetings.

3 Q: Okay. And the only, the only documents
4 that we have to record any intent by TSC
5 regarding that restructuring is in those
6 Board meetings, correct?

7 A: The only doc- -- can you repeat the
8 question, please?

9 Q: Sure. The only document -- or the only
10 statements from TSC documenting the intent
11 of the restructuring is con- -- contained
12 in those Board minutes, correct?

13 A: I think I understand the question now.

14 Q: Okay.

15 A: Do we -- the only documents that clearly say
16 restructuring with any types of reasons are --
17 well, I don't know if it's just the minutes, I
18 think there's also a PwC Work Plan. The, the
19 book, the PwC Memos or whatever. But -- did
20 you ask about the minutes explicitly?

21 Q: And I asked about the minutes. I'm not asking
22 you about what PwC thinks, I'm asking you about
23 what TSC thinks, and what TSC intended were the
24 goals or the reasons behind the restructuring.

25 A: I honestly forgot the question again. The --



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ROA_001313

1 are the only minutes that we have documenting
2 the -- is that what the question?

3 Q: What are the reasons for the restructuring?
4 What are the reasons and the goals for the 2001
5 restructuring according to TSC?

6 A: According to TSC.

7 Q: Uh-huh.

8 A: Expansion and enhancing its earnings through
9 expansion.

10 Q: All right.

11 A: It would be building out the procurement
12 function. It would be asset liability
13 protection, and minimization of taxes, if there
14 was an opportunity to do so.

15 Q: All right. So you, you gave four reasons as to
16 why TSC embarked on the restructuring process,
17 correct? It was expansion, procurement, asset
18 liability protection, and minimization of
19 taxes?

20 A: Yeah. Expansion, you know, growth of the
21 business, yeah.

22 Q: Growth of the business. But that would be
23 included in the expansion part, or is that a
24 separate reason?

25 A: I mean, you can grow in other ways -- well, I



1 mean, I guess, you can expand through, kind of,
2 organic growth or kind of self-growth, or
3 through acquisition, so it's a little bit --
4 but.

5 Q: So five reasons?

6 A: Maybe. Yeah, five. Sorry.

7 Q: Five, five reasons? Okay. So I've got growth
8 as one, expansion, procurement, asset liability
9 protection and minimization of tax.

10 A: Yes.

11 Q: Okay. Where are the Board minutes that talk
12 about the growth reason for the restructuring?

13 A: I don't know if there were, were any, I haven't
14 seen any. The, the expansion and the growth,
15 the ---

16 Q: But you did look for -- as the 30(b)(6) witness
17 for Tractor Supply, you did look for all
18 documents related to this ---

19 A: Yes.

20 Q: --- restructuring? And in that process you did
21 not find any documents related to TSC's stated
22 reason of growth?

23 A: I did not find any minutes.

24 Q: Okay. You didn't find any documents?

25 A: I did not find any, did not find any documents.



1 The, the website -- there was a -- you know, if
2 you were to Google kind of around that time
3 there's a website that talks about our purchase
4 of Quality about that time, and there are -- I
5 came across a internal -- it was a book that
6 was published that, that just documents our
7 history, and it talked about what was going on
8 during that time.

9 Q: All right. So you've got that website and that
10 manual, correct?

11 A: It's not a manual, it's a -- it was a book that
12 was published ---

13 Q: Okay.

14 A: --- or something.

15 Q: A book?

16 **THE COURT:** A book? By whom?

17 A: I don't recall the author's name.

18 Q: Okay. I'm just asking about Tractor Supply
19 Company. I want to Tractor Supply documents
20 that evidence their intent behind this
21 restructure. I'm not concerned about PwC
22 thinks or what anybody else thinks. I'm, I'm
23 just focusing on Tractor Supply Company.

24 A: To my knowledge, there are not any other
25 documents of those minutes.



1 Q: Okay. What about expansion? Does TSC have any
2 documents -- anything documenting the stated
3 reason of expansion for a reason for the
4 restructuring?

5 A: It does not. And not in the minutes, you know,
6 or, or any documents that say the intent of
7 this restructuring is for expanding through
8 growth or.

9 Q: Okay. What about procurement?

10 A: We do have a template or a, or a letter, a
11 vendor letter where we had indicated that
12 things were not changing but that our -- the
13 positions were not changing as far as the
14 locations, but that we were changing the
15 business of whom a vendor -- the merchant was
16 for, for purchasing of inventory.

17 Q: Okay. So let me, let me back up and make sure
18 I understand. So we're talking about the
19 procurement function and I'm asking were there
20 any documents, whether they're minute --
21 meeting minutes or otherwise, that say the
22 reason why -- one of the reasons we entered
23 into -- or are entering into this tax
24 restructuring is for procurement?

25 A: No, there is not a document that says that.



1 Q: Okay. What about asset liability protection,
2 are there any documents related to the
3 restructuring and asset liability protection?

4 A: I'm unsure if that was one of the items that
5 was mentioned in, in the minutes.

6 Q: Any other document at TS- -- or at TSC?

7 A: The PwC restructuring documentation.

8 Q: Again, we're leaving, we're leaving PSC out of
9 it, I'm just focusing on TSC. I understand
10 you're saying they're at Tractor Supply
11 Company, but I'm saying Tractor Supply
12 representations or statements regarding the
13 intent behind the restructuring?

14 A: Got you.

15 Q: Okay.

16 A: No. To me, that was support for Tractor Supply
17 Company, so. But it does not say that -- I
18 don't think there's a statement that says that
19 is the reason why we did that.

20 Q: And just to close the loop on that, we were
21 talking about asset liability protection,
22 correct?

23 A: I do not recall if there was a, a direct
24 statement in the Board minutes that says that
25 in one way or the other.



1 Q: Okay. Any other Tractor Supply document
2 besides the minutes? Are there any other
3 documents that reference asset liability
4 protection as a reason for the restructuring in
5 2001?

6 A: Not that I can recall, no.

7 Q: So the only documents that we have expressing
8 Tractor Supply's reasons behind the
9 restructuring in 2001 are related to tax
10 opportunities?

11 A: Those were cited in the minutes, yes.

12 Q: There's no other documents that we have ---

13 A: Oh, the -- then yes, you're correct.

14 Q: Okay.

15 **MS. WOOTEN:** I'm sorry, Your Honor. Please, bear
16 with me. My notes are all over the place.

17 Q: During your direct you also stated that TSCT,
18 Texas, determines the markup based on a 482
19 study. Do you recall that statement?

20 A: Yes.

21 Q: Is that an accurate statement? I mean, ---

22 A: It's ---

23 Q: --- accurately representing that you said that?

24 A: I believe so, yeah.

25 Q: Okay. Who commissioned the study for that



1 transfer pricing study at issue in this case?

2 A: Who commissioned the study?

3 Q: Yes. Was it Tractor Supply Company or Tractor
4 Supply Company Texas?

5 A: Tractor Supply Company.

6 Q: All right. During your direct you also
7 discussed with your attorney how the, the
8 intercompany transactions are documented in
9 Tractor Supply's accounting records, they are
10 journal entries and no checks are cut. Do you
11 recall that?

12 A: Yes.

13 Q: Okay. Okay. But you would agree, that if you
14 paid a third party for those same transactions,
15 those same fees for the same services, you
16 would have to move money, either by check or
17 electronic funds, etcetera?

18 A: Correct, or owe them money if I hadn't paid
19 them yet.

20 Q: Right. And you would agree that that income
21 then goes outside of Tractor Supply Group, it
22 is no longer inside and available for use by
23 Tractor Supply Company or any of its entities?

24 A: Correct, it goes outside the group.

25 Q: Okay. With the journal entries, the money



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1 stays within the group?

2 A: It does stay within the group.

3 Q: Okay. So the entities have use of that income?

4 A: Yes.

5 Q: Okay.

6 **MS. WOOTEN:** Can you pull up my org chart? Ms.
7 Buckner -- I'm sorry. I apologize, you were on
8 it.

9 *(Laughter.)*

10 **MS. WOOTEN:** I thought there was a delay on our
11 side.

12 Q: We're looking at Joint Exhibit 4, this is the
13 org chart that I believe you were discussing in
14 your earlier testimony?

15 A: It is.

16 **(Joint Exhibit Number 4 was referenced at this time.)**

17 Q: Okay. All right. And I believe your statement
18 was the, Department in their Determination,
19 combined only Tractor Supply Company, Tractor
20 Supply of Michigan, and Tractor Supply of
21 Texas, correct?

22 A: For the audit period?

23 Q: Yes, for the audit period.

24 A: It combined Tractor Supply Company, which has
25 all of these entities ---



1 Q: Okay.

2 A: --- that roll-up into it ---

3 Q: That's, that's my question.

4 A: --- with Michigan and Texas, yes.

5 Q: That's my question. So these other entities
6 that are on the screen, they are part of it as
7 well, because they are LLCs and they ---

8 A: They're sin- ---

9 Q: --- roll-up?

10 A: They're single member LLCs ---

11 Q: Okay.

12 A: --- that are owned by the parent.

13 Q: Okay. I just wanted to clarify that.

14 A: Yes. Their activities are in the parent for
15 the purposes of filing.

16 Q: So all of these were included in the
17 Department's Determination?

18 A: Correct.

19 Q: Okay.

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

21 Q: I'm gonna test your memory on this one.

22 A: Oh, gosh.

23 Q: I, I really don't have to go by the document
24 but I will. For any of the years, we'll say
25 '14, '15 or '16, do you recall Tractor Supply



1 Comp- -- or the group's cost of sales for
2 inventory?

3 A: The group's cost of sales?

4 Q: Uh-huh.

5 A: No, not offhand.

6 Q: Not an exact number, was it millions? Is it
7 billions?

8 A: Billions, probably.

9 Q: Okay. Does four billion sound about right?

10 **OBJECTION:**

11 **MS. GEER:** Objection, Your Honor.

12 A: Yeah, I don't know off the top of my head.

13 Q: But you would agree it's billions?

14 A: It's billions.

15 **THE COURT:** Wait a second.

16 A: I think.

17 **MS. WOOTEN:** Oh, I'm sorry.

18 **THE COURT:** You object?

19 **MS. GEER:** I objected based on speculation.

20 **MS. WOOTEN:** Okay. Well, we'll pull up the
21 document. Can you pull up ---

22 **MS. GEER:** I just think it'll be better if it's
23 accurate. I, I ---

24 **MS. WOOTEN:** I understand.

25 **MS. GEER:** --- I'm sorry to ---



1 **MS. WOOTEN:** I understand. (To Ms. Gamble) Can you
2 pull up ...

3 **THE COURT:** Well, she just agreed with it's
4 speculation, but I would ...

5 **MS. WOOTEN:** I understand. We'll keep the record
6 clear.

7 (To Ms. Gamble) Can you get Joint Exhibit
8 30? Here -- no, no.

9 *(Whispering.)*

10 **MS. WOOTEN:** I'm gonna go onto something while she's
11 finding that.

12 Q: Okay. So I'm gonna hand you a large notebook.
13 It is identified as Joint -- excuse me,
14 Department Exhibits 1 through 3, and it is the
15 10-Ks for Tractor Supply Company for 2000, 2001
16 and 2002.

17 **(Respondent's Exhibit Numbers 1, 2 and 3 were**
18 **introduced into the record at this time.)**

19 A: Okay.

20 Q: So, Joint Exhibit 1 would be 2000.

21 A: Huh?

22 Q: And I've got them marked. You can -- I'll let
23 you flip so you can identify them.

24 A: Okay.

25 *(Whispering.)*



1 **MS. WOOTEN:** Sorry, Your Honor. If you'll beg the
2 counsel -- the Court's indulgence, please.

3 **Q:** Excuse me, I'm sorry. I'm going to look at
4 something that's over here.

5 **A:** Okay.

6 **Q:** And I apologize.

7 **MS. WOOTEN:** Okay. I'll just use this one. It's
8 already in evidence? Okay.

9 **Q:** In 2000, Tractor Supply of Texas was not in
10 existence, correct?

11 **A:** Correct.

12 **Q:** You hadn't go through -- y'all hadn't gone
13 through the restructuring. Okay. As part of
14 the 10-Ks, 2000 -- I'm sorry, I'm gonna
15 approach just to walk over here -- there's a
16 section entitled purchasing and distribution.
17 Do you see that?

18 **A:** Yes.

19 **Q:** Okay. On the last sentence of that first
20 paragraph, could you read that sentence for me?

21 **A:** The company's merchandise purchasing is
22 centrally managed.

23 **Q:** Okay. All right. If you'll flip to Exhibit
24 Number 2, and that would be Tractor Supply
25 Company Annual Report and 10-K for 2001. And



1 this is the year of the tax restructuring,
2 correct?

3 A: Correct.

4 Q: And it was the year ---

5 A: Well, let's back up. What, what you're
6 referring to as, sometimes, in here as the tax
7 restructuring.

8 Q: All right. If you will bear with me just a
9 second.

10 **MS. WOOTEN:** Where is Exhibit 12?

11 Q: I'm gonna hand you what's been marked -- or
12 what's been admitted as Exhibit 12.

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

15 Q: Could you read that first sentence beginning
16 whereas?

17 A: Whereas the corporation has established a
18 strategy for reduction of state income tax
19 expenses, the details of which were previously
20 presented to the Board, the tax restructuring
21 in quotes.

22 Q: Okay. So Tractor Supply Company is calling it
23 the tax restructuring, correct?

24 A: In those minutes.

25 Q: Are the minutes not accurate?



1 A: The minutes are accurate for what was recorded,
2 yeah.

3 Q: Are they not a reflection of Tractor Supply's
4 statements?

5 A: They are a reflection of what was said.

6 Q: Are they a reflection of Tractor Supply's
7 statements?

8 A: They are a reflection of Tractor Supply's
9 statements.

10 Q: Okay. Thank you. 2001 was the implementation
11 of the restructuring, correct?

12 A: Correct.

13 Q: Okay. That 10-K does not discuss any of the
14 new entities under the restructuring?

15 A: Okay.

16 **THE COURT:** I think that one ---

17 A: Does it, does it mention the subsidiaries at
18 some point in this document?

19 Q: Is Tractor Supply's document -- I think I know
20 the answer, but I want to know what you -- what
21 your answer is.

22 A: I have not looked at this particular document
23 in detail.

24 Q: Okay. Does it describe the procurement
25 function, the new procurement function under



1 Tractor Supply Texas?

2 A: I'm reading the section purchasing and
3 distribution.

4 Q: Sure.

5 A: Not that I see in this section.

6 Q: Okay. And in that same section with purchasing
7 and distribution, that last sentence in the
8 paragraph that we read in the 2000 10-K, if you
9 could read the same sentence in the 2001 10-K?

10 A: The company's merchandise purchasing is
11 centrally managed.

12 Q: Okay. Great. Thank you. All right. Let's go
13 to 2002. So this is a year after the
14 restructuring, correct?

15 A: Correct.

16 Q: Okay. Actually let's -- before we go, let's go
17 back to the other, 2001. Does the 2001 10-K
18 discuss the income -- and I'm using this in
19 quotes, that Tractor Supply Texas receives from
20 this special purchasing function that's been
21 described by you in your earlier testimony?

22 A: I don't think we've ever separately dep- --
23 reported that in any of our financial
24 statements, so I would be surprised to see that
25 here.



1 Q: Okay. So it, it wouldn't be in the 2000, 2001
2 or 2002 10-K?

3 A: No.

4 Q: And it's not in the '14, '15, or '16 10-K?

5 A: No.

6 Q: Okay. Thank you. All right. Now, can we go
7 to the 2002?

8 Same questions as before. Does the 2002
9 10-K discuss Tractor Supply Texas or this newly
10 developed -- or implemented procurement
11 function?

12 A: Not that I can tell. Not that I see.

13 **MS. WOOTEN:** Your Honor, at this time, the
14 Department would move in -- would offer
15 Department Exhibits 1 through 3 into evidence.

16 **(Respondent's Exhibit Numbers 1, 2, and 3 were**
17 **offered into evidence.)**

18 **MS. GEER:** Your Honor, if they're coming in, then I
19 would suggest that they -- the whole document
20 comes in for context.

21 **MS. WOOTEN:** Sure. And we have the entire document
22 copy, and that was my intent.

23 **THE COURT:** All right. So is what you offered the
24 entire document?

25 **MS. WOOTEN:** I am offering the entire document.



1 **THE COURT:** Okay. It's admitted.

2 **(Respondent's Exhibit Numbers 1, 2 and 3 were**
3 **admitted into evidence.)**

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

5 **THE COURT:** Actually, they are admitted.

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

7 Q: Okay. I hope we're getting close. All right.
8 Marjorie ---

9 A: Uh-huh.

10 Q: --- I'm going to approach you again. This was
11 an exhibit that was admitted yesterday. It was
12 part of Mr. Sehgal's testimony.

13 A: Okay.

14 Q: It is a representation of the 26- -- or 2016
15 federal consolidated return. Do you see that
16 and agree that that is a representation of
17 that?

18 A: It's one of the, the white schedules supporting
19 the document ---

20 Q: Okay.

21 A: --- yes.

22 **(Respondent's Exhibit Number 32 was referenced at**
23 **this time.)**

24 Q: On that document is there a figure listed
25 related to cost of all goods sold?



1 A: There are a couple.

2 Q: Okay.

3 A: There's three at least.

4 Q: For -- okay. What's the total?

5 A: There isn't a total on this page.

6 Q: Okay. If you could give me the three figures?

7 A: So the three figures are 5 billion, 515,000,
8 600- -- sorry, \$5,515,609,574 for Tractor
9 Supply Company. Then we've got -- I'm sorry,
10 I'm reading the wrong line. That was, that was
11 the balance once he -- my bad. Cost of goods
12 sold, that would be \$3,935,481,108, and that's
13 for Tractor Supply Company.

14 Q: Okay.

15 A: Tractor Supply Company of Texas, \$4,329,255,700
16 -- 767. And then for Tractor Supply Company of
17 Michigan, \$261,863,133.

18 Q: For the inventory purchased by Tractor Supply
19 Company, does that include the intercompany
20 sales, or is that just -- tell me -- break
21 those down for me. What are the cost of goods
22 sold for Tractor Supply Company versus Tractor
23 Supply of Texas?

24 A: So Tractor Supply Company of Texas's cost of
25 goods sold would include the cost of



1 intercompany sales, cost of goods related to
2 the inter, intercompany sales, as well as the
3 cost of goods sold for the Texas stores.

4 Q: Okay. Now, with Tractor Supply Company.

5 A: Tractor Supply Company's cost of goods sold
6 would be the, the cost of goods sold for the
7 inventory it has acquired from Tractor Supply
8 Company of Texas.

9 Q: Okay.

10 **MS. WOOTEN:** Ms. Buckner can we have ... Is it on?

11 **MS. BUCKNER:** It should, it should be on.

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

13 Q: Do you recall earlier -- your testimony earlier
14 this week that -- well, what is your testimony
15 earlier this week regarding the amount of
16 inventory that is imported, so outside of the
17 United States? What percentage of the
18 inventory to Tractor Supply's total inventory
19 comes from vendors outside of the United
20 States?

21 A: I'm pretty sure it's about 14 percent of our
22 sales.

23 Q: Okay.

24 A: I ---

25 **MS. WOOTEN:** If you'll scroll down just a little



1 bit. Keep scrolling. Okay, stop.

2 Q: What is the limit on this policy?

3 A: 5 million.

4 Q: Okay.

5 **MS. WOOTEN:** If you'll pull up -- yeah. Like take
6 it, take it down first and then ... Yeah,
7 that's enough.

8 *(Whispering.)*

9 **MS. WOOTEN:** One moment, Your Honor, sorry.

10 Q: These are the official marked for Joint
11 Exhibits 1 through 3.

12 **MS. WOOTEN:** Your Honor, at this time we would also
13 move to ad- -- add these three slides back in
14 to Dr. Deramus's Exhibit under -- or
15 Respondent's Exhibit 33. These were the
16 statements that I asked the witness to read and
17 agree to and she agreed to all of them.

18 **(Respondent's Exhibit Number 33 slides number 12, 14,
19 and 15 were offered into evidence.)**

20 **MS. GEER:** No objection.

21 **THE COURT:** They're admitted.

22 **(Respondent's Exhibit Number 33 slides number 12, 14
23 and 15 were admitted as part of Exhibit Number 33
24 into evidence.)**

25 **MS. WOOTEN:** Thank you. It's -- and it would be



1 slides 14, fif- -- 12, 14 and 15.

2 (*Whispering.*)

3 **THE COURT:** I said they were admitted, I guess, the
4 correct ruling would be that they can now be
5 part of the, of the exhibit and -- so you can
6 reinsert them.

7 **MS. WOOTEN:** Thank you. We will reinsert them.

8 **THE COURT:** All right.

9 **MS. WOOTEN:** Also for a housekeeping matter, I
10 believe the Court may have the original marked
11 exhibit. Do you have the original marked
12 exhibit for Dr. DeRamus? We can, we can ---

13 **MS. BUCKNER:** You handed me a copy yesterday. I
14 don't know if it was the official marked copy
15 or not.

16 **MS. WOOTEN:** We can't find the original marked one
17 now, so that's why I'm asking. If you don't,
18 we can, we can print it again.

19 **MS. BUCKNER:** I may have it, but it'll ---

20 **MS. WOOTEN:** Okay.

21 **MS. BUCKNER:** --- be back at our office.

22 **MS. WOOTEN:** Okay. That's fine. Just housekeeping.
23 All right. Thank you, Your Honor, that's all
24 for the Department.

25 **THE COURT:** All right.



1 **MS. GEER:** All right. Real brief.

2 **THE COURT:** Okay.

3 **MS. MCKEOWN - RE-DIRECT EXAMINATION BY MS. GEER:**

4 Q: Marjorie, when did you -- when did the
5 Department first request for you to find -- for
6 Tractor Supply to find documents regarding the
7 restructure?

8 A: A long time ago. At this point, I don't even
9 remember when we started this?

10 Q: Prior to or after this litigation?

11 **THE COURT:** Prior to or after this -- okay.

12 A: Yeah, prior to this litigation. Prior to being
13 here, yes.

14 Q: Before or after this audit began?

15 A: After the audit began. Yes, that's when we
16 were -- when we, we got documents asking for --
17 repeat your question one ---

18 Q: What was the source of the, of the request?
19 How did you receive the request for documents
20 about the restructure?

21 A: For this litigation? Is that what -- that's?

22 Q: Yes.

23 A: I guess those came via -- through requests that
24 came from you guys. Sorry, through Nelson,
25 Nelson Mullins.



1 Q: And were you identified as a 30(b)(6) witness
2 during this case?

3 A: Yes.

4 Q: And as part of that 30(b)(6) Notice, were you
5 requested to speak to the issue of the
6 restructuring?

7 A: I believe so.

8 Q: What did you do to prepare for the deposition
9 and to respond to the request for documents?

10 A: Asked for whatever I could find. Asked legal
11 to go through their records to the extent that
12 they may even still have anything around us,
13 it's been so long, hardly anybody still works
14 there that would be in any type of position to
15 understand what was going on at that time at
16 any level to be able to get information from,
17 so that was an additional challenge of trying
18 to learn what was going on. I had limited
19 information that wasn't -- you know, based on
20 our retention policy, which is how we have to
21 documents that we, we did have related to the
22 restructuring. I Googled, you know, to see if
23 I could find anything on the internet and I had
24 just, honestly, didn't even realize I had it,
25 it was a book my boss had handed me before



1 leaving years ago, where I guess the company
2 had asked to document some of it's history and
3 it was published, and that's about it. And
4 then anything that ---

5 Q: And who did you speak ---

6 A: Oh, okay.

7 Q: Did you speak to anyone?

8 A: I did.

9 Q: And who did you speak to?

10 A: I spoke to one of our buyers who was there at
11 that time to get a better sense. First, I
12 actually spoke to our current CFO, Kurt Barton,
13 and he was not an officer at that time, he was
14 junior in his career, but I thought he might
15 know something about what was going on and he
16 remembered that there was, that there was a lot
17 of focus around wanting to, to -- looking, you
18 know, to build up that inventory function, so
19 that's what sent me to Matt McGrath to begin
20 with.

21 Q: And who is Matt McGrath?

22 A: He is a -- I just think it's -- I was trying to
23 think if there's a senior in front of his
24 title, but it's -- I think it's vice president
25 DMM of one of the category lines or verticals,



1 I guess, for products in, in the buyer group.

2 Q: And did you follow-up on the -- trying to learn
3 more about the reasons for the restructure with
4 him?

5 A: I did. He gave me a little bit more insight as
6 to all of the conditions that existed prior to
7 the restructuring, some of its limitations to
8 be am- -- and being able to, to go directly to
9 the vendor, why they wouldn't deal with us,
10 some of the things that we were hoping to
11 achieve but couldn't get there yet due to our
12 size, the seasonality. He gave me, basically,
13 the support for a lot of that information and
14 the back story.

15 Q: And then you mentioned earlier the PwC
16 documents. What is captured in the PwC
17 documents?

18 A: PwC documents pro- -- provide a little
19 additional information as to other reasons why
20 we would've wanted to restructure, ones that we
21 wouldn't've necessarily probably thought of,
22 given the fact that we didn't have a legal ---

23 **OBJECTION:**

24 **MS. WOOTEN:** I'm, I'm gonna object to this. Now
25 we're getting into hearsay and she's relying on



1 what PwC -- this is -- these are not TSC
2 reasons why they're doing it, she's now getting
3 into PwC reasons.

4 **MS. GEER:** She's testifying as to how she reached
5 her understanding of what the reasons for the
6 restructure are.

7 **MS. WOOTEN:** By relying on PwC statements that are
8 not in the record.

9 **THE COURT:** Yeah. But she can testify -- I'm not
10 even sure as the 30(b)(6), I guess, she could
11 testify to her ---

12 **MS. GEER:** I mean, she's obligated under that
13 30(b)(6) Notice to do the ---

14 **THE COURT:** Yeah, but you're ---

15 **MS. GEER:** --- research there, and so.

16 **THE COURT:** What you're doing, is you're going and
17 saying, here is a hearsay reason why I relied
18 upon it, and I just don't -- if you're gonna
19 give me a rul- -- an evidentiary rule that
20 would allow her to do that, but it's ...

21 **MS. GEER:** What about the ancient document exception
22 rule? Is it more than 20 years old?

23 *(Laughter.)*

24 **THE COURT:** I don't know.

25 **MS. GEER:** I mean, honestly.



1 **MR. STREISEL:** No, really. I mean, where's the
2 book?

3 **THE COURT:** Well, the ancient document exception to
4 the hearsay ru- -- rule would allow the ancient
5 document potentially to come in, but not her
6 testimony about the ancient document, therein
7 lieth your problem. But actually that makes
8 the point of why my ruling would be correct I
9 think, so I sustain the objection at this
10 point.

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

12 **THE COURT:** I think you can ...

13 Q: Did you find any documents from TSC that were
14 sent out to any third parties?

15 A: Just the letter that indicated that essentially
16 going forward, the, the buyer -- and I guess in
17 this case is, is going to be Tractor Supply
18 Company of Texas, I believe that's -- that we
19 would've sent to a third party at the time of
20 the re- -- I believe that's it. Can't -- I'm
21 trying to go through my mind of what was there.

22 Q: Right. And how hard was it, was it easy or
23 hard to find documents from 20 years ago?

24 A: Very hard, very difficult. We had moved
25 several times. We had been in different



1 buildings, different people who were
2 responsible for having those documents. We --
3 you wouldn't've been able to identify, we
4 didn't have a legal department or somebody who
5 was keeping up with those things consistently
6 the entire time to my knowledge, a formal legal
7 department. There may've been a -- an attorney
8 here or two, or you know, especially like I
9 said, I think earlier on real estate. But it
10 was difficult to try to find any information
11 documented that would support the restructuring
12 in TSC's documents.

13 Q: And ...

14 **MS. GEER:** Give me one minute, Your Honor.

15 (*Whispering.*)

16 **MS. GEER:** Your Honor, we don't have any further
17 questions.

18 **MS. WOOTEN:** Your Honor, I just have one question
19 based on ---

20 **THE COURT:** Whoa. That's rare a lawyer actually ---

21 **MS. WOOTEN:** Actually you know what ---

22 **THE COURT:** --- says that. Now, it's rare that ---

23 **MS. WOOTEN:** --- I have ---

24 **THE COURT:** --- they would say they have one
25 question and it ---



1 **MS. WOOTEN:** I have one topic.

2 **THE COURT:** --- only be one.

3 **MS. WOOTEN:** I have -- I'll rephrase, I have one
4 topic.

5 **THE COURT:** Oh, you're amending it now?

6 **MS. MCKEOWN - RE-CROSS EXAMINATION BY MS. WOOTEN:**

7 Q: I'm amending. You've got those -- the
8 restruct- -- or, I'm sorry. You got the Board
9 minutes from the legal department, correct?

10 A: I got them from a legal -- yeah, through the --
11 I had to ask for the -- our current legal
12 department for that, yes.

13 Q: Yeah. And lawyers save everything, right?

14 **THE COURT:** Ha.

15 A: That I don't know.

16 **OBJECTION:**

17 **MS. GEER:** Objection.

18 *(Laughter.)*

19 **MS. GEER:** I'm sorry.

20 **THE COURT:** I sustain that.

21 A: Can I -- am I still able to clarify any earlier
22 statement that I said?

23 **THE COURT:** No.

24 Q: No.

25 A: Okay. Dangit.



1 **MS. GEER:** Your Honor?

2 **THE COURT:** You, you want her to ---

3 **MS. GEER:** May I?

4 **THE COURT:** --- give a narrative?

5 **MS. GEER:** I don't, I don't want her to give a
6 narrative, but if she said something
7 incorrectly, I would like her to clarify.

8 **THE COURT:** Oh, geez.

9 **MS. GEER:** Ms. Wooten, do you have ...

10 **MS. WOOTEN:** Were you asking me something? Sorry.

11 **MS. GEER:** Okay, fine. I don't ---

12 **MR. VON LEHE:** (Whispering to Ms. Geer.)

13 **MS. GEER:** What question would you like to clarify -
14 - or what answer?

15 A: I just want to make sure I understood the
16 question. What documents would we would've, I
17 guess, sent to a third party indicating the
18 restructure, was that the question?

19 Q: That was not the question.

20 **MS. GEER:** Just if, if you had an answer that you
21 feel you need to clarify, you cannot clarify
22 the ---

23 A: Okay.

24 **MS. GEER:** --- question. And you -- so, no?

25 A: No.



1 **MS. WOOTEN:** Okay.

2 **THE COURT:** You may step down. Are we through for
3 today?

4 **MS. GEER:** I would like to be.

5 **THE COURT:** Okay.

6 **MS. WOOTEN:** I second that.

7 **THE COURT:** Okay. Well, then we'll be -- how about
8 are we on -- still on track?

9 **MS. GEER:** I think we're on track, Your Honor.

10 **THE COURT:** Okay. All right. Are you? Umm ... is
11 not ---

12 **MS. WOOTEN:** I, I don't know what they entail ---

13 **MS. GEER:** I think we should ---

14 **MS. WOOTEN:** --- for their case, so.

15 **MS. GEER:** I think we should be able to get through,
16 if not all of our witnesses tomorrow, almost
17 all.

18 **THE COURT:** Okay.

19 **MS. WOOTEN:** Okay. I just -- I know we'll have
20 rebuttal witnesses, Your Honor, and so if we
21 don't have time -- if we're not left time on
22 Friday for rebuttal ---

23 **MS. GEER:** I think you'll have most of Friday ---

24 **MS. WOOTEN:** Okay. That was my ---

25 **MS. GEER:** --- for rebuttal.



1 MS. WOOTEN: --- question, I just didn't know ---

2 THE COURT: Okay.

3 MS. WOOTEN: --- what her plans were.

4 THE COURT: All right. Hence the umm?

5 MS. WOOTEN: That was the umm.

6 (Laughter.)

7 THE COURT: Oh, okay. All right.

8 MS. WOOTEN: May I approach, Your Honor, for the
9 slides?

10 THE COURT: Yeah.

11 MS. WOOTEN: Okay. (Whispering to court reporter.)

12 COURT REPORTER: Off the record? Are we off the
13 record now?

14 THE COURT: Yeah.

15 (DAY THREE of the hearing adjourned at 5:14 p.m.)

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DAY FOUR - THURSDAY, JANUARY 26, 2023

THE COURT: Mr. Von Lehe okay?

MS. GEER: He's good. He'll be in shortly.

THE COURT: Okay.

MS. GEER: We can start without him.

THE COURT: Okay. We'll wait ---

MS. GEER: Is Your Honor ready?

THE COURT: Yeah.

ME. STREISEL: May I approach?

THE COURT: No.

(Laughing.)

MR. STREISEL: All right.

Your Honor, Tractor Supply would like to
call Jack Small.

THE COURT: Okay.

COURT REPORTER: If you'll raise your right hand for
me.

MR. SMALL: *(Witness complies.)*

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

MR. SMALL: I do.

COURT REPORTER: Thank you.

JOHN J. SMALL, having been duly sworn, testifies as
follows:



MR. SMALL - DIRECT EXAMINATION BY MR. STREISEL:

Q: Good morning, Jack.

A: Good morning.

Q: Could you please -- can I call you Jack?

A: Of course.

Q: Okay. Will you please state your full name for the record?

A: John James Small.

Q: Okay. And what do you do for a living?

A: I am a Partner and the State and Local Tax Practice Leader for a CPA firm called FORVIS. And I primarily focus on income franchise for my technical specialty, but I -- my group that I lead, handles all areas of state and local income tax, sales tax, property tax, so forth.

Q: Okay. And we'll, we'll get into that in a little more detail.

And so, Tractor Supply retained you to serve as an expert in this matter, correct?

A: That's right.

Q: And what were you generally asked to do?

A: Principally, just to review the financial records of the company, review the tax returns and offer an opinion on to each parties' position, as it relates to the South Carolina



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ROA_001347

1 income related in this case.

2 Q: And so, before we, you know, get into your
3 opinions in a little more detail, I wanna
4 discuss your background and qualifications.

5 Can you turn to Exhibit 27, to your CV?

6 A: 27.

7 Q: I believe it's 27.

8 A: Got to reorganize up here a second.

9 All right. Got it.

10 **(Joint Exhibit Number 27 was introduced into the**
11 **record at this time.)**

12 Q: All right. Is this a current version of your
13 CV?

14 A: It is not the most current, but I would say the
15 -- that the only distinction is, it says that
16 I lead the DHG, that stands for Dixon Hughes
17 Goodman State and Local Tax Practice. I still
18 work for DHG, but June 1 of 2022 we merged with
19 another, another large regional firm called BKD
20 to make FORVIS, so I -- so, I now work for
21 FORVIS. But it's a -- same, same position I've
22 held for years, just a merged firm now, so.

23 Q: Okay. And does it -- well, other than, other
24 than -- well, I guess, FORVIS wouldn't impact
25 this, but does it accurately summarize your



1 educational background?

2 A: It does.

3 Q: And then, other than the change you just
4 mentioned about how you became FORVIS during
5 the merger, does it accurately summarize your
6 employment background?

7 A: That's right. Yeah. It, it accurately
8 summarizes what I've -- what my roles and
9 responsibilities were at DHG and continue to be
10 FORVIS, so.

11 Q: Okay.

12 A: Yeah.

13 Q: And can you just briefly, you know, tell us
14 about your educational background?

15 A: Sure. I graduated from the University of
16 Georgia in 1996 with a B.A. in Sociology. I
17 spent about nine years in the IT industry after
18 that, in sales for a little while, and then ---

19 **THE COURT:** So, you graduated with a B.A. in
20 Sociology and spend nine years in IT?

21 A: Yes.

22 **THE COURT:** That's interesting.

23 *(Laughter.)*

24 A: I could- -- yeah, a confused guy in his 20s,
25 right, so. But then, at some point along the



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1 way, I real -- realized I wanted to do
2 something different, went to get my MBA from
3 Mercer University in Atlanta, focused my MBA,
4 to the extent I could, to all accounting and
5 tax classes because I gravitated to those right
6 away, graduated with an MBA in -- from Mercer
7 in 2005 and immediately started my first role
8 in public accounting with a regional -- east
9 coast regional firm called Cherry Becker. I
10 spent three years there. First couple years as
11 a stat -- just a staff accountant, or an
12 associate, you might want to call it, and did
13 federal and state income tax compliance. And
14 touched, touched all kinds of clients there.
15 I mean, I touched some publically traded
16 companies down to clo- -- you know, small
17 closely held C corporations, partnerships, you
18 have it. I did some consulting there as well.
19 I -- in my third year there, I was promoted to
20 Senior Associate. And all that time there, I
21 did have the benefit of working with a state
22 and local tax partner that had, that had
23 recently joined the firm and I gravitated
24 towards wanting to focus on state and local
25 tax. After three years there, I left and went



1 to what was called Dixon Hughes at the time as
2 a Senior Associate.

3 Q: And what year was that just to ---

4 A: Excu- -- excuse me, that was ---

5 Q: So, we're oriented.

6 A: That was in 2008.

7 Q: So, 2008?

8 A: Yeah.

9 Q: Okay.

10 A: In 2008, I started at Dic- -- Dixon Hughes as
11 a Senior Associate focused solely in state and
12 local tax and that -- my roles there would have
13 been preparation, but mainly -- mostly a
14 detailed review of state income tax returns.
15 And again, that would be all client types,
16 whether it's a -- you know, you know, a fairly
17 large publically traded to partnerships, a
18 little bit of individual work and a lot of
19 consulting projects.

20 In 2010, I was promoted to manager there.
21 Still having the same -- still providing the
22 same services for clients, just from more of a
23 managerial and supervisory role. I believe in
24 2012 I was promoted to Senior Manager, again,
25 same role just a -- even a -- a little more



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ROA_001351

1 elevated, a little more client facing
2 responsibilities to go out and meet with
3 clients, bring -- to bring in business for the
4 firm. I think that takes me to 2015, I was
5 promoted to Director. Again, heavily focused
6 on income franchise tax, multistate for, for
7 large multistate corporations, and promoted to
8 partner in 2019, at the same time, assumed
9 leadership of the state and local tax practice
10 for the firm.

11 Q: Okay. And so, I guess, tell me about the types
12 of clients that you're typically dealing with,
13 as far as whether they're multinational clients
14 or multistate clients, just generally speaking.

15 A: Sure. I mean, the -- and as a firm, we touch
16 almost every type of client from -- it could,
17 it could be a small company operating a single
18 state. But as far as what I'm personally
19 involved in, and as my career has grown, I deal
20 typically with our more complex clients and
21 larger clients. So, it could be publically
22 traded clients that are multinational or, at
23 least -- you know, if you file in every state
24 in the United States, a lot of consolidated
25 groups, so groups with a number of entities in



1 them, which are very complex structures, and
2 that have a lot of, have a lot issues around --
3 and determinations that need to be made about
4 filing methodologies, apportionment
5 methodologies. I do a lot of consulting around
6 that and -- consulting and planning in that
7 respect. Also, you know, I do some accounting
8 for income taxes as ASC 740 work for clients
9 like that, as well.

10 Q: Okay. And I don't know if you said this or
11 not, but you're in Atlanta now, correct?

12 A: That's correct.

13 Q: And have you been there for, you know, your
14 whole career?

15 A: I've been in Atlanta my entire career, yes.

16 Q: Okay. And so, you discussed, you know, state
17 corporate income tax returns, I believe, and
18 so, I guess, tell us a little bit about, you
19 know, your experience with allocation
20 apportionment, you know, in the context of
21 corporate state income taxes.

22 A: Sure. I mean, with -- it -- you know, whether
23 it's a new client or an existing client, the
24 biggest part of determining their state taxable
25 income is, I mean, obviously, you start with



1 federal taxable income and have to determine,
2 how is that, how is that divided among the
3 states, and states have varying rules on that.
4 I mean, some states, you know, want to use a
5 three-factor formula, which it would be your
6 property and payroll and sales in the state
7 divided by your property and payroll and sales
8 everywhere. Some states may be -- more heavily
9 weight that average to the sales factor. And
10 a number of states out there use just a single
11 sales factor, and we -- and we've seen a
12 migration of that over time as -- for a number
13 of reasons. One, our economy has changed,
14 where businesses don't -- the location of
15 property and payroll isn't necessarily as
16 indicative as to where businesses income could
17 be earned in a certain jurisdiction. And
18 there's also incentives, incentives to have a,
19 have a business come to your state, if it's a
20 single sales factor state because your property
21 and payroll in that state is not necessarily,
22 maybe, driving your apportionment in that
23 state.

24 Q: Okay. And so, how many state corporate income
25 tax returns total would you say you've prepared



1 in your career, if you had to guess -- or, not
2 if you had to guess, but what would you
3 estimate to be the number of state corporate
4 income tax returns you have prepared in your
5 career?

6 A: Well, I mean, I guess, if -- I mean, throughout
7 my whole career if you look at preparer versus
8 maybe detail reviewer versus now, where I'm
9 maybe just the ultimate si- -- top level
10 reviewer and ultimate signer, well into the
11 thousands, tens of thousands, for sure. I
12 mean, we've got -- you know -- and I've got
13 clients that have mul- -- you know, clients
14 that have multiple entities and every year
15 might be filing three or four hundred states
16 returns, so.

17 Q: And so, I believe -- so, have you had clients
18 where you've been filing returns in all 50
19 states, is that right?

20 A: That's right. Well, every state with an income
21 tax, there's a -- it's in the high 40s, but,
22 yeah.

23 Q: How many is it? I'm curious.

24 A: God, don't put me on the spot. Maybe, 46, so.

25 Q: Man. If it was 45, we wouldn't be here right



1 now.

2 A: I kn- -- yeah (laughter).

3 Q: And so, tell me about -- so what is your
4 understanding of, you know, separate reporting
5 versus combined reporting in the context of
6 state corporate income tax?

7 A: So -- I mean, separate reporting is regardless
8 of the structure of your organization. I mean,
9 you might be one in a -- you might have one
10 entity that's affiliate -- affiliated with nine
11 other entities and those ten entities might
12 file a federal consolidated return, but if that
13 one entity has nexus in a particular state and
14 it's a separate reporting state, it's going to
15 file on a standalone basis using its -- we call
16 it, its pro forma federal taxable income, is
17 the starting point. And it -- and then it's --
18 and it's going to apportion -- it's going to
19 make certain modifications and adjustments to
20 that pro forma federal taxable income to come
21 to the state taxable income, and then apply the
22 state's prescribed apportionment formula to, to
23 that state taxab- -- to that unapportioned
24 state taxable income to arrive at apportioned
25 state taxable income. All on a separate



1 company basis, disregarding the activities and
2 the income of the other nine entities. And a
3 combined, and a combined return, if, if it's a,
4 if it's a state that mandates combined
5 reporting and these entities are saying a uni-
6 -- deemed unitary under the laws of the state,
7 they would file a combined report combining all
8 of their income, all of their apportionment
9 factors as if they were one, and go through the
10 same exercise.

11 **OFFERED AS EXPERT:**

12 **MR. STREISEL:** Your Honor, I'd like to move to have
13 Jack Small admitted as an expert in tax
14 accounting with a specific focus in state
15 corporate income tax.

16 **MR. ANTLEY:** No objection, Your Honor.

17 **THE COURT:** He's so qualified.

18 **Q:** All right. Jack, can you -- let's start with
19 the -- can you just talk a little bit about the
20 materials you have reviewed specific to this
21 case, you know, in forming your opinions?

22 **A:** Sure. I mean, I reviewed the 10-K. I reviewed
23 the federal returns and the South Carolina
24 returns for the audit period. I reviewed the
25 audit report and the Determination, of course.



1 I reviewed the protest. As far as working
2 papers, I mean, I reviewed the trial balances
3 and the -- and some, some inter- -- inter- --
4 intercompany work papers, and reviewed the
5 transfer pricing study reports, as well.

6 Q: Okay. And so, tell me your, general
7 understanding of the business that's conducted
8 -- well, let's start -- let's get our names
9 right with these entities.

10 Tractor Supply Company of Michigan,
11 Tractor Supply Company of Texas, you know what
12 each entities those are, if I'm referring to
13 them by that name?

14 A: Yes, I do.

15 Q: Okay. And then, Tractor Supply Company or the
16 parent would be -- do you know what I'm
17 referring to by that name?

18 A: Yes.

19 Q: Okay. And I'm gonna try, try to be clear
20 throughout with my terminology, but I'm sure it
21 will vary, but -- so, anyways.

22 Tractor Supply Company of Michigan, can
23 you, can you describe in general their business
24 activity, as far your understanding of it?

25 A: My recollection is they own and run retail



1 stores in Michigan and Michigan only?

2 Q: Okay. And what's your understanding of their
3 business activity in South Carolina?

4 A: None. Well, my understanding is that there is
5 none.

6 Q: Okay. And Tractor Supply Company of Texas, you
7 know, what's your general understanding of the
8 business that they conduct?

9 A: They own and run retail stores in the State of
10 Texas and also serve a procurement, maybe,
11 merchandising function for the overall TSC
12 Group.

13 Q: And what's your understanding of the business
14 that they conduct in South Carolina?

15 A: Also, I believe there's no business conducted
16 in South Carolina.

17 Q: And the parent company, Tractor Supply Company,
18 what -- what's your understanding of, you know,
19 the general nature of their business?

20 A: They own ret- -- retail stores throughout the
21 Country, including South Carolina, excluding
22 Michigan and Texas. And I believe some, some
23 headquarters management function is performed
24 in, in the parent corporation, as well, so.

25 Q: And what's your understanding of the business



1 that they conduct in South Carolina?

2 A: It -- within South Carolina, it's just owning
3 and running retail stores.

4 Q: Okay. And, and have you been at trial at all
5 this week, listening to testimony from people?

6 A: Every day except Monday, yes.

7 Q: Okay. Today's Thursday, right? Yeah. I
8 believe so.

9 *(Laughter.)*

10 Q: Okay. Keeping myself oriented.

11 All right, Jack. So, what opinions did
12 you form with respect to Tractor Supply's South
13 Carolina tax returns for years 2014 through
14 '16?

15 A: You know, from an accounting perspective, they
16 were prepared correctly and properly under
17 South Carolina law.

18 Q: Can you just generally describe the process you
19 went through to make that determination?

20 A: Sure. I started with the 10-K, and as that --
21 you know, that, that would be the starting
22 point, which is book taxable income, you might
23 call it -- or excuse me, not taxable, book
24 income or, or gap income for financial
25 statement purposes. And that's at a



1 consolidated level. So, it would -- that would
2 include the income for the entire group. I did
3 go back to review the separate company trial
4 balances to conclude that the sum of those did
5 equal the combined amount, consolidated amount
6 included in the 10-K. From there, I was able
7 to trace that, that number to Schedule M-3 of
8 the, of the federal income tax return, which is
9 the schedule that starts with GAP, book income,
10 and shows the various adjustments you might
11 have to make to get from book income to federal
12 taxable income. A couple of examples of those
13 are depreciation. Depreciation lines and
14 methods for book purposes often differ than for
15 tax purposes, so that's a common one you'd see
16 on there. Bad debt expense is another for, for
17 book purposes. You're, you're allowed to make
18 an allowance, kind of, an estimate of your, of
19 your bad debt, where for tax purposes, you're
20 actually having to -- you're only allowed to
21 wri- -- to expense the amount you actually
22 wrote off during the year. So, a couple of the
23 -- a couple examples of the adjustments I saw
24 on there, which were all reasonable and ones I
25 would expect to see.



1 Q: Okay. And so, you started with the 10-K, I
2 believe you said. Why did you start with the
3 10-K?

4 A: Because that is -- those are the audited
5 financial statements of, of, of the company.

6 Q: Okay. And did you independently verify that,
7 that there's audited financial statements in
8 the 10-K or added therein?

9 A: I did not. Other than, I guess, what I
10 described, that the trial balances that fed
11 into them equal. But I -- I'm not, I'm not a
12 financial statement auditor, and to -- the work
13 that would've gone into auditing them -- fully
14 audit -- auditing the numbers that went to the
15 10-K is what I would imagine a three or four-
16 month long process by a team of financial
17 statement auditors, that was done by a Big Four
18 firm, I believe, so.

19 Q: Okay. And so, you're, you're assuming that the
20 information in the 10-K is accurate?

21 A: I am.

22 Q: Okay. And I believe you said after that -- so,
23 from the 10-K, then you went to the federal --
24 the consolidated federal tax return, is that
25 correct?



1 A: That's right.

2 Q: Okay. Let's just put that up real quick. Can
3 you turn to Exhibit 6?

4 **MR. STREISEL:** (To Ms. Geer) You'll probably have --
5 do you mind pulling that up?

6 **MS. GEER:** I'm working on it. Hold on.

7 **MR. STREISEL:** Once you get into the file, I want to
8 go Joint ...

9 **MS. GEER:** (Whispering.)

10 A: And I've got a book that says 1 through 3 and
11 8 through 33. I don't know where 6 ...

12 **MS. GEER:** (To Mr. Streisel) All right. Sorry.
13 Which one?

14 A: May have left -- or maybe it's not gonna be on
15 my screen, so.

16 **MS. GEER:** 6?

17 **MR. STREISEL:** 6, yes.

18 Q: What do you have? I mean ---

19 A: This says 1 through 3, and then the next one
20 says ---

21 Q: I'm not sure.

22 A: Oh, this is SCDOR Exhibit list 1 through 3, but
23 then I've got Joint Exhibits 8 through 33.

24 Q: 8 through ---

25 A: And I got a bunch of loose papers everywhere,



1 I'm not sure what that it.

2 **MR. STREISEL:** I mean, he's probably fine looking at
3 the screen.

4 **MS. WOOTEN:** Here's Joint Exhibits 1 through 7.

5 Q: If you want, you can look at the screen.

6 A: I can probably see it on the screen.

7 **MS. WOOTEN:** He's your witness. I'm just offering
8 it ---

9 Q: You good?

10 **MS. WOOTEN:** --- if you want it.

11 A: Well, bring it -- yeah, bring it over just in
12 case, but I can probably see it on the screen.

13 Q: Yeah, that's probably good.

14 A: Just in case it comes up later.

15 Q: You, you might be able to direct us to some
16 pages.

17 A: Yeah.

18 **MS. GEER:** All right. I'm going to try your
19 computer because it won't -- it's like -- I
20 think, I think -- but it's not opening.

21 **MR. STREISEL:** All right.

22 **MS. GEER:** Oh, no. Sorry.

23 **MR. STREISEL:** And then my password.

24 **MS. GEER:** I'm putting my password into your
25 computer. That's very strange. Now, it came



1 up. All right. Let me just log in.

2 **MR. STREISEL:** It's slow.

3 Q: And if you would, you know, turn to -- I
4 believe, it's page 4 of that document, TSC
5 0000-1604.

6 A: Yeah, that's it. Or, I see it. Uh-huh.

7 **MS. GEER:** What number?

8 **MR. STREISEL:** Page 4 of the PDF.

9 **MS. GEER:** What's the Bates number?

10 **MR. STREISEL:** You're, you're on 15.

11 **MS. GEER:** Where do you want to be in it?

12 **MR. STREISEL:** I guess, just show the top, nothing
13 too specific.

14 Q: And, Jack, do you recognize this document?

15 A: Yes. This is the -- this is essentially page
16 1 of their -- Tractor Supply Company and Subs,
17 2014 federal income tax return.

18 **(Joint Exhibit Number 6 was introduced into the**
19 **record at this time.)**

20 Q: Okay. And can you just, just generally explain
21 it or -- we already went through that. What,
22 what members of the Tractor Supply group are in
23 this tax return, and why?

24 A: Tractor Supply Company, Tractor Supply of
25 Michigan, and Tractor Supply Company of Texas



1 are all three in this return. And it --
2 assuming 80 percent common ownership among the
3 entities, they are eligible to be in a, in a
4 cons- -- to file their federal return on a
5 consolidated basis, which is why they're in
6 here.

7 Q: Okay.

8 **MR. STREISEL:** And can you scroll to the amount on
9 line 30, and ...

10 Q: So, what, what is that amount on line 30
11 representing?

12 A: That is their consolidated federal taxable
13 income. So, that's the consolidated -- that's
14 the federal taxable income of the group.

15 Q: Okay. And where can I find, where I can find
16 the amount that Tractor Supply, you know,
17 reports on its South Carolina tax return?

18 A: It would be -- let me flip to it for a minute.

19 Q: What would you call it?

20 A: It's called a consolidating schedule that's --
21 and it looks like it's page number 1667, if I
22 got to the right one.

23 **MR. STREISEL:** (To Ms. Geer) I got 667?

24 **MS. GEER:** And 67.

25 *(Whispering.)*



1 Q: Jack, what -- what's the Bates label that
2 you're looking at, at the bottom right?

3 A: It's TSC 00001667. Just need to go over one
4 more.

5 **MR. STREISEL:** Okay. So, go to -- all right. So,
6 you're going to 1667.

7 Q: And so, just generally tell me, you know, what
8 this is.

9 A: Thi- -- this is, essentially, what we were
10 looking at on page 1, but this is broken down
11 by the three separate companies. So, that --
12 this is the federal taxable income of, of each
13 separate company. One -- in one column, far
14 left -- or the column on the left is Tractor
15 Supply Company, and then the middle column is
16 Michigan, third column is Texas.

17 Q: Okay. And so, you said, on here is where you
18 can find the amount that Tractor Supply reports
19 on its South Carolina income tax return?

20 A: Yeah.

21 **MR. SMALL:** (To Ms. Geer) Scroll down. Probably,
22 also on line 30 on this page.

23 **MS. GEER:** (Complies.)

24 A: That -- there it is. It's 130,998,512 is the
25 -- you would almost -- you would call that the



1 federal pro forma taxable income of Tractor
2 Supply Company.

3 Q: Okay. And let's go to the South Carolina, or
4 -- just -- was gonna ask you if you recognize
5 the document, I just gave it way.

6 Will you turn to Exhibit 9?

7 A: Yeah. And are y'all bringing it up?

8 **MS. GEER:** Yeah.

9 A: Okay. I might just wait for you to bring it
10 up. These are clunky.

11 Q: You might want to -- yeah. If you could find
12 it. It might be easier just to flip through
13 stuff.

14 **THE COURT:** There it is.

15 A: Okay. I'm on it.

16 Q: And do you, do you recognize this document?
17 And if so, what is it?

18 A: This is the Separate Company South Carolina
19 income tax return for Tractor Supply Company.

20 **(Joint Exhibit Number 9 was referenced at this time.)**

21 Q: Okay. So, you're on there anywhere? I'm not
22 sure.

23 A: Go to page number ending in 44.

24 Q: Okay.

25 A: What should, should be the very next page,



1 maybe.

2 **MS. GEER:** Okay.

3 **MR. STREISEL:** Yeah, it's just a couple down. A
4 little more.

5 **MS. GEER:** One more page?

6 **MR. STREISEL:** You're good right there. You're good
7 right there.

8 **MS. GEER:** Okay.

9 Q: All right. Jack, so what'd you say this was?

10 A: This is Tractor Supply Company's separate
11 company South Carolina corporate income tax
12 return for 2014.

13 Q: Okay. And could you just, you know, walk us
14 through -- walk us through the process of
15 determining, you know, it's ultimate tax due in
16 South Carolina?

17 A: Sure. So, line 1, right there, is the number
18 we just discussed from the federal return --
19 federal taxable income for federal tax return,
20 130,998,512. Line 2 is -- it -- is the net
21 adjustment from Schedules A and B on the next
22 page. I don't know if we need to go into that
23 level of detail, but that's 17,478,426. And
24 these are essentially your federal to state
25 adjustments, just like we discussed book to tax



1 adju- -- book ta- -- book, book adjustments to
2 federal tax adjustments earlier for, you know,
3 for federal tax purposes and state tax purposes
4 they -- the -- there are certain expenses that
5 are allowed and disallowed. The bulk of this
6 17 million dollar number, which is an addition
7 to state taxable income, is state taxes that
8 were deducted for financial statement purposes
9 and federal purposes, which are not allowed as
10 a deduction for state purposes. Another one is
11 depe- -- also, depreciation. Many -- sta- --
12 states -- or for federal purposes, a lot of
13 states allow something call bonus depreciation,
14 or a more accelerated depreciation were a state
15 might not allow it, and so that's accounting
16 for the difference there in the fed and state
17 treatment of certain items.

18 **MR. STREISEL:** Your Honor, unless you want more
19 information about the state adjustments in line
20 2. You good?

21 **THE COURT:** I can't make comments of what I want one
22 way or another.

23 *(Laughter.)*

24 **MR. STREISEL:** Okay.

25 **Q:** All right. Well, you, you can keep going.



1 We're going to assume he's okay ---

2 A: Yeah.

3 Q: --- but we may come back to that.

4 A: Okay. So, you know, line 3 is, essentially,
5 the, the sum or the net of one and two. And
6 then, if you get to line 4, we should take a
7 quick look go -- if you, if you want to advance
8 a couple of pages to the apportionment
9 schedule, which is line 6 of Schedule G. It's
10 going to be three or four pages out. 40 --
11 page numbers ending in 47, a reference number.

12 **MS. GEER:** Okay. Good?

13 A: Right. So, if we look at Schedule H-1 right
14 down there at the bottom, that is total sales
15 within South Carolina on line 1, total sales
16 every one on line 2. So, roughly, 130 million
17 versus, you know, 4.6 billion. The ratio of
18 those 2.7865, we'll call it 2. -- you know 2.79
19 percent, that's the percentage of sales -- TSC
20 sales within South Carolina. That number --
21 that percentage is used to apply to
22 unapportioned state taxable income, which
23 you'll see up above on Schedule G, that 148
24 million th- -- is multiplied by the 2.79 to
25 4.138 -- or, excuse me, 4,137,310. Now, if we



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1 want to go back to page 1 of this return ---

2 Q: And, Jack, just real quick.

3 A: Uh-huh.

4 Q: That amount, 130 million right there ---

5 A: Yes.

6 Q: --- that -- very close to federal taxable
7 income, but I are those a rea- -- is that
8 coincidental or are they related?

9 A: That's coincidental, yeah. It's -- that's just
10 their sales in the State, so. Yeah.

11 Q: Okay. And, and where'd you want to go back to?
12 Just the first page?

13 A: Go, go back to page 1 where this carries back
14 to, yeah.

15 Q: Yeah. And what did you say the sales factor
16 ratio was here?

17 A: 2. -- 2.79 percent, roughly.

18 Q: Okay.

19 **MR. STREISEL:** And, Bryson, I think you gotta go
20 down one or two pages.

21 Q: What about the allocation provisions of the
22 South Carolina Code, how do they impact this
23 return here?

24 A: Yeah -- no, good question. So -- and just real
25 quick, so we're looking at line 4. That --



1 that's taking -- that's the apportioned South
2 Carolina taxable income. So, in addition to
3 apportioning federal taxable income, there's
4 certain items of income that might be allocated
5 direct- -- well, we call it directly allocated
6 for state purposes, it's getting more and more
7 rare that you have allocable income, but
8 something that might deemed non-business income
9 is something that would be directly allocated.
10 And what that means is, if there's non-business
11 income, either that should be directly allocate
12 to South Carolina or to another state, that
13 would be shown on here and it'd be taken --
14 would be removed form the apportion- -- the
15 apportionable income base. But there is no
16 allocable income on this return, and I wouldn't
17 expect to see any based on what I know of their
18 business, so. But -- and, again, if, if we
19 were not a multistate corporation apportioning
20 income, I believe, line 3 and line 4 would
21 match, so. But, we, we have apportioned to get
22 down to 4.1 million. Looking at line 5 real
23 quick, is the -- if there was a South Carolina
24 net operating loss from an earlier year that
25 could be used to offset it, that's where that



1 -- this would occur. Apparently, there are no
2 losses from prior years, so that leaves us with
3 roughly 4 point -- million subject to tax at a
4 five percent tax rate, getting us to a little
5 over 200,000 in South Carolina tax.

6 Q: Okay. And so, this is the 2014 return for
7 South Carolina. Did you also look at the 2015
8 and 2016 tax returns in this matter?

9 A: Yes, I did.

10 Q: Okay. And did you generally go through the
11 same process of verifying that they were
12 accurate?

13 A: Yes, I did.

14 Q: Okay. And the general process you just
15 described, you know, once we're on the state
16 tax return, starts -- start -- my words here,
17 starts with federal, there's some state
18 adjustments, allocation and apportionment, and
19 then ultimately, you know, taxed by the
20 corporate tax rate. Is that, is that fairly
21 similar to what, you know, other states do that
22 you have experience with?

23 A: Yes.

24 Q: Okay. And how does South Car- -- you're in
25 Atlanta you said, right?



1 A: That's right.

2 Q: Yeah. I guess, how does South Carolina law,
3 generally speaking, compare to -- to Georgia
4 the way that ---

5 **OBJECTION:**

6 **MR. ANTLEY:** Objection, Your Honor. Calls for a
7 legal conclusion. He's asking about South
8 Carolina law and how it compares to other
9 states.

10 **THE COURT:** I'll sustain the objection.

11 **MR. STREISEL:** Okay.

12 Q: So, how would you, very briefly, describe the
13 process of how Tractor Supply would file in
14 Georgia?

15 A: Georgia's ---

16 **OBJECTION:**

17 **MR. ANTLEY:** Objection, Your Honor; relevance.
18 We're here for South Carolina. We ---

19 **THE COURT:** (To Mr. Streisel) What would the
20 relevance be for Georgia?

21 **MR. STREISEL:** Just to explain that it's a fairly
22 similar process to South Carolina, neighboring
23 states.

24 **THE COURT:** I sustain the objection.

25 **MR. STREISEL:** All right. All right. That's all



1 right. Let's keep going.

2 Q: So, can you tell us a little bit about the
3 differences between reporting methods and
4 apportionment methods in state corporate income
5 tax that we're discussing?

6 A: Sure. So, a reporting method is -- and, and
7 the two most basic that we -- that we're
8 discussing in this trial are separate company
9 versus combined, there's some nuances there.
10 But, you know, separate company as I described
11 earlier is, if you've, if you've got a single
12 entity, regardless of who it's affiliated with,
13 and regardless of whether it's affiliated with
14 other entities, if the laws of a particular
15 state say that you file on a separate company
16 basis, that entity files on a standalone
17 separate company basis excluding the other
18 entities. Where a state with a mandatory
19 combined reporting prescribed in its statutes
20 would, would say that you -- it -- and
21 typically, the entities would need to be
22 unitary that you were -- that you're affiliated
23 with, but if you had a unitary relationship
24 with other affiliated entities, you would need
25 to file all of those entities in a combined



1 basis, combining the income of all entities,
2 combining the apportionment factors of all
3 entities, to come up with, come up with a ta-
4 -- one taxable income. And there's other,
5 other variations out there. I mean, some
6 states have kind of elective consolidations.
7 You would, at a first blush, think maybe
8 consolidated is the same as combined, but the
9 mechanics of those calculations are different
10 and a state can cons- -- an elective
11 consolidated return is not -- does not get you
12 to the same answer that a mandatory combined
13 return would.

14 Q: And could you, could you quickly, or briefly,
15 turn to Exhibit 13?

16 A: Oh, here.

17 Q: And do you recognize, recognize these
18 documents? And if so, just briefly, tell us
19 what they are.

20 A: Yeah. This was part of the audit work papers.
21 Yeah. For -- from the, from the South Carolina
22 audit of '14 to '16, and that ultimately show
23 the adjustments to get the, the tax assessment.

24 Q: Okay.

25 **(Joint Exhibit Number 13 was referenced at this**



1 time.)

2 **MR. STREISEL:** And, and Bryson, will you go to page
3 2 in this document?

4 **MS. GEER:** Are you gonna ask him about it?

5 **MR. STREISEL:** Yeah.

6 Q: And, Jack, if you would just briefly explain,
7 you know, what this is, and the reported versus
8 audited columns on this page?

9 A: The reported columns for 2014 actually are
10 identical to the numbers we just looked at on
11 the South Carolina Return. So, that -- that's
12 how it was file by Tractor Supply Company. You
13 -- you know, using the separate port --
14 reporting methodology prescribed by the State.
15 The audited numbers are aft- -- after the South
16 Carolina auditors tried to implement a
17 mandatory unitary combined reporting mechanism.
18 So, you know, big -- biggest difference here is
19 obvious on line 1, federal taxable income
20 increases from 130 million to 552 million.

21 Q: Okay. And so, you know, I guess, well, you --
22 I think you just named one, but what other main
23 differences are there between ---

24 A: Well, I mean, the 552 million would cascade
25 down to every other numb- -- almost every other



1 number on the audited column, but you'll see
2 the total South Carolina net income as reported
3 by the taxpayer, 4.1 million has now increased
4 to 12.9 million. I mean, I think what's of
5 significance there is -- yeah. And the -- and
6 it's -- sorry, I'm looking -- I'm talking about
7 line 4, so the -- comparing the 4.1 to the
8 almost 13 million. I mean, what's of
9 significance there is, I mean, I believe we
10 discussed earlier, 4.1 million is roughly 2.79
11 percent of TSC's South -- South Carolina
12 taxable income of -- the number up there on
13 line 3, but the 13 million that is now being
14 subject to South Carolina tax is roughly nine
15 percent of that same number. So, we have 2.9
16 percent of our sales in South Carolina, but our
17 -- but almost nine percent of our income is
18 being subject to tax in South Carolina.

19 Q: Okay. And I think you just said 2.9 percent,
20 you said ---

21 A: 2.79. Excuse me. Yeah.

22 Q: Okay. So, so ---

23 A: Yeah.

24 Q: --- 2.79 percent. And just say that one more
25 time with the correct number.



1 A: Yeah. So, roughly 2.79 percent of TSC sales
2 are in the State of South Carolina, but close
3 to nine percent of its income is being subject
4 to tax in the State of South Carolina under
5 the, under the auditor's approach.

6 Q: Okay. And so, why is it significant to you
7 that a little under nine percent of its income
8 is apportioned to South Carolina based on its
9 business activity there?

10 A: Well, I mean, its business activities is re- --
11 is retail sales. And I would, I would think
12 that the -- that's a -- the level of sales into
13 the state divided by the level of sales
14 everywhere are -- is a very -- pretty good
15 measure of your activity in the state. So,
16 having to apply that same ratio to, to a much
17 elevated number gets you, gets you to a very
18 different answer. A ver- -- what seems to be
19 a very inequitable answer that does not fairly
20 represent income in the state.

21 **OBJECTION:**

22 **MR. ANTLEY:** Objection, Your Honor. He -- he's
23 talking about equity. And that calls for a
24 legal -- that's a legal conclusion.

25 **THE COURT:** I don't know if -- about legal



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1 conclusion, it's his opinion that it's not
2 equitable.

3 **MR. ANTLEY:** Well, it ---

4 **THE COURT:** I'll overrule that.

5 **MR. ANTLEY:** Thank you.

6 **MR. STREISEL:** All right.

7 **THE COURT:** I don't know, I don't know if that's an
8 area of expertise to comment about equity. I
9 mean, that may have been the more appropriate
10 objection, but I'm just going to let it go
11 right now. It's not gonna prejudice me.

12 *(Laughter.)*

13 Q: And ---

14 **MR. STREISEL:** May I proceed? Yeah.

15 Q: And, John, just so -- so from an accounting
16 perspective, just tell us your thoughts about
17 the amount of income that's reported to South
18 Carolina in relation to its business activity
19 here.

20 A: Well, its business activity is retail sales in
21 the State. Tractor Supply Company is filing on
22 a separate company basis as -- as prescribed by
23 South Carolina Law. And so, they would take
24 their separate company federal taxable income
25 and apply the prescribed South Carolina



1 apportionment ratio to it, which is -- we've
2 established is 2.79 percent, to come up with
3 the amount of, the amount of tax -- the amount
4 of income subject to tax in South Carolina.
5 And I think that's the appropriate treatment.

6 Q: Okay. And then, and then, also, you know, from
7 an accounting perspective, will you tell us
8 your thoughts on the Department's use of
9 combined unitary reporting in this matter and
10 how that compares to the taxpayer's business
11 activity?

12 A: Well, I think it's bringing, it's bringing
13 income to the -- into the state that didn't
14 occur in the state.

15 Q: Okay. Can you ---

16 A: Yeah.

17 Q: --- elaborate that on a little bit more?

18 A: Sure. I mean, I mean, we've got, we've got
19 income from two separate legal entities, TSC of
20 Texas and TSC of Michigan, that are in the --
21 now in the unapportioned tax base for South
22 Carolina, but neither of those companies do
23 business in South Carolina. They don't have
24 any sales in South Carolina, yet their in- --
25 yet their income is now driving a much larger



1 South Carolina apportioned income.

2 Q: Okay. And from an accounting perspective, what
3 are your thoughts on whether separate reporting
4 can fairly rep- -- excuse me. Let me rephrase
5 that.

6 From an accounting perspective, can
7 separate reporting represent a taxpayer's
8 various activity in the state?

9 A: Yes, it absolutely can.

10 Q: Okay. And do you file a number of separate
11 returns here for clients?

12 A: Yeah. I file -- in South Carolina, I file only
13 separate returns.

14 Q: Okay. Is there anything about Tractor Supply's
15 business structure that makes it difficult for
16 you to, you know, accurately determine the tax
17 to report here?

18 A: No, not at all. It's -- you, you would look at
19 which entity has nexus in sou- -- in South
20 Carolina, which that is Tractor Supply Company,
21 and you would, you would calculate its taxable
22 income in South Carolina on a separate company
23 basis.

24 Q: And, I guess -- you know, you've been here in
25 trial and you're aware that there is a markup



1 that Tractor Supply Company pays to Tractor
2 Supply of Texas for the procurement of
3 inventory and other functions, correct?

4 A: Right. That's right.

5 Q: Okay. And do you know what that number is, the
6 percentage markup on the inventory that was
7 charged during the audit period?

8 A: I believe it's 9.7 percent.

9 Q: And so, from an accounting perspective, you
10 know, that 9.7 percent markup is not an arm's
11 length price. How would that impact your
12 opinions that the income is, reported to South
13 Carolina, consistent with the taxpayer's
14 business activity here?

15 A: You're saying if it's ---

16 **OBJECTION:**

17 **MR. ANTLEY:** Objection, Your Honor. I think this is
18 getting into 482 expertise and outside of
19 accounting.

20 **THE COURT:** (To Mr. Streisel) Are you asking if it's
21 not an arm's length transaction, how would that
22 ---

23 **MR. STREISEL:** Impact his opinions that the income
24 reported here is a fair representation of the
25 business activity.



1 **THE COURT:** As an accountant. Does he have
2 expertise in this area?

3 **MR. STREISEL:** I -- I believe -- I mean, I'm asking
4 if the price is too high. I mean, he -- he's
5 talking about the income reported here, he
6 believes is accurate, and I'm asking him if
7 that price is incorrect, how does that impact
8 his opinions.

9 **THE COURT:** I -- unless you lay a further
10 foundation, I think I'm going to sustain that
11 objection. He's an accountant and I don't
12 understand how he -- his opinions as far as
13 income transfer would affect fairness in that
14 area. I -- at least, my understanding of
15 accounting, they don't really get involved in
16 fairness, they just calculate the numbers and
17 address that issue. So, I'm missing the --
18 that as an aspect of accounting.

19 **MR. STREISEL:** I -- I'm asking, if the price was too
20 high, how does it impact his opinions. Whether
21 it destroys his opinions, or whether it doesn't
22 impact his opinions, that's all I'm asking him.
23 If it turns out that that price is incorrect,
24 how does it impact his opinions ---

25 **THE COURT:** All right.



1 **MR. STREISEL:** --- right now.

2 **THE COURT:** I see that point. That the -- (to Mr.
3 Antley) do you want to respond to that point?

4 **MR. ANTLEY:** So, it's a -- it -- just to make sure I
5 understand. It's a hypothetical? If this is
6 an invalid 482 study, does that affect his
7 opinion from an accounting perspective?

8 **MR. STREISEL:** The question is, you know, if it
9 turns out that that 9.7 percent markup was
10 inappropriate, meaning it was too high, you
11 know, from our perspective, how does it impact
12 his opinions that he has given.

13 **THE COURT:** Yeah. From an accounting perspective.
14 (To Mr. Small) So, can you answer it?

15 A: I can answer it. I mean, if the 9.7 percent is
16 too high, the most reasonable way to fix that
17 would be to adjust the transfer pricing.

18 **OBJECTION:**

19 **MR. ANTLEY:** Objection. He's not an expert in the
20 reasonableness or, again, a legal conclusion.
21 And when you talk about reasonableness, you're
22 also getting more and more into the territory
23 ---

24 **THE COURT:** Yeah. I sustain that. You can answer
25 it from an accounting perspect- ---



1 A: Okay.

2 **THE COURT:** Can you answer from that perspective?

3 A: I'll sa- -- a manner in which you can address
4 that would be to adjust the price that is
5 deemed reasonable, at -- adjust the price to
6 something that is deemed reasonable. And this
7 is something that would occur, you know, not on
8 the tax return, it would occur back prior to
9 the financial statements, but that price would
10 be adjusted ultimately impacting, ultimately
11 impacting the tax return, so.

12 **THE COURT:** All right.

13 Q: Okay. And so, Jack, this will be a
14 hypothetical, but. They charged 9.7 percent
15 markup on the inventory, if it turns out that
16 they should've charged 7 percent on this
17 inventory, how long would it take you to
18 determine the South Carolina tax due on --
19 using a separate tax return as required by
20 South Carolina law?

21 A: A couple hours. Not long.

22 Q: Okay. And can you just tell me, what type of
23 -- just briefly, tell me what -- so, if the
24 price, you know, should've been a 7 percent
25 markup, what would you do as an accountant to



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1 make that adjustment?

2 A: As a tax accountant, I would -- if I'm just
3 going in and calculating what the adjustment
4 would be, I mean, I would start with my book
5 taxable income and reduce the expense that was
6 created by the 9.7 to the -- I think, now a
7 hypothetical 7, that -- reducing that expense
8 would increase book income, which would in turn
9 increase federal taxable income, which would in
10 turn increase South Carolina taxable income.

11 **THE COURT:** On the separate reporting?

12 A: On a separate report. Correct.

13 **THE COURT:** Okay.

14 Q: Okay. And if it turns out that the price
15 should be 7 percent markup instead of 9.7
16 percent markup, do you believe that combined
17 unitary reporting is a good solution, rather
18 than the process you just described?

19 A: No, I do not. I think ---

20 Q: Why is that?

21 A: Yeah. I think a ---

22 **OBJECTION:**

23 **MR. ANTLEY:** Objection. We're getting back into the
24 reasonableness question that he was asked
25 before.



1 **MR. STREISEL:** I don't think I even said reasonable.

2 **THE COURT:** You're getting back into reasonableness,
3 why?

4 **MR. ANTLEY:** His -- he's not an expert on the
5 reasonableness of combined versus separate
6 entity reporting. He's an accountant, so he
7 can talk about how the form might be different
8 or how the tax return might be filled out
9 differently, but not whether or not it's
10 reasonable under combined unitary reporting.

11 **THE COURT:** All right. And what's your response to
12 that?

13 **MR. STREISEL:** I don't think that I asked whether it
14 was reasonable.

15 **THE COURT:** I know, but -- you don't have to ask
16 whether it's reasonable if your question infers
17 -- or the answer to your question would result
18 in addressing the point of reasonableness, so.

19 **MR. STREISEL:** Okay.

20 **THE COURT:** How about rephrase the question and
21 let's see.

22 **MR. STREISEL:** Okay.

23 **Q:** So, from an accounting perspective, the markup
24 on inventory should've been 7 percent instead
25 of 9.7 percent that it was actually charged,



1 would your solution be -- now, let me back that
2 one up.

3 **THE COURT:** You're asking him about policy issues,
4 it appears to me. And I -- I -- unless you lay
5 a foundation as an accountant, I don't, don't
6 know if accountants address policy issues, so.

7 **MR. STREISEL:** Okay. Policy issues?

8 **THE COURT:** Because it sounds like that's what you
9 were asking him. The policy of whether you
10 should take this approach or that approach,
11 that's tax policy, right? If I'm missing it,
12 explain to me then.

13 **MR. STREISEL:** I mean, if you're talking about
14 adopting a statute or something. I -- let me
15 just rephrase the question, here.

16 **THE COURT:** Okay.

17 Q: All right. Just got to move on. That's all.

18 All right. Tractor Supply's business
19 structure, just, generally, explain to me how
20 -- you know, you understand the business
21 structure, high level.

22 A: We have Tractor Supply Company the parent, that
23 owns and operates retail stores nationally,
24 with the exception of Texas and Michigan. And
25 they've got some manage -- management,



1 administrative, executive functions. We've got
2 Tractor Supply of Texas, owns and operates
3 retail stores in the State of Texas and
4 provides a procurement function for the overall
5 group. And we've got Tractor Supply Company of
6 Michigan, which owns retail stores in Michigan.

7 Q: And can you just tell me, approximately, what
8 the groups revenues were for each year in the
9 audit period -- or just one year?

10 A: I mean -- I think, roughly -- or -- high five
11 billion, you know, about six billion.

12 Q: Okay. And tell us your thoughts on whether you
13 would expect Tractor Supply to be operating as
14 a single entity, as opposed to multiple
15 entities like it is.

16 A: From my experience, a company that large would
17 almost always have multiple entities. I mean,
18 in fact, I deal with companies with much less
19 revenue, that have completely more complex org
20 structures with 50, 60, 70 entities on them,
21 compared to the -- I think we had three
22 regarded entities on this one, and maybe four
23 diff -- four disregarded entities, so. But
24 this is a relatively simple structure.

25 Q: Relatively simple, compared to what? Just so



1 we, just we have something to compare ---

2 A: Yeah. Sure.

3 Q: --- to what we're talking about.

4 A: Com- -- compared to clients -- compared to --
5 not clients, excuse me, compared to taxpayers
6 or businesses the same size as them or -- and
7 even smaller than them.

8 Q: And, I mean, in your, in your experience, you
9 know, as an accounting -- as accountant for
10 large, multistate entities and multinational
11 entities, can you just, generally, describe
12 some of the benefits you're aware of that are,
13 that are achieved by operating through multiple
14 entities?

15 A: Yeah. You know, operational expertise in
16 certain areas, one entity is doing something
17 better than the other and they ho- -- like to
18 house and build that expertise. Liability
19 protection. Ease of reporting. Reporting the
20 success or performance of one entity versus the
21 other.

22 Q: And is there anything from Tractor -- you know,
23 about Tractor Supply's business structure
24 that's problematic from an accounting
25 standpoint?



1 A: No, not at all.

2 Q: Is there any- -- so, again, we're talking about
3 the 9.7 percent markup on inventory that was
4 charged during the audit period. Do you know
5 what I'm talking about?

6 A: Yes.

7 Q: If it turns out that that charge should have
8 been 6 percent, is there anything that would
9 interfere with your ability to calculate the
10 income due to South Carolina using a separate
11 return as required by South Carolina law?

12 A: There is not.

13 Q: Is there -- so, can you -- what, what other
14 company transactions are you aware of in this
15 matter? Just, generally speaking, which ones,
16 you know, do you know exist?

17 A: I mean, I think the largest one would be the
18 purchase of inventory from TSC of Texas by TSC.

19 Q: Okay. Well -- so, for that intercompany
20 transaction, how do, how do the members of the
21 group pay Texas for that transaction?

22 A: They do it through a journal entry, I believe,
23 on -- that's recorded contemporaneously on a
24 month basis.

25 Q: Okay. And so explain to me, on a monthly



1 basis, what that means? Does that mean it's
2 done at the end of the month or what?

3 A: It, it would be done at the -- in the -- yeah.
4 I'm, I'm not there doing it, but from reviewing
5 the documents, the -- it appears it's done at
6 the end of every month. The price is already
7 set by the transfer pricing analysis and that
8 markup is applied as they closed the books
9 every month.

10 Q: Okay. And what are your thoughts on the fact
11 that they are not making cash payments or
12 transfers each day on that particular
13 intercompany transaction that we're discussing?

14 A: It is very rare, if at all, I see companies in
15 similar situations actually move cash.

16 Q: Okay. So you have experience filing state tax
17 trends in all states, you said, that didn't
18 have an income tax return, right?

19 A: Right.

20 Q: That have a corporate income tax, correct?

21 A: That's right.

22 Q: Okay. And for those states that require
23 combined returns, how do you know -- generally
24 speaking, how do you determine which members of
25 a group to include in the combined return?



1 A: Well, you would look at the state statute that
2 -- one, I mean, you would look at the state
3 statute to confirm their -- they require
4 combined reporting for unitary groups. You
5 would also look at the state statute that
6 defines unitary, and while uni- -- unitary is
7 a somewhat universal definition, but each --
8 and each state has its own writing of it and
9 there's -- there are some different nuances and
10 it's possible that a group of entities could be
11 unitary under one state's rules and not the
12 other depending on the facts. But -- but,
13 yeah, you would need to examine the
14 relationship between all entities in the group
15 and compare that to the language in the, in the
16 unitary statutes provided by the state, and
17 make that determination.

18 Q: I believe that's ...

19 All right. So, from an accounting
20 perspective, is there anything that would
21 interfere with your ability to determine -- let
22 me back that up.

23 Is there anything that would interfere
24 with your ability to file a unitary combined
25 return in South Carolina that includes only the



1 parent and Tractor Supply of Texas?

2 A: Mechanically, from an accounting perspective,
3 is there anything? No.

4 Q: Okay.

5 **MR. STREISEL:** That's all that I have. Oh, wait.
6 That's all I have.

7 **THE COURT:** Go ahead.

8 **MR. SMALL - CROSS EXAMINATION BY MR. ANTLEY:**

9 Q: Good morning, Mr. Small.

10 A: Good morning.

11 **MS. WOOTEN:** Yeah. I'm sorry.

12 Q: Currently, half your time is dedicated to
13 leading your team as opposed to actual client
14 work, correct?

15 A: That's fair. Yes.

16 Q: Okay. Other than today, you've never served as
17 an expert witness?

18 A: That is correct.

19 Q: And you're not a tax policy expert?

20 A: No.

21 Q: Okay. You're not an economist?

22 A: No.

23 Q: Roy Strickland first approached you about
24 serving as an expert in this case, right?

25 A: That's correct.



1 Q: Mr. Strickland is a partner at your firm?

2 A: That's right.

3 Q: And Mr. Strickland has a relationship with
4 Nelson Mullins?

5 A: I believe so, yes.

6 Q: Mr. Strickland is not a tax person?

7 A: He is not.

8 Q: Mr. Strickland's expertise is in financial
9 statement evaluations?

10 A: I believe so, yes.

11 Q: Okay. You do not recall any significant
12 involvement, in any matter with a South
13 Carolina Department of Revenue, do you?

14 A: Me, personally, representing a client before
15 the South Carolina Department of Revenue?

16 Q: Yes.

17 A: No. I mean, outside of resolving a notice or
18 -- but, no. Certainly, no -- not -- I've not
19 had a client involved in litigation that I have
20 assisted or anything like that, no.

21 Q: So, nothing of significance?

22 A: That's right.

23 Q: Okay. You did not attend any of the public
24 meetings for Revenue Ruling 15-5?

25 A: No, I did not.



1 Q: You're not a lawyer?

2 A: I am not.

3 Q: Your opinion is, if I understood this
4 correctly, is that the returns were prepared
5 properly under South Carolina law?

6 A: Yes.

7 Q: Is that correct? Okay. You're not licensed as
8 a CPA in South Carolina, right?

9 A: No, I'm not.

10 Q: Okay. Continuing professional education events
11 is a -- those are things that CPAs attend to
12 keep up their licensure?

13 A: That's right.

14 Q: Okay. You have never discussed South Carolina
15 and combined reporting.

16 A: Discussed it? You mean -- you're talking in
17 the context of me teaching it?

18 Q: Yes, you, as in a speaker.

19 A: Well, I have certainly discussed combined
20 reporting.

21 Q: South Carolina and combined reporting.

22 A: Probably, not.

23 Q: Okay. And I'm going to refer to those
24 continuing professional ---

25 A: Yeah.



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ROA_001398

1 Q: --- education as CP, is that fair?

2 A: Sure. That's fair, yeah.

3 Q: Okay. At CP events, you have discussed
4 Equifax, Inc. versus misi- -- Mississippi
5 Department of Revenue?

6 A: That's right.

7 Q: Okay. Did you discuss how Equifax argued that
8 the Department of Revenue violated
9 Mississippi's Administrative Procedures Act by
10 requiring alternative apportionment that
11 amounted to an unduly promulgated rule? I know
12 that was a mouthful. I will repeat it if you
13 need me to.

14 *(Laughter.)*

15 A: Equifax was a while ago, now. I did speak on
16 it a couple times when it was going on. I
17 would have trouble recollecting the exact facts
18 of the case or what I spoke on, today. I'll
19 say, I spoke on the facts of the case.

20 Q: Okay. Did you discuss how Mississippi's
21 Supreme Court rejected that argument that I
22 just mentioned?

23 A: I probably did, yeah.

24 Q: Okay. Did you discuss how the Court held that
25 the Commission required Equifax to use an



1 alternative apportionment method under an
2 existing rule, which provides that if the
3 standard allocation and apportionment
4 provisions do not fairly represent the extent
5 of the taxpayer's business activity in this
6 state, the Commissioner may require the
7 employment of any other method to effectuate an
8 equitable allocation and apportionment of the
9 taxpayer's income? Did you discuss that?

10 A: I -- well, I bel- -- my recollection is that
11 that was a big part of the case, so I imagined
12 I discussed it, yeah.

13 Q: Is that language similar to South Carolina's
14 alternative apportionment statute?

15 A: It is.

16 Q: Okay. Did you discuss how the Mississippi
17 Supreme Court ultimately upheld the Department
18 of Revenue's use of alternative apportionment?

19 A: I probably did, yes.

20 Q: Okay. Your opinion today is limited to whether
21 the South Carolina returns were properly -- or,
22 sorry, were prepared accurately and properly,
23 and whether the income reported on the returns
24 fairly represents Petitioner's business
25 activities in South Carolina?



1 A: Right.

2 Q: Okay. And your opinion relies on the accuracy
3 of the 2014 transfer pricing study by
4 PricewaterhouseCoopers?

5 A: To some extent, yeah.

6 Q: Okay. And just for clarification, that is
7 what's been admitted as Joint Exhibit 20.

8 **(Joint Exhibit Number 20 was referenced at this**
9 **time.)**

10 A: Okay.

11 Q: Would you like to see the exhibit, or do you
12 need to see it?

13 A: I don't need to see it.

14 Q: Okay. You relied on the accuracy of Tractor
15 Supply Company's 10-K?

16 A: I did.

17 Q: Okay. You would advise a taxpayer to request
18 to file a combined unitary basis in South
19 Carolina, if it would reduce the -- its taxes.

20 A: If they -- if it would reduce the ta- -- its
21 taxes and -- and that the -- and there was a
22 mechanism in the law for them to file under --
23 to file on a combined basis, yes.

24 Q: Are you saying there's not a mechanism?

25 A: I'm saying there's not a, there's not a default



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ROA_001401

1 mechanism. I'd say that there is a mechanism
2 that I think it's highly unlikely the state
3 would grant, if it's resulting in less tax.

4 Q: Okay. You would certainly not advise a
5 taxpayer to file on a combined unitary basis in
6 South Carolina if it would increase its taxes?

7 A: I would not. I would only advise them to file
8 on a combined basis in South Carolina if South
9 Carolina law provided for combined reporting,
10 as its, as its default method.

11 Q: Most of Tractor Supply of Texas, LLP's revenue
12 is from intercompany transactions, correct?

13 A: I can't commit that from memory, but I would
14 say yes.

15 Q: Give me one moment. I might ---

16 A: Yeah.

17 Q: --- have something that might help.

18 A: Oh, sure.

19 **MS. BUCKNER:** Oh. I'm sorry, if you're waiting on
20 me (laughter).

21 Q: Okay. Do you -- are you able to see this?

22 A: Oh, it's right in front of me, yeah.

23 Q: Yeah. All right. Do you -- do you remember
24 this, this exhibit? This is Respondent's
25 Exhibit 32.



1 A: Yeah. I couldn't see it well the other day,
2 but I see it now.

3 **(Respondent's Exhibit Number 32 was referenced at**
4 **this time.)**

5 Q: Okay. Do you see that the source is Exhibit
6 30, and then there's a Tractor Supply Bates
7 label -- label underneath that that says 4558?

8 A: Yes.

9 Q: Okay. Do you see where it shows intercompany
10 sales?

11 A: Yes.

12 Q: Okay. All right. So, I'm going to ask you
13 again that same question. So, most of Tractor
14 Supply Texas, LLP's revenue is from
15 intercompany transactions?

16 A: That is correct.

17 Q: Okay. All right. And you said this earlier,
18 but that revenue is from, actually, from
19 journal entries.

20 A: It is recorded as journal en- -- I mean, it, it
21 is a sale of inventory from Tractor Supply of
22 Texas to Tractor Supply Company and Tractor
23 Supply Michigan, recorded as -- and, and it is,
24 it is recorded as a journal entry.

25 Q: Okay. Tractor Supply of Texas does not send an



1 invoice to Tractor Supply Company.

2 A: I can -- I am unaware of that.

3 Q: Okay. And Tractor Supply Company does not cut
4 a check to Tractor Supply of Texas.

5 A: No. I do not believe they do.

6 Q: Okay. So, money is not moved from Tractor
7 Supply Company's bank account to Tractor Supply
8 of Texas' bank account?

9 A: No, it is not.

10 Q: Okay. Tractor Supply Company, Tractor Supply
11 Company of Michigan, LLC and Tractor Supply of
12 Texas, LLP are a unitary group, right?

13 **OBJECTION:**

14 **MR. STREISEL:** Objection. Calls for legal
15 conclusion.

16 Q: From an accounting perspective.

17 **THE COURT:** Okay.

18 A: I would say, they have traits of a unitary
19 group. And I would say, that as I mentioned
20 earlier in my testimony, I mean, you would, you
21 would make that determination based on their
22 facts and the unitary laws written in the
23 statute of each respective states, so. And
24 there is a possibility they're unitary in one
25 state and not another.



1 Q: You mentioned earlier a somewhat universal
2 definition of unitary.

3 A: Yeah.

4 Q: Are they unitary under that definition?

5 A: Unitary is a little, I mean, little subjective.
6 But, I mean, it -- centralized management, yes,
7 I believe is in place. Functional integration,
8 the entities are -- some of the entities are
9 buying and selling from one another, greater
10 than 50 percent common controller to the test.
11 So, I -- yes, they seem like a unitary group.

12 **THE COURT:** That wasn't a legal conclusion, was it?

13 **MR. ANTLEY:** I ---

14 **THE COURT:** Aware of what, what you're asking him.

15 **MR. ANTLEY:** Well, I'm asking from an accounting
16 perspective.

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

18 **MR. ANTLEY:** So, I'm sorry.

19 **THE COURT:** Okay.

20 **MR. ANTLEY:** He had earlier mentioned in his
21 testimony there was a somewhat universal
22 definition, and so I just wanted to ask him of
23 applying that definition to this fact -- these
24 facts.

25 **THE COURT:** Okay.



1 **MR. ANTLEY:** Okay. I beg the Court's indulgence.

2 Q: Okay. Tractor Supply's attorneys told you to
3 avoid using the word unitary, didn't they?

4 A: I don't recall.

5 *(Whispering.)*

6 Q: Okay. Are you able to see the screen fine?

7 A: Yes, I see this. Yeah. That -- yeah.

8 Q: Okay. I'm showing you what's been marked as
9 Respondent's Exhibit 23, it has not been
10 offered into evidence.

11 **(Respondent's Exhibit Number 23 was introduced into**
12 **the record at this time.)**

13 **MS. GEER:** Not yet.

14 Q: Do you -- are, are -- I'm sorry. Did you have
15 a call with Tractor Supply's attorney on May
16 18th, 2022?

17 A: I've had several calls with their attorneys.
18 I, I could not point to a date.

19 Q: Okay. All right. What I'm showing you in
20 front of you, Exhibit 23, those are notes from
21 a meeting with Tractor Supply's attorneys on
22 May 18th, 2022?

23 A: Okay.

24 Q: I'm asking you.

25 A: Oh, I don't know. I mean, I ---



1 Q: This was produced as part of your file.

2 A: Oh, part of my file? Okay.

3 Q: Is, is that correct?

4 A: I mean, it looks like it is notes from a
5 meeting we had, but, yeah. I don't, I don't
6 remember it specifically. And I -- I know I
7 did not take these no- -- I know I did not
8 personally take these notes, so.

9 Q: Okay.

10 A: Yeah.

11 Q: Just -- let's look at this. If you could ---

12 A: Yeah.

13 **MR. ANTLEY:** Go to page 2, please.

14 **OBJECTION:**

15 **MR. STREISEL:** Objection to the extent it's used for
16 impeachment, because he just said they're not
17 his notes.

18 **THE COURT:** Any response?

19 **MR. ANTLEY:** I -- I'm going to ask him some more
20 questions about this just to confirm that these
21 are not his notes.

22 **THE COURT:** Well.

23 **MR. ANTLEY:** Still laying the foundation for the
24 document.

25 **THE COURT:** Okay. I'll let him go further down the



1 path.

2 Q: Okay. So on here we see that -- let me make
3 sure I'm looking at this correctly. I see what
4 appears to be, May 12th, 2022, Tractor Supply
5 Matter Opinion Discussion. Do you see that?

6 A: Yes.

7 Q: Okay. I see something that underneath that
8 says, call with Bryson, Bobby and Jack Small.

9 A: (Nods head.) (No audible response.)

10 Q: Is, is that ---

11 A: Yeah. Yeah, I'm sorry. I'm nodding. Yes, I
12 see it.

13 Q: Okay.

14 A: Yeah.

15 Q: You were asked about this document in your
16 deposition.

17 A: Okay.

18 Q: Do you recall that?

19 A: Not specifically. I'm sure I was, but I don't
20 specifically remember it.

21 Q: Okay. I'm unsealing the deposition of Jack
22 Small. I'm going to hand you ---

23 A: How long has it been sealed?

24 Q: Okay. Just, what you have in front of you, do
25 you, do you see that, recognize it?



1 A: Yes.

2 Q: Okay. Is that a copy of your deposition?

3 A: It is.

4 Q: Do you, do you remember receiving a copy of

5 that deposition?

6 A: Yes.

7 Q: Okay. All right. If you could please flip to

8 page 51. And just let me know when you get

9 there.

10 A: Not tab 51, right? But -- okay. I see it. I

11 gotcha.

12 Q: Page 51.

13 A: Yeah. Okay.

14 Q: Okay. Are you there?

15 A: Yes.

16 Q: All right. So, if you could go to line 14 on

17 page 51.

18 A: Uh-huh. Yes.

19 Q: Okay. It says; just one exhibit, if we could

20 flip to it, it's 18.

21 A: Okay.

22 Q: All right. Do you recall what Exhibit 18 was

23 in your deposition?

24 A: No. I don't recall ---

25 Q: Okay.



1 A: --- eight -- the number 18. No.

2 Q: Would you go to the portion of the deposition
3 that contains the Exhibits, and if you'll look
4 at Exhibit 18 to refresh your memory?

5 A: Yeah. And it's what's on the screen up here,
6 so. Yeah.

7 Q: It is. It's ---

8 A: Yeah.

9 Q: It's consistent with what's been marked as
10 Respondent's Exhibit 23?

11 A: Yes, it is.

12 Q: Okay.

13 A: Yeah.

14 Q: All right. So, if you could just -- if you --
15 if we could go back to page 51.

16 A: Yeah. I'm there.

17 Q: All right. I'm going to keep reading this, so
18 just let me know if I'm reading this correctly.
19 Okay?

20 A: Uh-huh.

21 Q: All right. You were asked; just one exhibit,
22 if we can flip to it, it's 18. Do you
23 recognize this document? (Respondent's Exhibit
24 Number 18 was referenced at this time.) Did I
25 read that right?



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ROA_001410

1 A: Yes.

2 Q: And Respondent's Exhibit 18 is Respondent's
3 Exhibit 23 in this, in this tri- -- in this
4 hearing, is that correct?

5 A: 23 being, what's on my screen?

6 Q: That's correct.

7 A: Yes.

8 Q: Okay. All right. So, I'm going to keep
9 reading. Your answer; I do. Okay. Question:
10 Okay. What is it? Answer: These were some
11 notes taken by a colleague of mine firm -- in
12 my firm. Question: When were they taken, and
13 what were they taken as part of? Answer: I
14 believe they were taken as a part of internal
15 discussions between myself and Tractor Supply's
16 counsel and they were taken -- I -- look --
17 yeah. As you can see, probably, over a period
18 of time. There's various dates in here.
19 Question: Okay. If you'll look halfway down
20 the page, it says working analysis and then
21 there is a August 31st, 2021 meeting. Answer:
22 Uh-huh. Question: Questions from JVL. Is
23 that John Von Lehe? Do you know? Answer:
24 Yes, it is. Question: Okay. All right. Bear
25 with me just a second. Is this an accurate



1 reflection of the notes from those meetings?

2 Have I read it correctly up to this point?

3 A: You have.

4 Q: Okay. And Ms. Geer: Object to the form.

5 Answer: You know it's hard to say because,

6 one, I didn't write them, and I mean, it's like

7 -- it's almost like a -- the author, you know,

8 train of thought a little bit on, on various

9 things as I -- as I'm reading it, I mean.

10 Question: Okay. Answer: But that -- I mean,

11 for the most part, yes. I, I don't think that

12 captures a great deal of what we were talking

13 about.

14 Okay. Does that re- ---

15 A: Well, I ---

16 Q: --- refresh your memory about this document?

17 A: Yeah, but I think you misread that one.

18 Q: Okay.

19 A: I think I -- I say; I think that captures a

20 great deal of what we're talking about.

21 Q: Oh, excuse me.

22 A: Yeah.

23 Q: Okay. Thank you for that correction, it's

24 important. Okay. All right. So, let's go

25 back to Respondent's Exhibit 23. If you --



1 that last sentence ---

2 **MR. ANTLEY:** If you could scroll down.

3 Q: And just let me know if I'm reading this
4 correctly. Avoid using the word unitary ---

5 **OBJECTION:**

6 **MR. STREISEL:** I'll object. They're, they're
7 clearly not his notes, he just said so.

8 **THE COURT:** Say that again.

9 **MR. STREISEL:** They're still trying to impeach him
10 with notes that are not his.

11 **THE COURT:** And the -- your response?

12 **MR. ANTLEY:** They're notes taken by a colleague of
13 his. He's already said that it reflects
14 generally what they discussed at that meeting.

15 **THE COURT:** Yeah, that -- that's my struggle a
16 little bit. The transcript said, they don't
17 capture what I'm saying. He corrected the
18 transcript that said that he what he really
19 said was they do capture what ---

20 **MR. ANTLEY:** And I'm sorry, Your Honor. I misread
21 the transcript, at that point, so ---

22 **THE COURT:** Oh. Oh, you ---

23 **MR. ANTLEY:** --- what he said was correct. He ---

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

25 **MR. ANTLEY:** The transcript and, and what -- his



1 statement are consistent. It says, I think
2 that captures a great deal of what we were
3 talking about.

4 **THE COURT:** So, if he said that; it captures a great
5 deal of what I'm talking about. Does that --
6 how does that affect your objection?

7 **MR. STREISEL:** I mean, I don't, I don't think that
8 confirms that whatever statement he's trying to
9 impeach him with is his statement.

10 **THE COURT:** And there's -- a little bit of struggle
11 I have is, if it captures a -- what was it? A
12 great deal of what we're talking ---

13 **MR. ANTLEY:** Yes, Your Honor.

14 **THE COURT:** --- about? That doesn't necessarily
15 mean it's his thoughts. I think you would need
16 to lay a further foundation if you want to get
17 this in.

18 **MR. ANTLEY:** Yes, Your Honor. I -- and I haven't
19 tried to offer it.

20 **THE COURT:** Or not just his thoughts, but what he --
21 -

22 **MR. ANTLEY:** Yes.

23 **THE COURT:** Well, what he was told.

24 **MR. ANTLEY:** Yes, sir.

25 **THE COURT:** So, you can ask him if it refreshes his



1 recollection.

2 Q: Okay. I -- I'm going to read a line from this.
3 Just tell me if I'm reading this correct.
4 Avoid using the word unitary.

5 Did I read that correctly?

6 A: That's what I'm reading.

7 Q: All right. Does that refresh your memory as to
8 the attorneys for Tractor Supply telling you to
9 avoid using the word unitary?

10 A: Not rea- -- well, I'd say it's inconsistent
11 with -- I would imagine in my deposition, I
12 used the word unitary. Maybe, I didn't. And
13 I think we -- we've tried to discuss unitary up
14 here today. So, I don't recall that being
15 said. And I don't think there's been an
16 attempt to avoid the word -- using the word
17 unitary any- -- anywhere throughout, throughout
18 the process, so.

19 Q: My question is just, did they tell you to avoid
20 using the word unitary, not whether ---

21 A: I don't recall that. No.

22 Q: Okay. All right. You agreed that the
23 Department is authorized to use any other
24 method to effectuate an equitable apportionment
25 of the taxpayer's income, including the



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ROA_001415

1 combined entity apportionment method?

2 A: You're ---

3 **THE COURT:** Can you do that question again for my
4 sake?

5 **MR. ANTLEY:** Yes, Your Honor.

6 Q: You agree that the Department is authorized to
7 use any other method to effectuate an equitable
8 apportionment of the taxpayer's income,
9 including the combined entity apportionment
10 method?

11 A: I believe that if you get to the combination of
12 the Section 18 statute and what it says in
13 Ruling 15-5, then that is what the Department
14 has concluded. Yeah.

15 Q: Okay. Does it change your opinion if I have
16 read a quote from the South Carolina Supreme
17 Court?

18 **OBJECTION:**

19 **MR. STREISEL:** Calls for a legal conclusion.

20 **THE COURT:** Now, you're ---

21 **MR. ANTLEY:** I'm asking if it just changes his
22 opinion, the source of the quote.

23 **THE COURT:** As an accountant.

24 **MR. ANTLEY:** Your Honor?

25 **THE COURT:** You -- you're asking if it changes his



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ROA_001416

1 opinion as an accountant, if he reads a South
2 Carolina Supreme Court ---

3 **MR. ANTLEY:** No. If he, if he knows that the source
4 of that quote was from a South Carolina Supreme
5 Court decision, if that affects his decision,
6 his opinion.

7 **THE COURT:** As an accountant.

8 A: No, it does not.

9 Q: Okay. All right. Do you agree that the
10 Department has the discretion to select an
11 alternative method that fairly measures the
12 taxpayer's income in South Carolina?

13 A: I believe they have -- repeat it one more time
14 because I want to repeat it as you did.

15 Q: Sure. Do you agree that the Department has the
16 discretion to select an alternative method that
17 fairly measures the taxpayer's income in South
18 Carolina?

19 A: I believe they have the discretion to select a
20 method that -- yeah, that fairly reflects
21 income in South Carolina, yes.

22 **THE COURT:** So, is that, is that ---

23 **MS. GEER:** Oh, yeah.

24 *(Whispering.)*

25 Q: I think I have one topic, maybe, hopefully, one



1 question.

2 So, earlier when we -- you were talking
3 about the percentages, you were talking about
4 nine percent of the income.

5 A: Uh-huh.

6 Q: Okay. What apportionment percent -- I'm sorry.
7 The Department used a two percent -- the
8 Department's only taxing two percent -- okay.
9 One second. Let me make sure I'm saying this
10 correctly.

11 **THE COURT:** There's always the option of not asking
12 the question.

13 *(Laughter.)*

14 **MR. ANTLEY:** Yeah, I think I'll ---

15 **THE COURT:** Go with option B?

16 **MR. ANTLEY:** I'll take that option.

17 **MR. SMALL - RE-DIRECT EXAMINATION BY MR. STREISEL:**

18 Q: Jack, do you recall just being asked about a
19 quote from the South Carolina Supreme Court
20 about the use of a combined entity
21 apportionment method?

22 A: Yes.

23 Q: Okay. And in this case, the Department's using
24 combined unitary reporting, correct?

25 A: That's right.



1 Q: Okay. And earlier today, you talked about the
2 difference between reporting methods and
3 separate -- and apportionment methods ---

4 A: That's right.

5 Q: Okay. So, you were also asked whether you
6 believe that the Department has the discretion
7 to use an alternative method that fairly
8 represents the business activity of the
9 taxpayer in this State.

10 A: Right.

11 Q: Do you recall that question?

12 A: I recall that.

13 Q: Okay. Can you tell us your thoughts on whether
14 you agree with the way they have exercised
15 their discretion in this case?

16 A: Well, I see -- but, before they can, before
17 they can offer a new method, I believe the
18 State has to prove that the current method ---

19 **OBJECTION:**

20 **MR. ANTLEY:** Objection, Your Honor. I just want to
21 make sure this is from an accounting
22 perspective. So- -- sounds like a legal
23 conclusion.

24 **THE COURT:** Seems like you opened the door to me on
25 all this, so I'll let him proceed.



1 A: I believe the State has to make a -- has to
2 prove that the current method, the prescribed
3 method, the prescribed method under state law,
4 does not fairly represent income in the state.
5 Nothing, nothing I've read about this case or
6 seen about this case leads me to believe that's
7 been done, as of yet. And, I'm sorry, did --
8 was there -- did that fully answer your
9 question? Or repeat your question, if you
10 don't mind, so I can ...

11 Q: The, the question is, is based on what you know
12 about this case ---

13 A: Right.

14 Q: Well, this is a different question beginning
15 the same way.

16 A: Yeah.

17 Q: Based on what you know about this case and what
18 you've heard in trial, do you believe that they
19 have -- the Department has appropriately
20 exercised the discretion they have to use an
21 alternative method that fairly represents the
22 business activity in this ---

23 A: I got you. Well, as I mentioned, I don't
24 believe they've proven it's, it's -- it's not
25 fairly reflected under, under the current



1 prescribe statutes. And ---

2 **OBJECTION:**

3 **MR. ANTLEY:** Objection, Your Honor. He's talking
4 about statutes. Legal conclusion.

5 **THE COURT:** You can, you can answer the question
6 from an accounting perspective, if that is a
7 proper ---

8 A: Okay. It ---

9 **THE COURT:** You can answer ---

10 A: From -- from the, from the method, from the
11 method that the State has historically required
12 taxpayer's to file.

13 Q: Okay.

14 A: But imposing combined reporting to resolve a
15 perceived -- the perception that, that income
16 is not fairly reflected in the State, I think
17 is a drastic measure when this could be
18 resolved by a simple account adjustment, if it
19 were to be proving that, that something --
20 something's wrong with the pricing or the
21 intercompany adjustments, or something along
22 those lines. I think combined reporting is the
23 far extreme, will get the far extreme result,
24 where, where an accounting adjustment somewhere
25 in the middle might be more appropriate.



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ROA_001421

1 Q: And do you recall being asked if you were a
2 licensed CPA in South Carolina right after
3 being asked about your opinion of the income
4 reported to South Carolina?

5 A: Yes, I recall.

6 Q: Okay. And what was your answer to that
7 question, as to whether you are a licensed CPA
8 in South Carolina?

9 A: It is -- it -- no.

10 Q: Okay.

11 A: I'm not.

12 Q: And you -- are you a licensed CPA in Georgia?

13 A: Yes, I am.

14 Q: Okay. And so, how does the way Georgia
15 requires ---

16 **OBJECTION:**

17 **MR. ANTLEY:** Objection, Your Honor. We're talking
18 about Georgia again. Relevance.

19 **MR. STREISEL:** They ---

20 **THE COURT:** I think this is responsive to your
21 questioning. What -- do you -- your question
22 indicated that since -- I mean, I would infer,
23 I assume, that since he's not licensed in South
24 Carolina that his opinion is not as qualified.

25 **MR. ANTLEY:** And he's not able to opine on South



1 Carolina law.

2 **THE COURT:** Okay. Well, he's exploring that --
3 imply, I should've said, not infer. No, I'll
4 let him to pursue this, to a point.

5 Q: So, tell me how the way Georgia requires
6 corporations to file corporate state income tax
7 returns compares to the way South Carolina
8 requires corporations to file South Carolina
9 tax returns.

10 A: Remarkably similar. Both separate company
11 states. Both single foc- -- both single sales
12 factor states. Georgia, although, it does have
13 a Section 18-type statute, I'm unaware of them
14 ever mandating combined reporting through it.
15 And you just -- a little bit -- I mean, to the
16 question, it's -- I, I know it was just
17 specifically in Georgia and South Carolina, a
18 multistate tax professional, licensed in one
19 state does not preclude them from, from working
20 in multiple states. I'd say, I'd say most
21 state and local tax experts work in, you know,
22 30, 40, all 50 States, potentially, it get- --
23 that's the purpose of the job we do, so. And
24 there's not a requirement that we be licensed
25 in all 50 states to have the necessary



1 expertise to, to get -- to, to assist clients
2 in all 50 states.

3 Q: And I believe you said Georgia has an
4 alternative apportionment statute like South
5 Carolina does?

6 A: That's -- yes, it does.

7 Q: Okay. And how many -- okay. And have you ever
8 filed combined unitary returns in Georgia for
9 your clients you have?

10 A: I have not.

11 Q: Okay. How many Georgia corporate income tax
12 returns would you estimate you have filed in
13 your career on behalf of clients?

14 A: Thousands.

15 Q: Okay.

16 **MR. STREISEL:** No further questions.

17 **THE COURT:** Any follow-up on those questions?

18 **MR. ANTLEY:** No, Your Honor.

19 **THE COURT:** You may step down. Okay. We're going
20 to take a short break. Thank y'all.

21 (Off the record from 11:35 a.m. to 11:49 a.m.)

22 **ADMINISTRATIVE MATTERS:**

23 **MS. GEER:** Your Honor, just a little housekeeping --
24 or, not housekeeping, but just procedural.

25 I think we have a -- our next witness is



1 going to be Rick Pomp. And we're thinking,
2 it's probably a -- somewhat of a lengthy -- so,
3 maybe, get started with it. And then, I talked
4 with the Department, and maybe, at least, get
5 through his qualifications, and then take a
6 lunch break?

7 **THE COURT:** Okay.

8 **MS. GEER:** Will that suit -- okay.

9 **THE COURT:** Well, his qualifications could be a
10 while.

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

12 **MR. VON LEHE:** Thank you, Your Honor.

13 Your Honor, we'd like to call as our next
14 witness, Professor Rick Pomp.

15 **THE COURT:** Okay.

16 **COURT REPORTER:** If you'll raise your right hand for
17 me. Do you swear to tell the truth, the whole
18 truth and nothing but the truth, so help you
19 God?

20 **PROFESSOR POMP:** I do.

21 **COURT REPORTER:** Thank you.

22 **RICHARD POMP,** having been duly sworn, testifies as
23 follows:

24 **PROFESSOR POMP - DIRECT EXAMINATION BY MR. VON LEHE:**

25 **Q:** Hello, Professor Pomp.



1 A: Good morning.

2 Q: How are you this morning?

3 A: We'll see.

4 Q: Please state your full name for the record.

5 A: Richard D. Pomp.

6 Q: And what's your involvement or role in this
7 matter?

8 A: I was asked to opine on two issues in this
9 case.

10 Q: All right. So, have you then -- have you been
11 asked to come as an expert witness?

12 A: I'm sorry. Ask ---

13 Q: Have you been asked to come as an expert
14 witness?

15 A: Yes.

16 Q: In what area?

17 A: In tax policy.

18 Q: And what two -- what two questions have been
19 presented to you?

20 A: The first is the appropriateness of using the
21 alternative apportionment formula under the
22 facts of this case. And the second is to talk
23 about the policies underneath separation of
24 powers and state sovereignty and the right of
25 a legislature to make tax policy.



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ROA_001426

1 Q: All right. So, before we get to your opinions
2 in this matter, I'd like discuss your qual- --
3 your background and qualifications.

4 MR. VON LEHE: And we have his CV in Exhibit 29, I
5 believe.

6 MS. GEER: Yes. And I've got it up. Can -- would
7 y'all switch over for us, please?

8 MS. BUCKNER: Uh-huh.

9 Q: Is this a current version of your CV?

10 A: It's missing probably one recent publication,
11 but otherwise, yes.

12 **(Joint Exhibit Number 29 was introduced into the**
13 **record at this time.)**

14 Q: All right, sir. What was that publication?

15 A: Publication involved a recent North Carolina
16 Supreme Court Case in -- Quad, Q-U-A-D.

17 Q: And does, does the CV otherwise accurately
18 summarize your education and employment
19 background?

20 A: The dates for NYU Law School are not right.
21 So, I started there in 1987.

22 Q: All right, sir.

23 A: Otherwise, I think everything else is correct.

24 Q: So, for the Court's benefit, could you briefly
25 tell us about your educational background?



1 A: I have a Bachelor of Science degree, summa cum
2 laude from the University of Michigan and a
3 Juris Doctor degree from Harvard Law School,
4 magnum cum laude.

5 Q: And where are you currently employed?

6 A: I am the Alva P. Loiselle Professor of Law at
7 the University of Connecticut, and the Board of
8 Trustees Distinguished Professor. At NYU, I am
9 an adjunct professor in the LLM program in
10 taxation.

11 Q: And have you taught elsewhere?

12 A: I have. I've taught at Harvard, Columbia,
13 Boston College, University of Tokyo, a law
14 school in Thailand, and ---

15 Q: And what kind of classes did you teach?

16 A: Different aspects of taxation; federal
17 individual, federal corporate, federal
18 international, American-Indian taxation.

19 **THE COURT:** Where did you teach in Thailand?

20 A: Chulalongkorn University.

21 **THE COURT:** And why did you go to Thailand?

22 A: Why not? I like the food.

23 *(Laughter.)*

24 **THE COURT:** Yeah, that's -- okay.

25 A: And it was a good place to transit to, what was



1 called Burma in those days.

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

3 A: So, I spent some time in, in Burma.

4 **THE COURT:** It's great place to teach, then.

5 A: You had to clear the salamanders off of your
6 blackboard most nights, that's the only
7 disadvantage. But the students were very good
8 with good English, so.

9 **THE COURT:** All right.

10 A: That was an interesting month.

11 Q: And have you been qualified as an expert
12 witness in other tax cases?

13 A: I have.

14 Q: And, approximately, how many times?

15 A: It's about less than three per year, which
16 comes to about 130 cases.

17 Q: And how do you decide on whether to, whether to
18 serve as an expert witness in a tax litigation
19 matter?

20 A: I have a set criteria because I get a lot of
21 calls and, and most of them I do not accept.
22 So, it has to be a case that I believe in. So,
23 I have to understand what the issues are and
24 whether I feel whomever's making the, the
25 request is on the correct side of the issue.



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ROA_001429

1 Is it with people who I respect and will enjoy
2 working with? Because in a long trial, people
3 can get a little testy and so, it's got to be
4 people who I think will be comfortable to work
5 with, people who I respect. Will I be a better
6 scholar and teacher because of it? Will it
7 advance the law in a positive direction?
8 Because I often get calls, I'd say every ten
9 days from someone who says, you know, I'm a
10 friend of a friend. I don't always recognize
11 the alleged friend, but -- do you have ten
12 minutes? Now, we all know there's no ten-
13 minute phone calls, so -- but I always listen,
14 and after about 30 minutes they will say, so
15 what do you think? And in many cases, I say,
16 what do I think? Three to six. Three to
17 6,000? No. Three to six years that this
18 really is tax evasion. Oh, so you're not
19 interested? No. And then I wonder who this
20 friend was who sent this person to me.

21 So, there's other -- there's more calls
22 like that than you think, and then there's
23 calls from lawyers who I know, who I just think
24 have it wrong -- on the wrong side of the
25 issue. And, obviously, I don't get involved



1 with those.

2 Q: So, the first criteria you mentioned was you,
3 you must believe in the issue?

4 A: Well, you have to.

5 Q: So, in your experience, do you think other
6 expert witnesses apply the same criteria,
7 except in your observation?

8 A: Well, usually, every case I'm involved in
9 there's an expert witness on the other side.
10 And I would say that, I don't think everyone
11 has the same criteria as I do. I think there's
12 witnesses who except an assignment without
13 caring much about what the issue is, so.

14 Q: Now, you testified -- or, have you, have you
15 testified for both state taxing authorities and
16 for taxpayers?

17 A: I have. I would say for many, many years, it
18 was about 50/50. In the last ten years, it's
19 probably become more 60 for a taxpayer, it's 40
20 for states.

21 Q: And is that unusual for a tax policy experts in
22 this ---

23 A: It, it is unusual. Most expert witnesses have
24 either a practice representing states or
25 representing taxpayers. So, it is, I think



1 very unusual, my experience.

2 Q: And I think most people here in this room
3 probably know that you've testified in South
4 Carolina before.

5 A: I have.

6 Q: And do you recall generally what those cases
7 were, and who you were testi- -- who you
8 testified on behalf of?

9 A: I had -- many years ago, there were at least
10 two property tax cases I testified on behalf of
11 the Department. And Elaine Pike may be a name
12 some people here or are familiar with. And I
13 testified for Richland County in a case. I
14 think it's known as the Penny sales tax case,
15 something like that. I then have testified re-
16 -- most recently in AutoZone. And going back
17 in time, DirecTV, and Rent-A-Center.

18 Q: And have you written articles on state tax
19 matters?

20 A: I have.

21 Q: Approximately, how many?

22 A: Oh, there may be about 140. The real question
23 is, how many have been read by people, but at
24 least there's a 140 out there.

25 Q: Have any of those writings dealt with the topic



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ROA_001432

1 of alternative apportionment?

2 A: Yes.

3 Q: Or combined versus separate entity reporting?

4 A: Yes.

5 Q: And have you written a casebook?

6 A: I have. I have a casebook in its ninth edition
7 and the tenth will be coming out sometime end
8 of this year.

9 Q: And does it discuss these topics?

10 A: It does.

11 Q: Have you written law review articles in this
12 area?

13 A: I have.

14 Q: And did you write one in the Louisiana Law
15 Review?

16 A: I did.

17 Q: And I believe you testified earlier that had
18 you taught classes on state income tax issues.

19 A: At NYU, I think I teach the only semester-long
20 course on state corporate income taxes at any
21 law school.

22 Q: Have you ever drafted a state income tax
23 statute?

24 A: I -- I've done states. I drafted most recently
25 the Alaska personal income tax, which has



1 passed one of their chambers and is pending the
2 other, a income tax in Alaska is quite
3 anathema, so we'll see what happens. I worked
4 on the Connecticut income tax. I drafted the
5 first Chinese income tax. I did some drafting
6 for Zambia in Africa.

7 Q: There are lot of honors on your CV, but could
8 you tell us a little more about one or two of
9 them?

10 A: Yeah. I got one from the Council on State
11 Taxation known as COST, which is a -- an
12 association of the largest corporations in the
13 country, and often have been on the other side
14 of most of the issues I have testified before
15 legislatures on. So, that was kind of a nice
16 one. Kind of an olive branch, I suppose. I
17 received from Tax Analyst, I think, State Tax
18 Lawyer of the Year, of if you scroll down it's
19 probably on the CV somewhere. And that was
20 nice. I think that was in response to my work
21 as a hearing officer for the Multistate Tax
22 Commission on some of their proposals to amend
23 the Uniform Division of Income for Tax Purposes
24 Act, what we call UDITPA. And then, recently,
25 I got this Board of Trustees Distinguished



1 Professor Award, which is the highest award the
2 University gives to faculty.

3 So, those are three. The ones I like the
4 most.

5 Q: All right, sir.

6 **OFFERED AS EXPERT:**

7 **MR. VON LEHE:** At this point, Your Honor, we'd like
8 to move to have Professor Pomp admitted as an
9 expert in tax policy in the multistate area,
10 including apportionment of income, combined
11 reporting, separate entity reporting, and
12 alternative apportionment.

13 **OBJECTION:**

14 **MR. LUTHER:** Your Honor, the Department objects to
15 qualifying Professor Pomp as so stated. And I
16 feel like I probably need to explain my
17 objection ---

18 **THE COURT:** Yep.

19 **MR. LUTHER:** --- if I may. I'm not going to quibble
20 at all with resume. I think it speaks for
21 itself. He's clearly a leader in his
22 profession, and particularly in his role as a
23 tax professor. So, I'm not arguing with his
24 bonafides. But his field is tax law. If you
25 look at his resume, that's what he does, he's



1 a tax law Professor. And he's being offered in
2 the same manner as he was on the expert
3 disclosures, but I think it misses a word. And
4 that, he's an expert in state and local tax law
5 policy, and will provide testimony re- --
6 regarding historical background and state tax
7 law policy related to these subjects. In other
8 words, what he is going to opine on is chalked
9 full of legal conclusions. And I understand --
10 and you may tell me I'm putting the cart before
11 the horse here because his opinions are ---

12 **THE COURT:** Yeah. Well, being qualified ---

13 **MR. LUTHER:** --- quali- ---

14 **THE COURT:** --- is one thing, and then when he's
15 actually asked a question, then I'll have to
16 rule on that.

17 **MR. LUTHER:** Correct. The, the difficulty I'm
18 having is that his opinions are so closely tied
19 to the way that he's being qualified and the
20 filed that he's being qualified in, which is
21 tax law. You can't separate them in a way
22 that's permissible. So, he has written
23 extensively on this subject, he's spoken on it,
24 he's lectured on it, he teaches on it, but what
25 he's doing? He's teaching future lawyers about



1 what the law is and what it should be. He's
2 talking to current lawyers, both practicing and
3 the bench, about what the law is and should be.
4 And he's speaking to legislatures about what
5 the law is and what it should be. And there's
6 two times that that is appropriate in a
7 litigated matter, in my opinion. One, is for
8 the folks sitting at the chairs right here, the
9 lawyers, for us to argue to you what the law is
10 because, ultimately, that is your conclusion to
11 make.

12 The second time, I think it's appropriate
13 is at the amicus level at the appellate courts,
14 and Professor Pomp has done that repeatedly in
15 his career. Because that is where it is
16 appropriate for us, as lawyers, to opine on
17 legal issues. In fact, I received a request
18 yesterday from the Court of Appeals, here, to
19 respond to an amicus brief that's been filed in
20 a matter by two tax law professors. But that's
21 an argument, that's what lawyers do. That's
22 what he's trained to do. That is not expert
23 testimony. And South Carolina's laws on ex- --
24 on expert testimony do not allow for legal
25 testimony -- expert legal testimony.



1 **THE COURT:** Well, how about in *Vortex*?

2 **MR. LUTHER:** *Vortex* ---

3 **THE COURT:** Professor Freeman was allowed to
4 testify. Well, it was ---

5 **MR. LUTHER:** That is correct.

6 **THE COURT:** --- it was disallowed, but it -- the
7 Court said that he should've been allowed to
8 testify to understand the evidence and the
9 facts at issue.

10 **MR. LUTHER:** That's correct. And I think if you
11 look at *Vortex*, and you also look at the case
12 that *Vortex* was discussing, in which Professor
13 Freeman also was in that issue, the Court made
14 it very clear that it is not permissible expert
15 testimony to opine on the law. And the
16 distinguishing factor they made with Professor
17 Freeman was that, at the time he was offered to
18 testify, the Court had first heard what his
19 opinions were going to be and then it rendered
20 a decision that, in that case, there was a
21 duty, a fiduciary duty owed by one of the
22 parties. And so, once he had established that
23 legal issue, he then allowed Professor Freeman
24 to testify as to some facts that may relate to
25 that duty. You have not established any duties



1 in this case. You have not construed any
2 statutes yet and so, to allow Professor Pomp to
3 go into that prior to you making a decision,
4 and to tell you how you should make that
5 decision, I believe runs afoul of, of our
6 established law.

7 **THE COURT:** All right.

8 **MR. LUTHER:** And if I may make one more point, which
9 I think will explain why I'm raising this now.
10 So, Professor Pomp in his deposition said
11 something that, when I first read it, struck me
12 as odd and I couldn't quite figure out why.
13 And when I reread it last night, it was sort of
14 a lightbulb moment for me.

15 So, he was asked the question about, have
16 you ever been not qualified as an expert in
17 your case, and he gave a few examples. And one
18 of those was in a case a number of years ago.
19 He -- his recollection was it involved General
20 Motors in Virginia. And he says this, one time
21 I was offered as an expert and the Judge says,
22 you know what, I'd like the professor to argue
23 this. I'm going to admit him pro hac vice.
24 And what I find most interesting, is how
25 Professor Pomp then describes that. So, I was



1 declined as an expert and ended up arguing the
2 particular issue that I was being offered as an
3 expert on. In other words, he turned around
4 and the very opinions he was going to offer
5 became his legal arguments.

6 And so, what he's going to do today, is
7 essentially an oral recitation of a post-trial
8 motion. He's going to argue what would
9 otherwise be included in our proposed orders at
10 the end of this case. He's going to tell you
11 what the law is in South Carolina. He's going
12 to give you an oral recitation of string cites,
13 here are all the other cases around the
14 country, my friends, this is what the Court's
15 saying and what they mean. He's going to talk
16 to you about Constitutional issues. As you
17 heard, his second opinion deals with separate
18 of powers, that's a legal question. In fact,
19 it's a Constitutional question.

20 **THE COURT:** I understand that.

21 **MR. LUTHER:** And he's going to talk to you about
22 what the legislature intended, which is an
23 issue of statutory construction and I can -- we
24 can get into that, but that's not the province
25 of an expert. And there's case law on that.



1 And then he's going to talk to you about
2 policy, which every lawyer does at some point
3 in their briefing.

4 So, I don't think that what he's going to
5 say can be separated from what he's being
6 qualified for. And I think the appropriate
7 place for him to make those arguments is
8 sitting -- is seated right over there, rather
9 than in this chair being questions by Mr. Von
10 Lehe.

11 **MR. VON LEHE:** Your Honor?

12 **THE COURT:** Yeah.

13 **MR. VON LEHE:** May I? I liked the la- -- very last
14 part of his argument that he just made. He
15 said, and lastly, he's going to testify
16 concerning the tax policy. That's what was
17 just said, and that's quite accurate. That is
18 what Professor Pomp is here to testify to.
19 He's not going to interpret our statute or
20 attempt to do that -- of course, obviously,
21 that's within the Court's province. He's not
22 going to try to give an answer in this case.
23 He's just going to talk about what is the
24 better tax policy to apply under these
25 circumstances.



1 **THE COURT:** Well, is there an avenue for which I can
2 consider tax policy within the perimeters of
3 apply- -- of applying the law as the
4 legislature has already written, or is your
5 approach to tax policy that the -- the statute
6 is not properly written?

7 **MR. VON LEHE:** No. I think that, Your Honor, I
8 don't -- I do not anticipate Professor Pomp
9 arguing that the statute is not properly
10 written.

11 **THE COURT:** Okay.

12 **MR. VON LEHE:** I don't anticipate that.

13 **THE COURT:** Okay.

14 **MR. VON LEHE:** I do, I do anticipate he's -- his
15 giving you expert opinions, answering your
16 questions with regard to what is the better
17 application of different types of tax statutes.
18 Not how -- not whether those statutes apply or
19 not apply. He's been qualified, of course,
20 there was a mention a moment ago of another
21 jurisdiction, and, yes, of course, he's been --
22 he's been certified -- or approved, admitted as
23 a tax policy expert in a number of
24 jurisdictions, many jurisdictions, which he
25 spoke of. But, again, that's other



1 jurisdictions. We're here to argue this thing
2 in front of you.

3 **THE COURT:** All right. I'm going to qualify him as
4 an expert in tax law and tax policy.

5 **MR. VON LEHE:** Thank you, Your Honor.

6 **THE COURT:** How we proceed down the path, I'll go
7 ahead and tell you, Professor Pomp, I'd love to
8 hear you talk about all of this, honestly.
9 Now, there -- if I make a ruling that I decide
10 that I shouldn't hear something, it's not
11 because I don't -- I wouldn't love to hear you
12 give me your opinions on that. Yeah. It's
13 just ---

14 A: Judge, you know, there's no Judge before whom
15 I enjoy losing more than you.

16 *(Laughter.)*

17 **THE COURT:** I remember one time, I decided against
18 your client, but I agreed with everything you
19 said.

20 **MR. VON LEHE:** Yes, we -- I think we remember that,
21 Your Honor.

22 **THE COURT:** But you didn't lose on that case, the
23 other people did, I think.

24 **MR. VON LEHE:** I think, I think we do recall that
25 case.



1 **THE COURT:** All right. Well, I'm -- with that said,
2 I've qualified him. And we're gonna just take
3 a lunch break now?

4 **MR. VON LEHE:** Thank you, Your Honor.

5 **THE COURT:** Thank you.

6 **MR. VON LEHE:** You can step down.

7 **(Off the record from 12:12 p.m. until 1:32 p.m.)**

8 **Q:** Professor Pomp, you're still under oath, of
9 course. And do you understand that you have
10 been admitted as an expert in tax policy in the
11 multistate tax area including, apportionment of
12 income, combined reporting, separate entity
13 reporting and alternative apportionment?

14 **A:** Yes.

15 **Q:** And I also want to ask you the following, you
16 may have heard an argument prior to our taking
17 a break from the Department of Revenue that
18 you, in fact, should not be allowed to testify
19 because you're going to testify as to legal
20 conclusion, did you hear that?

21 **A:** I did.

22 **Q:** All right. But I've I wanted, I wanted to ask
23 you this, do you understand this, that you have
24 been admitted to testify on tax policy, not
25 render legal conclusions or interpretations of



1 law?

2 A: Correct.

3 Q: And do you understand that that would include
4 items such as the context, including the
5 background, the history, and general -- what
6 general systems of taxation are preferred, is
7 that tax policy?

8 A: Yes.

9 Q: Can you elaborate a little more on what tax
10 policy is?

11 A: Well, tax policy is sort of the normative
12 principles that should underlie the
13 construction of a state tax system.

14 Q: Thank you. I want to -- want to begin by
15 asking about separate entity reporting and
16 combined reporting.

17 What are the two different reporting or
18 filing methods used by states that impose
19 corporate income taxes?

20 A: Yeah. There are two primary methods of filing.
21 One, is separate entity filing. And that means
22 that a corporation that has nexus with a state
23 will file a return showing only its income and
24 calculate only its apportionment formula. And
25 the other is -- goes by different names,



1 combined reporting, the unitary method, the
2 California method, and that requires
3 determining whether you have a unitary business
4 or not. And you've heard a lot of testimony
5 about that. And if you do, the members of that
6 unitary business would file a combined return.
7 And under that combined return, the income tax
8 base would be the income of all of the members
9 of the combined group. It gets all added
10 together, and then you would calculate and
11 apportionment percentage that was based on the
12 combined group. So, fundamentally, very
13 different approaches to filing.

14 Q: And -- make sure of my understanding of your
15 answers. You said that separate reporting only
16 taxes entities with nexus to the state, you
17 defined nexus, while combined reporting would
18 tax entities that don't have nexus to the
19 state. Am I correct about that?

20 A: Well, someone has nexus with the state. So,
21 that person would be the entity that would be
22 -- and it goes by different names -- kind of,
23 the lead entity of the combined group because
24 they have nexus. And as part of their
25 activities, it would bring in to the tax base



1 all the members of this big unitary family.

2 Q: And you talked about the two filing methods.

3 Now, do each of those filing methods have
4 methods of apportionment?

5 A: Yes.

6 Q: And what is the -- what is, sort of, the --
7 some of the common standard methods of
8 apportionment which are used?

9 A: So, here's the history of apportionment and
10 some of the methods.

11 So, you could think of the tax base as a
12 pizza pie, whether we're talking separate
13 entity or combined. So, here you have a pizza
14 pie, and you have a taxpayer with activities in
15 a whole bunch of states, and the question is,
16 what slice of that pizza pie should a state be
17 entitled to tax. And early on, we experimented
18 with different methods, but the method that has
19 evolved is known as apportionment. So, imagine
20 now a scissors comes along and it cuts the pie
21 into slices, and here's the slice of the taxing
22 state. So, how does that scissors work? Well,
23 it as two blades. One blade represents the
24 demand side of producing income, your sales,
25 your sales market, that's demand for your good.



1 The other blade represents the production of
2 the good, capital and labor. And so, the
3 scissors, historically, took into account both
4 the production side and the market side. How'd
5 it do that? It created an evenly weighted
6 three-factor formula that looked at each
7 state's share of sales, property and payroll.
8 And it would produce a fraction.

9 So, let's say, you had no property in this
10 state, no payroll in the state, and you had
11 sales in the state, so you'd have a zero and a
12 zero. And let's say, all your sales were in
13 this state, to make it easy, and so, you'd have
14 100 percent. And now, you would take the
15 average of those three, zero plus zero, plus a
16 100 divided by three, and you would get 33 and
17 a third percent of the pizza would be
18 apportioned to the state. And that state then
19 would say, okay, what's your income, we'll take
20 a third of it, we'll multiply it by our tax
21 rate, we'll give you any credits you might
22 have, and that will determine your tax. And in
23 a combined ---

24 **THE COURT:** Well, how can that be fair if it's 100
25 percent of your sales are in the state?



1 A: It's fair because you have weighted the
2 property and the payroll equally with the
3 sales.

4 **THE COURT:** And that, and that was zero.

5 A: And those were zeros. Zero plus zero, plus 100
6 divided by 3. So, even though 100 percent of
7 your sales are in the state, only one-third of
8 your total income would be given to the state
9 to be taxed, because we're taking into account
10 property and payroll, sort of, their supply
11 side of the scissors.

12 **THE COURT:** Okay.

13 A: But, but you're anticipating something, which
14 is interesting. I'm ge- -- getting -- I could
15 get to that now or, because I think His Honor
16 is kind of put it in play.

17 So, over time, over time, let's take a
18 State like South Carolina, but it could be any
19 number of states, it wants to encourage
20 business to come to this State. Business says,
21 gee, under that formula, if we come to your
22 State, you're going to be looking at our
23 property and our payroll and our sales. And
24 you know what? We're an export oriented
25 business. Export in the sense of just selling



1 outside the state. We may be Boeing. We may
2 be BMW, Mercedes, Volvo. And so, we don't like
3 that three-factor formula because you're going
4 to weight it heavily with our property here,
5 and our payroll here, and we have no sales
6 here. So, you're really going to have a --
7 apportionment formula that's heavily weighted
8 toward the supply side. And so, over time, the
9 states have moved, including South Carolina ---

10 **OBJECTION:**

11 **MR. LUTHER:** Your Honor, I'm going to object at this
12 point, because what is implied in his comment
13 is that, he's applying the intent of a
14 particular statute, the gen- -- the General
15 Assembly's intent of a particular statute or
16 method.

17 **MR. VON LEHE:** He's speaking for ---

18 **THE COURT:** Sir?

19 **MR. VON LEHE:** If I may. He's speaking generally,
20 Your Honor, general back down -- general
21 background and context. He's not talking about
22 the South Carolina General Assembly.

23 **MR. LUTHER:** Well, what he said was, a state like
24 South Carolina, would do X for X reason. If he
25 wants to talk about in generic terms, that's



1 fine, but I don't think he can speculate or
2 offer legal opinions about what the legislature
3 intended.

4 **THE COURT:** Well, I -- I'm going to hear your
5 objections, but on that one, he just picked
6 South Carolina, and I think he was just
7 referencing us out of -- just because we're
8 here in South Carolina. I, I didn't, I didn't
9 get a -- the gist that he was trying to
10 reference what we have done in this State.

11 **MR. LUTHER:** Well, I -- if, if I may. And I
12 understand your ruling. I just want to put
13 some context on it because this is where we're
14 headed.

15 **THE COURT:** Okay.

16 **MR. LUTHER:** Then he said, let's pick a state like
17 South Carolina, and then he picks particular
18 taxpayers, all of which we know operate in
19 South Carolina, Boeing, Mercedes, Volvo, and
20 what he's going to do is, he's going to say
21 there was a specific intent by the General
22 Assembly to enact this Law. And then he's
23 going to say, and these, these entities came
24 here based on that intent, ergo, the intent is
25 correct.



1 **THE COURT:** Okay.

2 **MR. LUTHER:** All of which is speculating as to
3 legislative intent, which is a legal conclusion
4 that experts cannot make. That's my objection.

5 **THE COURT:** Your objection then is as to what he is
6 going to say.

7 **MR. LUTHER:** I -- well, I think he's already half
8 said it, that's I'm objecting.

9 **THE COURT:** Okay. Well, I overrule it at this
10 point.

11 **MR. LUTHER:** Thank you, Your Honor.

12 **MR. VON LEHE:** All right. Thank you, Your Honor.

13 Q: Professor Pomp, I want to ask you a general
14 question. What are the tax policy reasons that
15 a state might choose either separate entity
16 reporting or combined reporting? What are some
17 tax policy reasons that they might choose one
18 or the other?

19 A: Separate entity filing is often chosen for
20 economic development purposes. And you could
21 look at this historically. You know, the
22 country develops really from east to west. And
23 so, in the early days, we have a lot of
24 manufacturing going on in the northeast. And
25 the south was agricultural and not industrial.



1 Then, with the advent of air conditioning, the
2 south really opened up, that was one of the
3 turning points to the development of the south,
4 and they're a little late to the party in
5 trying to attract -- attract industry because
6 the northeast, midwest kind of have a monopoly
7 on a good infrastructure and all of that. And
8 so, how does a state compete for economic
9 development if it doesn't have necessarily a
10 comparative advantage? Well, you could look at
11 a state like Delaware, you know, a small state,
12 wants to attract business, what does it do?
13 First thing it does, is not have a sales tax.
14 Well, that's attractive to certain businesses,
15 certainly attractive to consumers. Next thing
16 it does is, it has a very pro-business
17 favorable corporate law and it has a Chancery
18 court, which is considered to be pro-business.
19 So, it uses its regulatory structure and its
20 tax structure to attract business. What did
21 the states in the south -- and I have a map
22 that I think really shows this. What did they
23 decide to do?

24 Well, they knew businesses didn't like
25 combined reporting. And we can talk about why.



1 And they preferred separate entity reporting.
2 So, it's not a coincidences ---

3 **OBJECTION:**

4 **MR. LUTHER:** Your Honor, you're going to think
5 there's a tact in my seat as this afternoon
6 goes along.

7 **THE COURT:** Yeah.

8 **MR. LUTHER:** This is why I was trying to make the
9 argument at the beginning about ---

10 **THE COURT:** And we spent so much money to get
11 comfortable seats.

12 *(Laughter.)*

13 **MR. LUTHER:** They, they are great seats. And we
14 appreciate that.

15 Again, I think where this is starting to
16 go, and Professor Pomp is going to do this
17 throughout his testimony if it falls true with
18 his deposition, is he's gonna speculate about
19 what businesses are going to do. Now,
20 speculation is just not admissible testimony
21 whether it's a lay witness or an expert
22 witness.

23 **THE COURT:** Well, what he's testifying now about, is
24 the background of why states may have chosen
25 separate reporting verus combined reporting.



1 **MR. LUTHER:** Correct.

2 **THE COURT:** Well, I'm not sure how that yet
3 enlightens, me as far as applying the facts of
4 this case. But it hasn't reached the point of
5 telling me how to apply the law either, so ---

6 **MR. LUTHER:** Correct. And I, I would separate the
7 legal conclusions that we'll have concerns
8 about later with what is, an inordinate amount
9 of speculations that will be injected into his
10 opinion. And I think 403 says, and, and 402
11 says, speculation is not relevant evidence. In
12 fact, it's impermissible ---

13 **THE COURT:** 403? 403 says, if scientific, technical
14 or otherwise special knowledge will assist the
15 trier of fact in determining facts at issue or
16 -- determining facts of issue ---

17 **MR. LUTHER:** I think that's 7-0 -- I think that's
18 704, Your Honor.

19 **THE COURT:** Four? Were you -- you're on 704?

20 **MR. LUTHER:** 7-0 -- 703 is the, is the expert
21 testimony. I'm talking about probative versus
22 ---

23 **THE COURT:** Oh, you said, 403.

24 **MR. LUTHER:** Yes. Yes, Your Honor.

25 **MS. WOOTEN:** 403.



1 **THE COURT:** I'm sorry. I missed your ---

2 **MR. LUTHER:** My apologies.

3 **THE COURT:** All right. You don't have to apologize,
4 'cause I misunderstood you.

5 **MR. LUTHER:** Well, I have may have misspoke, but.

6 **THE COURT:** Oh.

7 **MR. LUTHER:** I meant to say 403.

8 **THE COURT:** Okay. Were ---

9 **MR. LUTHER:** So, again, an expert can provide all
10 sorts of helpful testimony, but an expert can't
11 speculate.

12 **THE COURT:** Correct.

13 **MR. LUTHER:** In fact, the -- one of the
14 determinations for whether expert testimony is
15 admissible if it's reliable. And speculation,
16 by definition, is not reliable.

17 **THE COURT:** Well, I don't get the gist that he's
18 speculating at this point. So, I'll overrule
19 the objection on that.

20 **MR. LUTHER:** Understood. Thank you.

21 **MR. VON LEHE:** Thank you, Your Honor.

22 **Q:** So, Professor Pomp, approximately, how many
23 states, and where are they located, have
24 adopted separate entity reporting versus
25 combined entity reporting?



1 A: I have a map here that ---

2 Q: Well, that map can be put up as a
3 Demonstrative, assuming there's no objection to
4 it.

5 MR. LUTHER: No, no objection.

6 MR. VON LEHE: All right.

7 A: So ---

8 MR. VON LEHE: You need to keep it or you got it?

9 MR. LUTHER: I'll ---

10 MS. WOOTEN: We'll take it. Thank you.

11 MR. LUTHER: Thank you, John.

12 MS. GEER: Do you need it blow -- blown up more or
13 no, or is it good?

14 MR. VON LEHE: It's not totally clear, but it can --
15 you can get your ---

16 MS. GEER: Okay. I'm going the wrong way.

17 MR. VON LEHE: There you go.

18 MS. GEER: Oh.

19 MR. VON LEHE: That's better. Is that as far as
20 it'll go?

21 MS. GEER: Well, it's as far as it'll go on, on
22 there.

23 MR. VON LEHE: Oh, that's much better. You can read
24 -- if you've got -- well, if I can read it, I
25 suspect most people can, particularly, His



1 Honor.

2 (Exhibit Number XX was introduced into the record at
3 this time.)

4 Q: What does that map show, Profession Pomp?

5 A: Well, if you notice the colors that look kind
6 of greenish, you see the separate entity states
7 and they tend to be neighboring states in the
8 southeast and over a little to the southwest,
9 picking up Missouri and Oklahoma and Arizona.
10 Not a coincidence. What you're looking at is
11 the attempt of the southern states to compete
12 with the industrial northeast and later the
13 west. And this one attempt. And one way of
14 doing it, is to have a favorable business
15 climate with separate entity filing.

16 Q: And what affect, if any, does separate entity
17 reporting have as an economic development
18 incentive?

19 A: I think that is the entire goal of it, based on
20 conversations I have had with three former Tax
21 Commissioners of this State, attending many
22 conferences where this issue is discussed, and
23 reviewing the website of Department of Commerce
24 here in South Carolina. A clear pattern
25 emerges.



1 Q: Which is?

2 A: Which is separate entity, along with, because
3 we have to add one piece in the puzzle that you
4 anticipated, the apportionment formula. That
5 these states tend to apportion income using
6 only sales. So, after you get done
7 establishing the tax base through separate
8 entity filing, you then have to apportion it.
9 That's your pizza pie. What slice will a state
10 take. For companies that are selling to other
11 states, what's the best formula that they will
12 find attractive? A simple ratio, sales in the
13 taxing state, and in the denominator sales
14 everywhere else in the country. So, for a
15 state -- and let's take a car manufacture,
16 because they tend not to sell all of their cars
17 in the state in which they're located, that
18 numerator, sales in the state in which they're
19 located, is going to be pretty small. The
20 denominator is going to be pretty big because
21 they're selling cars all over the United
22 States. So, you are now taxing a very tiny
23 fraction of their business because that
24 numerator of the sales factor is going to be
25 pretty small. And that's the whole intent of



1 what we call a single sales factor.

2 So, we have moved away from a factor --
3 from an apportionment formula that takes into
4 account property and payroll. If you're
5 looking to attract property and payroll, you
6 don't want to penalize them by coming to your
7 state, and establishing a plant. So, you
8 remove payroll, property from the apportionment
9 formula and then, you use only sales, knowing
10 that the industries you're looking to attract
11 aren't going to be selling in your state,
12 predominantly, they're going to be selling all
13 over the country. And so, you put separate
14 entity reporting together with single sales
15 factor and you have about the best tax climate
16 you can want. And this is the point the
17 Commerce Department makes on its website. And
18 this is -- you talk to -- well, you know, my
19 conversations with these former Tax
20 Commissioners, of course that's what we're
21 doing here in South Carolina. But it's not
22 just South Caroli- -- look at the map. This is
23 what neighboring states are doing, and your all
24 in competition now to attract business. Now,
25 I don't know if -- I can't sit here and tell



1 you that the reason Mercedes and BMW and Volvo,
2 and now I understand you're getting this
3 billion dollar electric battery plant that's
4 somehow connected with Tesla, is coming here,
5 I can't tell you that it's because of separate
6 entity filing and the single sales factor, it's
7 a complicated question. So, all I know is
8 that, in my conversations people feel quite
9 strongly that that's really been the key to
10 South Carolina's success. Maybe, yes, maybe
11 no. So -- but it's a classic example that we,
12 we teach in class, about how a state can use
13 tax policy to further economic development,
14 along with tax credits. A lot of tax credits
15 in this state, as well.

16 Q: All right. Well, you've given a reason -- a
17 tax policy reason why a state might adopt
18 separate entity reporting. What policy reasons
19 exist that a state might choose to adopt
20 combined reporting?

21 A: I've been a big proponent of combined
22 reporting. And if this were a legislative
23 hearing, I would be sitting here suggesting
24 that combined reporting would be something that
25 should be considered. It, it eliminates the



1 need for transfer pricing because what you're
2 doing is, you're putting -- it's like Humpty
3 Dumpty, you're putting Humpty Dumpty back
4 together again. So, you don't care about these
5 intercorporate transactions, they're all going
6 to be put back together again. So, you don't
7 have transfer pricing to worry about.

8 If you do it properly, and do it on a
9 worldwide basis, you've now undercut all the
10 tax havens in the country -- in the world
11 because you're going to add the income you
12 tried to shift over to those countries back
13 into the tax base. And it's a, it's a
14 wonderful measure to stop the abuse of tax
15 havens, these little, in some cases, countries
16 only stamp collectors have ever heard of, like
17 Nauru, N-A-U-R-U. A little spit of land that's
18 covered with, with bird droppings, which now
19 have become valuable, ironically, because of
20 the phosphate. But it's a little spit of land.
21 And it's a major tax haven for the Australians
22 and the New Zealanders 'cause it sits
23 somewhere, you know, off their, their coast.
24 The income you would be shifting to them would
25 come back under combined reporting. And it



1 applies substance over form. We don't care how
2 you're formerly organized, we're going to put
3 you back together again. And it's a way of
4 dealing with tax minimization strategies, like
5 holding companies. It has these advantages,
6 which is why business generally opposes it, you
7 know, it's not a darling of the business
8 community. But, that would be -- those are
9 some of the advantages of combined reporting
10 that I would espousing of this were before the
11 legislature.

12 Q: And do you know if South Carolina has ever
13 studied combined unitary reporting?

14 A: You had a famous commission called the TRAC
15 Commission, which was chaired by a well-known
16 tax lawyer, and they made a recommendation that
17 the legislature should consider adopting
18 combined reporting -- or study it, study it to
19 see if they should adopt combined reporting.

20 Q: And what happened?

21 A: Nothing.

22 Q: Nothing happened?

23 A: Nothing. No bill was ever introduced. I don't
24 know why, but no bill was ever introduced.

25 Q: Now, you said a moment ago, that you favor this



1 -- you're a proponent of combined reporting.

2 A: Yes.

3 Q: And therefore, why would -- why are you here
4 testifying on behalf of a taxpayer when we know
5 that they filed separately and had an
6 assessment against them?

7 A: Because I feel very strongly in the
8 underpinnings of our democratic form of
9 government, where the legislature enacts laws,
10 the executive branch executes those laws, and
11 then the judicial branch interprets and
12 resolves controversy. And I'm very big on
13 maintaining the separation between the
14 Executive Branch and the Legislative Branch.
15 The Legislative Branch couldn't care less my
16 views on combined reporting, but I care very
17 strongly that their views should be respected,
18 right or wrong. I might disagree, but their
19 views should be respected and shouldn't be
20 undercut by an executive agency.

21 Q: All right, sir. Well, you have, you have
22 described separate entity and combined
23 reporting methods to us. You have briefly
24 gotten to it. I'd like to get into more deeply
25 with you, the apportionment methods as applied



1 to those two types of filings.

2 A: Well, let's take separate entity to begin with.
3 The apportionment formula -- and we could use
4 single sales factor because that's become one
5 of the most common approaches for economic
6 development purposes, there's no state I am
7 aware of that said, let's use only sales to
8 apportion income because we think that's a
9 better measure of income, we'll just disregard
10 property and labor. You know, how can -- how
11 is possibly a better measure of income? They
12 do it for the reasons I suggested economic
13 development. It says -- it sends the right
14 message. Come to our state, set up your plant,
15 you won't be penalized for all that property
16 and payroll. And so, when it comes time to
17 apportion in a separate entity filing regime,
18 you look only to the income of that entity that
19 has nexus with the state, and then you apply
20 your apportionment formula, the single sales
21 factor, for example, to only that entity. So,
22 you would say, okay, entity, do you have any
23 sales in this state? Oh, not much. Okay. You
24 have a very small numerator. You have a lot of
25 sales in the U.S.? Oh, yeah. Well, you have



1 a big denominator. So, small numerator divided
2 by a big denominator, you're going to get a
3 very small fraction. That will be the fraction
4 that will be multiplied times the income of
5 separate entity.

6 Now, in a California approach, you would
7 say to the company that has nexus with
8 California, who else is part of your combined
9 family, your unitary family? And that may have
10 30 corporations all around the country. Well,
11 add their income to your income and that's the
12 tax base. And now, let's calculate the
13 apportionment formula. And let's suppose,
14 because California does use a single sales
15 factor for the same reasons everyone else does,
16 but in the numerator would go, the sales in
17 California of the entire unitary group, and
18 then the denominator would go, the sales across
19 the country of the entire unitary group. So,
20 you would be doing everything in a combined
21 reporting state on a combi- -- a combination of
22 the members of the unitary business. And that
23 is the fundamental difference between separate
24 entity, the greens on the map, and the blues on
25 the map. The ones in white have adopted a



1 little different approach to economic
2 development, they have no income tax, no
3 corporate income tax, so ---

4 Q: All right, sir. Well, I'm going to ask you
5 about a concept, alternative apportionment and
6 where it fits in to combined and single filing
7 taxpayers.

8 First of all, what is alternative
9 apportionment?

10 A: So, alternative apportionment says that ---

11 **MR. LUTHER:** Your Honor ---

12 A: --- we know ---

13 **OBJECTION:**

14 **MR. LUTHER:** Your Honor, if I may. I just want to
15 make sure we're -- where we're going here.
16 This is from a tax policy perspective and not
17 his opinion as to the law in South Carolina, is
18 that correct?

19 **THE COURT:** If I can instruct you to give it -- give
20 this testimony regard -- regarding tax policy
21 and not anything specific ---

22 **MR. LUTHER:** Thank you.

23 **THE COURT:** --- regarding this case. Well, you
24 know, regarding the application of the statute.

25 Q: Okay. Please ---



1 A: Yeah.

2 Q: --- proceed.

3 A: The policy behind alternative apportionment is
4 that one size doesn't fit all. That standard
5 formula, whatever it might be, may not work
6 reasonably well depending on the particular
7 facts of a taxpayer. And it's like a safety
8 valve, if the tax department thinks that the
9 standard formula isn't working well as applied
10 to these facts under conditions set forth in
11 the statute, it can apply some alternative
12 method. But there's symmetry here. If the
13 taxpayer thinks that somehow the standard
14 formula isn't working well, they can petition
15 the tax department to use an alternative
16 formula. So, it's good for the goose, good for
17 the gander. And so, it sits there for either
18 side to use in appropriate circumstances.

19 Q: And what is the origin of these alternative
20 apportionment formulas?

21 A: Well, they can be almost anything depending on
22 the facts and circumstances, you're not
23 limited. Once you enter this world of
24 alternative apportionment, the statutes almost
25 -- well, they give you sort of a blueprint



1 where you can adjust the factors, you could do
2 this, you could do that, and then there's a
3 fourth method that, or anything else that's
4 equitable, reasonable, fair, you can impose.

5 Q: But what I'm asking is this, when I said the
6 origin of it, I should have said, what is the
7 history of these alternative apportionment
8 formulas? Where does that come from?

9 A: So, the history goes back to the Uniform
10 Division of Income for Tax Purposes Act, know
11 as UDITPA, adopted in 1957, attempt to impose
12 some kind of uniformity on the states when it
13 comes to taxing multistate corporations. And
14 it's brought to you by the Uniform Law
15 Commissioners, the same group that brought you
16 the UCC, for example. And they went through a
17 very lengthy series of provisions in this Act
18 with special rules for dealing with the sale of
19 tangible personal property, special rules for
20 dealing with services. And then, in the very
21 last section of the Act, Section 18, they put
22 in this alternative; hey, we've just gone to a
23 lot of trouble telling you what the rules
24 should be, but we know they're not going to
25 always work well because we can't anticipate



1 every unintended consequence the future might
2 bring. And so, we'll have a safety valve here.
3 And it will allow a deviation from the standard
4 formula in unusual circumstances, and that --
5 the standard formula would otherwise be viewed
6 as operating arbitrarily, injudiciously.

7 Q: And from your memory, with regard to this
8 Section 18 of UDITPA, can you quote it or
9 paraphrase it?

10 A: Paraphrase Section 18?

11 Q: Yes. Unless you happen to have it in front of
12 you, which I don't think you do.

13 A: Yeah. I -- it just so happens I have Section
14 18.

15 Q: You do? Okay. What is it?

16 A: I never go anywhere without this or a pocket
17 Constitution of the United States.

18 Q: Put that aside, please.

19 A: Section 18, if the allocation and apportionment
20 provisions of this Act do not fairly represent
21 the extent of the taxpayer's business activity
22 in this state, then the taxpayer may petition
23 or the tax administrator may require, in
24 respect to all or any part of the taxpayer's
25 business activity, if reasonable -- and then,



1 you have four categories that's set forth:
2 Separate accounting, the exclusion of any one
3 or more of the factors, the inclusion of one or
4 more additional factors which will fairly
5 represent the taxpayer's business activity in
6 this state. And then, the catchall, the
7 employment of any other method to effectuate an
8 equitable allocation and apportionment of the
9 taxpayer's income.

10 Q: And who is Professor Pierce?

11 A: Professor Pierce was a Law Professor at the
12 University of Michigan, not a tax professor.
13 And he was the reporter for the UDITPA Project.

14 Q: And what's a reporter?

15 A: A reporter is the person who can do the
16 drafting, if that's the wish of the
17 Commissioners. Keeps minutes. Pro- -- in
18 Professor Pierce's case, he was the primary
19 drafter of UDITPA. The Uniform Law Commission
20 took on a project to revise UDITPA. I mean, it
21 was adopted in 1957, never amended, which is
22 quite remarkable, of course. And the Uniform
23 Law Commission took on a project to amend it,
24 and I was the co-reporter of that project. But
25 the project was stillborn. They did not



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1 anticipate the amount of business push-back
2 they were getting, although, I and my co-
3 reporter warned them about this. It's a
4 project which the current group of
5 Commissioners really had never taken on. They
6 were comfortable with the Uniform Notary Act
7 and the Uniform Anatomy- -- Anatomical Gifts
8 Act, you know, things pretty uncontroversial.
9 But this was a hot button issue, and so, they
10 backed off at some point. And then the
11 Multistate Tax Commission undertook the project
12 to revise UDITPA. And I was the hearing
13 officer for that group.

14 Q: And if I may ask you to go back to Professor
15 Pierce for a moment, and you've described who
16 he was. I assume he's no longer with us, but
17 ---

18 A: Correct.

19 Q: But he -- did he do public -- did he publish
20 with regard to this Section 18 of UDITPA?

21 A: He published an article after UDITPA came out,
22 where he kind of summarized section-by-section
23 what they were doing. And when he to Section
24 18, he basically said, look, this is for the
25 unusual, arbitrary type of result that the



1 standard formula would otherwise result in --
2 and that's what Section 18 is meant to do, and
3 it should be used judiciously, you know, when
4 you would otherwise be confronted with
5 unreasonable results.

6 Q: And, obviously, he felt that that would be good
7 tax policy?

8 A: Yes.

9 Q: But do you agree with that, and if so, why?

10 A: Oh, I certainly do. And then, the MTC has its
11 own regulations under Section 18. It -- it's
12 good policy to make sure that this relief
13 mechanism doesn't swallow up the standard
14 formula. And if you were so aggressive in your
15 use of alternative apportionment, then what's
16 left of the standard formula? Well, it's a
17 standard formula that taxpayers rely on. And
18 so, we have another important consideration in
19 this whole business, and that's reliance
20 interest.

21 If someone is making a hundred-million-
22 dollar investment relying on the statute
23 adopted by the legislature, we can't willy
24 nilly pull the rug out from under them through
25 the backdoor of alternative apportionment. And



1 so, it should be used carefully, sparingly and
2 judiciously.

3 Q: Okay. But, but you're ---

4 **THE COURT:** Are you taking a -- we're moving into a
5 similarity with stare decisis ---

6 A: I, I am. That's right. Absolutely. So, you
7 know, formerly, not, but the same values that
8 stare decisis incorporate.

9 **THE COURT:** Or one of the four.

10 A: Uh-huh. You know it's reliance interest, yeah.

11 **THE COURT:** Yeah.

12 A: That's the way I at least teach the students.
13 People make life decisions.

14 Q: But, but you believe that there are times when
15 the standard formula should yield to
16 alternative apportionment?

17 A: Sure. There are situations ---

18 Q: Can you give some samples of that?

19 A: I may be a taxpayer that uses a lot of
20 independent contractors in my business. I
21 outsource a lot. And the payroll factor under
22 UDITPA ignores the payroll paid for independent
23 contractors, so they don't enter into the
24 payroll factor. And so, I might say, look, I
25 want them in the payroll factor or it could be



1 the state saying, we want to put them in the
2 payroll factor, you know, this is symmetrical.
3 And without taking into account independent
4 contractors, there may be an unfair
5 representation of what is going on in this
6 state. Now, the MTC has regulations dealing
7 with independent contractors. So, they
8 recognize this as a -- as a weakness in the
9 definition of the payroll factor.

10 You may be in a business where intangible
11 property is the key to your success and income
12 generation. The property factor in UDITPA
13 takes into account only real and tangible
14 property, not intangible. So, you might
15 petition a state to take into account our
16 intangible property, the value of our secret
17 processes or algorithms or intellectual
18 property, whatever it is, because for us,
19 that's the equivalent of a factory for someone
20 that sells widgets. So, you know, these -- I'm
21 not saying these are winners of arguments, but
22 they're arguments. They're situations where
23 the standard formula might not work well. And
24 so, it's a safety valve. I plead my case or
25 the tax department makes its case.



1 Q: Can we talk a little bit about transfer
2 pricing?

3 A: Sure.

4 Q: You're not a transfer pricing expert.

5 A: No.

6 Q: However, what tax policies underline the use of
7 transfer pricing studies? Why does -- why are
8 they necessary?

9 A: If I can determine that a price that would be
10 paid to third parties is X, and in my
11 intercorporate transaction I have priced it at
12 X, then I think, we are comfortable saying,
13 okay, you have an arm's length price there
14 because you are charging exactly what a third
15 party would have charged. So, they are useful
16 in substantiating a taxpayer's intercorporate
17 charges. In combined reporting, it's
18 irrelevant and that's ---

19 **THE COURT:** That's what I was going to ask.

20 A: Yeah. And that's one of the advantages.

21 **THE COURT:** So, it would only be relevant in the
22 separate reporting?

23 A: Exactly right. So ---

24 **THE COURT:** To ascertain whether or not it was
25 fairly -- or the tax would fairly be



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1 apportioned to the state?

2 A: And you can see how complicated these transfer
3 pricing reports can get, and expensive, so.

4 Q: Now, can states police this transfer pricing
5 question?

6 A: Sure.

7 Q: And how could do they do that?

8 A: And should.

9 Q: And should, did you say?

10 A: And should.

11 Q: All right.

12 A: States should be able to police any charge that
13 a taxpayer is claiming, whether it be for
14 travel and entertainment, compensation,
15 depreciation, whatever. And they are forced to
16 come up with their own transfer pricing report
17 to counter that of the taxpayer, or they can
18 examine the taxpayer's report and say, you know
19 what, we don't think the proper charge is X, we
20 think it's something less than X. In which
21 case, the state can lower the charge to
22 whatever they think is appropriate. It is the
23 same way if I come in and I have all my
24 entertainment expenses, not that I do it, but
25 let's suppose I did, and they -- the auditor



1 sits there and say, you know, that's not valid,
2 that's okay, that's personal, that's business,
3 we're going to give you a haircut and we're not
4 going to let you deduct 100, we think you
5 should deduct only 30. I mean, this, this
6 happens all the time, where there's a dispute
7 over what the proper price should be. And not
8 unique -- or you look at property tax cases,
9 where you have two expert witnesses and one
10 says the value is X, the other says, no, it's
11 Y, and the Judge has to make a decision, so.

12 Q: So, are you saying that in an instance in which
13 a transfer price is not accurate, that it's not
14 even reasonably accurate, then an adjustment
15 can be made to that price from a tax policy
16 standpoint, that would be the next step to do
17 that?

18 A: I think so.

19 Q: All right. And what about switching to an
20 alternative formula th- -- from a tax policy
21 standpoint, is that called for because the
22 transfer price is not reasonable?

23 A: I wouldn't think so. That's a -- that -- to
24 me, that's a very broad sweeping approach to
25 what is something that's a pricing issue.



1 Q: Okay. I wanna talk to you a little bit about
2 business structures and economic substance, and
3 the tax policies associated with these business
4 structures.

5 What tax policies are involved in a
6 taxpayer choosing to change his business
7 structure from a single entity to multiple
8 entities?

9 A: I think, when it comes to how you structure
10 yourself, that there's no broad constraints on
11 that. That if you want to come to a state
12 purely for tax reasons, you can. If I want to
13 form an LLC purely for tax reason, I can. If
14 I want to create a corporation purely for tax
15 reasons, I can. If I want to change my state
16 of residency, suppose, I move to Florida and I
17 become -- we'll stipulate, I become a bonafide
18 resident of Florida. I do everything you're
19 supposed to and I've severed all my connections
20 with my former state. And on a deposition, I
21 answer under oath, I made this move solely for
22 tax reasons. I owed it to my grandchildren. It
23 was just too much money I would be leaving on
24 the table if I didn't go to Florida, with their
25 favorable state tax and favorable income tax



1 rules. Personally, I hate it in Florida. And
2 I was told, with my light complexion, never go
3 out during the daytime. And I don't like the
4 people I'm with, but I owe it to the
5 grandchildren. I don't think any state would
6 say, oh, no, you're still a resident of our
7 state because you moved solely for tax reasons.

8 **THE COURT:** You mean ---

9 A: So, that's like an organizational change in a
10 sense for individuals.

11 **THE COURT:** Living in Connecticut, you might to
12 consider that yourself.

13 *(Laughter.)*

14 A: Many people have suggested that, but I'm one of
15 those that would hate it, Your Honor. And I
16 don't have grandchildren yet.

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

18 A: I might be different.

19 **THE COURT:** Hence, there it's not that bearable.

20 A: Yeah. I better not have grandchildren yet, so.

21 *(Laughter.)*

22 Q: So, from a tax policy standpoint ---

23 A: Yeah.

24 Q: --- does a taxpayer have a right to consider
25 tax savings as a reason for picking a potential



1 structure?

2 A: That's what tax lawyers do for a career.
3 Absolutely right.

4 Q: But many business decisions -- this is a
5 question. Are many business decisions, and if
6 so, what kinds, are driven by non-tax
7 considerations?

8 A: Well, if any decisions are driven by non-tax
9 considerations, you know, a very basic non-tax
10 consideration is limited liability. You know,
11 so you sort of learn it the first day in law
12 school or, certainly, the first day in your
13 business organization course or corporation
14 course, that you've got to protect yourself
15 against judgements, and the way to do that is
16 to make sure that not everything is sitting in
17 one entity. And so, in a world without taxes,
18 you know, another way to sort to get your hands
19 around this, say, in a world without taxes,
20 would this transaction have occurred? And, of
21 course, the business transactions that we read
22 about every day would occur without taxes. So,
23 they're not always tax driven.

24 Now, taxes will obviously be taken into
25 account. If not, probably, malpractice is



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1 being conducted. But if I go to, as I heard,
2 PricewaterhouseCoopers, and I say to them,
3 look, we're a single business, we don't think
4 that's wise. We are anticipating maybe some
5 acquisitions in the future. We're, we're
6 anticipating growth in the future. Can you
7 give us a more efficient organization
8 structure? Well, of course, they're going to
9 take into account tax considerations. And so,
10 yes, we're going to divide you up and we're
11 going to do it in a tax efficient matter.
12 That's bread and butter for tax lawyers.

13 Q: All right. So, I'm going to turn to some of
14 the facts of this case, finally. But, at the
15 same time, I would admonish you no legal
16 conclusions.

17 Have you been here since the inception of
18 this case -- or ---

19 A: I have.

20 Q: --- trial? Have you heard the testimony?

21 A: I did.

22 Q: All rights, sir. So, I wanna ask you about
23 some facts that the Department, at least,
24 appears to be relying on to claim that there's
25 no economic substance here and get your



1 response to each of these from a tax policy
2 standpoint.

3 First one is, the Department seems to be
4 arguing that it doesn't believe the reasons
5 Tractor Supply gave as to why it did a
6 restructure to begin with, don't appear to the
7 Department to be legitimate. Did you hear the
8 reason which were given by Ms. McKeown?

9 A: I did.

10 **OBJECTION:**

11 **MR. LUTHER:** Your Honor, I'd object to the extent it
12 mischaracterize the Department's position. I
13 don't think we've ever used the term legitimate
14 in this case.

15 **MR. VON LEHE:** Perhaps, I -- well then, perhaps
16 hearing their position on that would be
17 informative.

18 **THE COURT:** Say that again.

19 **MR. VON LEHE:** Perhaps hearing their position on
20 that would be informative. If he's mi- -- if
21 he's mischaracterized it, or if I have.

22 **THE COURT:** Well, he hasn't testified about it yet,
23 so you're the only one that can be
24 mischaracterizing.

25 **MR. VON LEHE:** Well, Your Honor, well pointed out.



1 I don't believe I have, Your Honor.

2 **THE COURT:** Okay.

3 **MR. VON LEHE:** I think ---

4 **THE COURT:** So ---

5 **MR. VON LEHE:** I think ---

6 **THE COURT:** Do you wish to respond to that or you --
7 he said he -- his objection was to the
8 legitimate. Wasn't it?

9 **MR. LUTHER:** Correct.

10 **THE COURT:** Yeah.

11 **MR. LUTHER:** I think he can probably rephrase the
12 question. I just think it -- imbedded in it's
13 facts not in evidence.

14 **THE COURT:** Okay.

15 **MR. VON LEHE:** I'm not trying to, to, to cast any
16 dispersions on their arguments either, so.

17 **THE COURT:** Well, look at the question and where you
18 have the word legitimate, you may wish to
19 reconsider.

20 **MR. VON LEHE:** I would like to reconsider that, Your
21 Honor.

22 Q: The -- the Department's arguments, are they,
23 are they well-founded, in light of the
24 testimony which you have heard?

25 **OBJECTION:**



1 **MR. LUTHER:** Your Honor, I'm going to object. That
2 seems to call for a legal conclusion?

3 **MR. VON LEHE:** As is factually. From a tax policy -
4 --

5 **THE COURT:** Well, are they well-founded, could cover
6 many areas. It could cover legal. It could
7 cover factual. I mean, that's a pretty ---

8 **MS. GEER:** Well-founded from a tax policy
9 perspective.

10 **THE COURT:** Oh.

11 **MR. VON LEHE:** Thank you. Well -- well-founded.

12 **THE COURT:** I want words.

13 **MR. VON LEHE:** Well-founded from a tax policy ---

14 **MR. LUTHER:** Your Honor, I just ---

15 **MR. VON LEHE:** --- perspective. I'd just like,
16 basically, Your Honor, just to say this. I'd
17 just like to hear his remarks because I think
18 it might aid the Court, as well as us,
19 obviously, to just find out what a tax policy
20 expert's reaction is to, well, you shouldn't
21 have done this because you had no reasons for
22 doing it when, it's already been testified to
23 and he heard the testimony, as we all did, that
24 they did have specific reasons for doing this
25 besides tax.



1 **THE COURT:** All right. Mr. Luther?

2 **MR. LUTHER:** Yeah. I just don't think that -- I
3 think what he's asking him is, what is -- does
4 he believe the facts meet the statutory
5 requirements. And that's a legal conclusion,
6 even you want to say, but I mean it from a tax
7 policy perspective. You can't cloak it in that
8 term and get away from the fundamental problem
9 with the answer.

10 **MR. VON LEHE:** Not trying to cloak it, Your Honor.
11 Just want to know -- he heard those facts, I'd
12 like to have his reaction to them from a tax
13 policy standpoint. Of course, we hope it will
14 help our case. But we also hope it will
15 enlighten, what is the right answer.

16 **THE COURT:** How would a tax policy standpoint differ
17 from the statutory construction in this case?

18 **MR. VON LEHE:** The statutory construction would not
19 be at stake here because we're not talking
20 about whether -- there's no allegation, as I
21 understand it, that ---

22 **THE COURT:** Well, here, let me rephrase it. So,
23 I'll just pick one statutory construction
24 principle. Words must be given their plain and
25 ordinary meaning without resort to subtle or



1 forced construction to limit or expand the
2 operation of the statute.

3 **MR. VON LEHE:** Yes, sir.

4 **THE COURT:** So that's my -- that's what I'm called
5 upon to do. So, I'm called -- trying to follow
6 the words of the statute.

7 **MR. VON LEHE:** Yes, sir.

8 **THE COURT:** So, what would this testimony offer,
9 other than telling me how to apply those words?

10 **MR. VON LEHE:** It would let you know, from a factual
11 standpoint, which of course is why an expert
12 witness is here, is to help you interpret the
13 facts, it would let you know that these are
14 commonplace business objectives which are
15 achieved when anybody sets up a structure or
16 changes a structure to meet business needs.
17 Now, he knows that. Many people know that, but
18 he's the person who's qualified to testify to
19 it.

20 **THE COURT:** And one second. I think I'm okay with
21 what he just said.

22 **MR. VON LEHE:** Yeah ---

23 **MR. LUTHER:** I think that's a fundamentally
24 different question than what he ---

25 **THE COURT:** Yeah.



1 **MR. LUTHER:** --- initially asked.

2 **THE COURT:** Yeah. (To Professor Pomp) So, you can
3 answer that question. Let's just go ahead and
4 start down the -- or that subject matter. Did
5 you, did you follow it?

6 A: No. Maybe, we could succinctly state the
7 question. (Laughter.)

8 **THE COURT:** Okay. If you could state it ---

9 **MR. VON LEHE:** Yes, sir.

10 **THE COURT:** --- using the phraseology you just used.

11 **MR. VON LEHE:** Yes.

12 Q: From a, from a tax policy standpoint, were
13 these various reasons, which were given, which
14 you heard, were these a good tax policy reasons
15 to use multiple corporations?

16 A: Oh, okay. Well, to use multiple corporations,
17 certainly can be good tax policy ---

18 Q: Oh, tell us ---

19 A: I mean ---

20 Q: Sometimes proving a certainty is not that --
21 it's ---

22 A: Yeah.

23 Q: --- not the easiest thing in the world.

24 A: And tax policy does not dictate that you should
25 be one big corporation. Tax policy says, you



1 can organize yourself the way you want.

2 Q: All right. And ---

3 A: As they have done. They have LLCs,
4 corporations, disregarded entities.

5 Q: There are many -- again, this is from a tax
6 policy standpoint. You have given some reasons
7 why, from a tax policy standpoint, it is
8 recognized as a good tax reason -- a good
9 business reason to form separate entities. I
10 believe you gave those yourself a few minutes
11 ago ---

12 A: I gave one. There's ---

13 Q: You gave one. Are there ---

14 A: There's ---

15 Q: --- others you're ---

16 A: --- others. And, again, you know, one of the
17 interesting ways to think about tax policy is
18 to ask, what would happen in a world without
19 taxes? Would these tax shelters that we saw a
20 rash of in the, I don't know when, five years,
21 ten years ago, would those have taken place in
22 a world without taxes? And the answer is no.
23 But those tax shelters were strictly driven by
24 tax considerations. In a world without taxes,
25 no one would think of doing those.



1 Let's ask the same question here. In a
2 world without taxes, the restructuring would
3 have taken place. It may not have taken the
4 same form, to be sure, but if that
5 restructuring was done to obtain limited
6 liability and greater accountability, and all
7 the other issues that we heard testimony about
8 why they went to PricewaterhouseCoopers, those
9 would've taken place in the world without
10 taxes. You're going to be worried about
11 measuring performance and limiting your
12 liability, whether there's taxes are not.
13 Again, the structure might be different, you
14 know. They, no doubt, came up with a tax
15 efficient structure. And, and why not?

16 Q: Now, one of the things that the Department of
17 Revenue has alleged, and continues to allege,
18 is that there's no economic substance to this
19 reorganization because the employees stayed in
20 the same physical location where they had been
21 before the restructuring. From a tax policy
22 standpoint, does it -- is that a reason to
23 disregard the substance of a transaction?

24 A: You know, those employees were, what we would
25 call today, remote workers, when you think



1 about it. They were just ahead of the game.
2 During COVID, I taught my course at NYU totally
3 online. I wasn't in the same state that my
4 employer was in, NYU. I was working remotely.
5 And today, even with COVID having subsided, we
6 see a lot of remote workers. A lot of law
7 firms have their lawyers working all around the
8 Country, away from the mother ship. So, this
9 is commonplace today. Maybe, it wasn't back in
10 2001 or '02, but certainly commonplace today.
11 I don't see any tax policy issue that says you
12 have to work close to your employer. There's
13 no tax policy issue that says that.

14 Q: So, I now have a couple of -- kind of, closing
15 questions for you. Both of them may be --
16 well, we'll find out. May be outside of the
17 scope of what you have been qualified to
18 testify to. They may be objectionable to the
19 Department of Revenue and they may not, but ---

20 **MR. LUTHER:** Should I get ready to stand up, now?

21 **MS. GEER:** You're starting in a hole, John.

22 *(Laughter.)*

23 Q: But I'm going to ask those questions, all
24 right. And we'll see what Mr. Luther says.
25 How -- and should he object, I'm going to ask



1 if you'll stipulate to it because there's no
2 question about it.

3 The first one is, is South Carolina a
4 separate entity state? Has it adopted separate
5 entity? You may answer unless he objects.

6 A: (Laughter.) Yes.

7 Q: That's obvious, correct?

8 A: Yeah.

9 Q: And the second one is, did South Carolina word-
10 for-word, verbatim, adopt Section 18 of UDITPA?
11 You may answer that, unless he objects.

12 **THE COURT:** Well ...

13 **OBJECTION:**

14 **MR. LUTHER:** Your Honor, I'm going to object, in
15 that -- well, actually, if he can rephrase the
16 question, I'll fi- -- I will not object, which
17 ---

18 Q: Is -- is South Carolina's alternate
19 apportionment statute identical to UDITPA's?

20 A: Yes.

21 Q: All right. Very good. Thank you, Professor.

22 **THE COURT:** You wish a break? Do you, do you need a
23 break, Professor?

24 **PROFESSOR POMP:** Excuse me?

25 **MS. GEER:** I -- I wished to break.



1 **THE COURT:** Do you need a break?

2 **MR. LUTHER:** Yeah. We'd like ---

3 **PROFESSOR POMP:** No, I'm fine.

4 **THE COURT:** It doesn't matter? Okay. I've heard
5 requests over here, so.

6 **PROFESSOR POMP:** Oh, okay. Well.

7 **THE COURT:** We're going to take a five-minute break.

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

9 **MR. LUTHER:** Thank you, Your Honor.

10 **(Off the record 2:35 p.m. to 2:47 p.m.)**

11 **THE COURT:** Mr. Luther, you look like you have
12 questions.

13 **MR. LUTHER:** A few.

14 **THE COURT:** Okay.

15 **MR. LUTHER:** Do we need to wait?

16 **THE COURT:** Well, she went to the bathroom -- or the
17 restroom. So, unless you want to put something
18 on the screen?

19 **MR. LUTHER:** I, I will, actually.

20 **THE COURT:** Oh, okay. Well, then we are gonna have
21 to wait. I told her I didn't think that was
22 gonna happen.

23 **(Off the record from 2:48 p.m. until 2:51 p.m.)**

24 **PROFESSOR POMP - CROSS EXAMINATION BY MR. LUTHER:**

25 **Q:** Professor Pomp, good afternoon.



1 A: Hello.

2 Q: I think you said you're a big proponent of
3 combined reporting, right?

4 A: Correct.

5 Q: In fact, you've spent, as a tax policy expert,
6 you've spent the majority of your career
7 advocating for combined reporting.

8 A: I don't know, majority, but I've certainly
9 advocated.

10 Q: You've written extensively about it, right?

11 A: Yeah. I don't know, extens- -- yeah.

12 Q: And you've testified to legila- -- legislative
13 bodies encouraging them to adopt combined
14 reporting?

15 A: Correct.

16 Q: I know you've testified in Vermont and
17 Pennsylvania. Where else have you testified?

18 A: Maybe, Wisconsin. I'm not sure. I don't keep
19 track on the resume of the testimonies. So, I
20 don't know. But, broadly.

21 Q: Have you ever testified to a le- -- legislative
22 body that -- and encouraged them, from a good
23 tax policy perspective, to adopt separate
24 entity reporting?

25 A: No.



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1 Q: Given the option, you would recommend combined
2 reporting, wouldn't you?

3 A: Yes.

4 Q: You talked earlier about the scope of your
5 engagements as an expert and that they have
6 shifted -- or the pendulum, I think you said,
7 the pendulum is swinging towards representing
8 taxpayers, correct?

9 A: Yeah. I don't know that it's a pendulum, but
10 it certainly has swung.

11 Q: And you think, I believe you said in your
12 deposition, that was because of budgetary
13 constraints on the part of the states, right?

14 A: I think so.

15 Q: Meaning, you're not cheap?

16 A: I am willing -- I have a special state rate,
17 but no one seems to ask about it, so.

18 Q: You also have a special John Von Lehe rate,
19 right?

20 A: A special what?

21 Q: John Von Lehe rate.

22 A: John ---

23 Q: John Von Lehe rate.

24 A: Oh, oh, oh. Yes. I do, actually. John takes
25 care of his clients very well.



1 Q: And you're being compensated in this case,
2 right?

3 A: I am.

4 Q: Okay. I want to make sure we don't just gloss
5 over your support of combined reporting. So,
6 I want to ask you some questions about that.
7 And the way I want to do it is, I want to read
8 you a statement and I want to ask if you agree
9 with it.

10 **MR. LUTHER:** If we could put that on the screen?

11 Q: All right. I'm gonna read it to you. Tax
12 specialists have promoted combined reporting
13 for many years as an affected method for fairly
14 apportioning the tax base of the corporate
15 income tax and for combating certain forms of
16 aggressive tax avoidance.

17 A: Uh-huh.

18 Q: Do you agree with that?

19 A: Yes.

20 Q: Is that your opinion?

21 A: Yes.

22 Q: Okay.

23 **MR. LUTHER:** Next slide.

24 Q: Essential element for the case for combined
25 reporting is that the substance of the business



1 activities in the state should control, not the
2 organizational structure of the business entity
3 or entities conducting those activities, that
4 is, whether a business enterprise chooses to
5 have numerous divisions or whether it chooses
6 to incorporate those divisions and operate them
7 as subsidiaries, should have as little impact
8 as feasible on the amount of the taxing state's
9 income paid by that enterprise.

10 A: Uh-huh.

11 Q: Do you agree with that?

12 A: Yes.

13 Q: Okay. Is that your opinion?

14 A: Yes.

15 Q: Okay. From a good tax policy perspective,
16 correct?

17 A: Yes.

18 Q: A combined report treats the parent and its
19 subsidiaries as if they were divisions of the
20 same unitary business. It contains a
21 tabulation of the aggregate taxable income
22 derived by the members of the group from that
23 unitary business. The initial step in
24 preparing a combined report is to determine the
25 scope of the group's unitary business. Do you



1 agree with that?

2 A: Yes. Who writes so well as this?

3 Q: Do you recognize it?

4 A: I ho- -- I -- no, but I hope it's mine.

5 Q: I will, I will -- I -- let's look.

6 Let's see, I believe your CV includes a
7 number of publications. One of them, you
8 talked about just a minute ago, was in
9 conjunction with your testimony in Wisconsin.
10 Do you recall that?

11 A: Yes.

12 Q: Does the State Tax Reform Proposals for
13 Wisconsin ring a bell?

14 A: Yeah.

15 Q: Can I hand you a copy of it?

16 A: Sure.

17 **MR. LUTHER:** Your Honor, would you like a copy?

18 **THE COURT:** No. I don't need one.

19 **MS. GEER:** I would like a copy.

20 Q: Can you turn to page 54 of your Law Review
21 article?

22 A: All right.

23 Q: And it should be a sentence that starts with;
24 a combined report -- let's see ... Make sure
25 I'm on the right page.



1 Yeah, right in the middle of the second
2 paragraph. The combined report also includes
3 -- nope, that's the wrong one.

4 Oh, I see it. There we go. At the very
5 top of the page. Second, second line in. Can
6 you read that?

7 A: A combined report would treat the parent --
8 that one?

9 Q: Yes.

10 A: A combined report would treat the parent and
11 its subsidiaries as if they were divisions of
12 the same unitary business. Continue?

13 Q: No, you scan stop there, that's the next quote.
14 Why don't we just go on and I'll come back to
15 that one. All right. In a combined report,
16 intercorporate transactions between the parent
17 and subsidiary are eliminated and the income
18 reported on the books of the subsidiary would
19 be added to the income reported on the books of
20 the parent and modified pursuant to state law.
21 Do you agree with that?

22 A: Yes.

23 Q: Is that your ---

24 A: If this were a legislative hearing, I would be
25 quoting these.



1 Q: And that's your opinion?

2 A: Yes.

3 Q: Okay.

4 **MR. LUTHER:** All right. The next one.

5 Q: Combined reporting is both a better method for
6 measuring the income of a unitary business and
7 safeguard against taxpayer manipulation.

8 A: Uh-huh.

9 Q: Correct?

10 A: I don't know what the better reference is.
11 Something must have preceded it, but it's
12 certainly a reasonable method for measuring the
13 income of a unitary business and a safeguard
14 against taxpayer manipulation.

15 Q: Compared to separate entity reporting, is that
16 ---

17 A: Well, I don't know if that's the context.

18 Q: Well, I'm just asking. Compared to, to
19 separate entity, it's a better method, right?

20 A: Well, I think that depends on the facts and
21 circumstances, so. You know, these statements
22 are all general statement, so.

23 Q: What was -- was Wisconsin a separate entity
24 State when you wrote this?

25 A: It probably was.



1 Q: And you were advocating they changed to
2 combined reporting, correct?

3 A: Correct.

4 Q: If you'll look at that Article I just handed
5 you, bottom of page 54. Do you see, do you see
6 the sentence that begins with; The U.S. Supreme
7 Court?

8 A: Yes.

9 Q: Could you read that sentence?

10 A: The U.S. Supreme Court has acknowledged that
11 combined reporting is both the better method
12 for measuring the income of a unitary business
13 and a safeguard against taxpayer manipulation.

14 Q: Okay.

15 A: And that is from the *Container* case, which
16 involved a U.S. parent and foreign
17 subsidiaries.

18 Q: All right.

19 **MR. LUTHER:** Let's go onto the next one.

20 A: The premise?

21 Q: Yeah. I'll read it. The premise of combined
22 reporting is that the synergies,
23 interdependencies, and sharing of knowledge,
24 know-how, and experiences that are typical
25 features of a unitary business, often cannot be



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1 properly captured by separate entity
2 accounting.

3 A: Uh-huh.

4 Q: Do you agree with that?

5 A: Well, again, facts and circumstances. But as
6 a general statement, yes.

7 Q: Okay.

8 **MR. LUTHER:** Next sentence -- or, next slide.

9 Q: By taking into account only the income and
10 factors of the corporation having nexus with
11 the taxing state, separate entity accounting
12 often cannot provide an accurate measurement of
13 the income of the unitary business that is
14 properly attributable to that state, correct?

15 A: Yes. Again, facts and circumstances. And if
16 this were a legislative hearing, this would be
17 one of the arguments in favor of combined
18 reporting.

19 Q: Understood.

20 **MR. LUTHER:** Next slide.

21 Q: Combined reporting avoids this failing by
22 automatically apportioning all of the unitary
23 business income of a unitary group among the
24 states where it is engaging in meaningful
25 business activities. Correct?



1 A: Yes.

2 Q: Okay. That's your opinion?

3 A: Yes.

4 Q: All right. Combined reporting also helps
5 create a level playing field for intrastate
6 corporate groups, whether large or small, and
7 levels the playing field between businesses
8 conducting themselves as one corporation or as
9 a group of corporations. Correct?

10 A: Correct.

11 Q: And that's your opinion ---

12 A: Yes.

13 Q: --- of good tax policy?

14 A: Correct.

15 **MR. LUTHER:** Next slide.

16 Q: The improved equity under combined reporting is
17 due to its superiority over separating
18 reporting as a method of tax accounting.
19 Correct?

20 A: In general, correct.

21 Q: Okay. The corporate income tax in separate
22 entity reporting states is subject to abuse
23 through tax planning techniques that are very
24 familiar to members of the tax avoidance
25 community. Correct?



1 A: Correct.

2 Q: And you've seen that in your, in your career,
3 correct?

4 A: Absolutely.

5 Q: All right.

6 **MR. LUTHER:** Next slide.

7 Q: Separate entity states, this is the same thing,
8 different version.

9 Separate entity states are vulnerable to
10 a panoply of common tax planning techniques
11 that have turned the corporate income tax into
12 a voluntary one for many of the larger
13 multistate corporations. Correct?

14 A: Yeah. I don't know if, if the article gave
15 examples, but. You know, none of this has
16 anything to do with these facts. And, again,
17 this is not a legislative Commission, so --
18 hearing.

19 Q: Well, we'll get to some of those examples in a
20 little bit.

21 **MR. LUTHER:** All right. Next slide.

22 Q: Transfer pricing holding companies and more
23 subtle and less notorious strategies exists for
24 exploiting separate entity states. Once the
25 province of only the most sophisticated



1 practitioners, these tax minimizations stra- --
2 approaches are now so widespread as to
3 constitute orthodox planning tools, right?

4 A: Right.

5 Q: Okay.

6 **MR. LUTHER:** Next slide.

7 Q: The bigger accounting firms have groups devoted
8 to developing tax minimization strategies that
9 place a premium on pressing formal rules to
10 their limits, aggressively exploiting
11 weaknesses in state tax structures, shifting
12 income and deductions among the states,
13 identifying and capitalizing on gaps in the
14 interfacing of state laws, and the lack of
15 harmonization restructuring corporate entities,
16 and the use of pass-through entities.

17 **OBJECTION:**

18 **MR. VON LEHE:** Your Honor, I'm going to impose an
19 objection here, if I may. Couple of grounds.

20 First of all, there's -- it -- it's irre-
21 -- it's relevance. It is so relevant because
22 the question is not, whether or not separate
23 entity reporting is better or not as good as
24 combined, or is combined better than separate
25 entity? That's not an issue here. It's not an



1 issue before the Court. It makes no
2 difference, so far as this case is concerned,
3 which of those two entities is the better one.
4 That's the first objection, is based on
5 relevance.

6 The second is, these facts that are being
7 put in here, there's no background for them,
8 there's nobody here to testify to this.
9 They're just a bunch of facts being -- sure
10 Professor Pomp wrote these things, but he
11 hadn't even been asked where he got them from.
12 They seemed to be put in for purposes --
13 probative evidence that this is what has
14 actually occurred.

15 So, those are the two reasons I'm
16 objecting to this continuation of these slides.

17 **THE COURT:** Okay.

18 **MR. LUTHER:** I'll start with the ladder argument
19 first. These are all -- and I think he's
20 already acknowledged, at least, so far, these
21 are quotes from things he's written.

22 (PHONE RINGING.)

23 **THE COURT:** Whose ...

24 **MR. LUTHER:** Sounds like Star Wars is coming from
25 back there.



1 *(Laughter.)*

2 **THE COURT:** Oh.

3 **MR. LUTHER:** These are all things that he's written.
4 I'm entitled to ask him about his opinions.
5 But, as far as impeachment is concerned, I've
6 put it in this fashion to try to streamline the
7 process, so I don't have to hand him every
8 single article to get him to quote, quote from
9 them.

10 **MR. VON LEHE:** We're not impeaching anything here,
11 Your Honor. I mean, this thing's -- Professor
12 Pomp basically has said he, he feels that the
13 combined method is the better one. It's just
14 not South Carolina's is basically the issue
15 here.

16 **MR. LUTHER:** Well, one of the issues raised by
17 Tractor Supply is whether combined reporting is
18 a reasonable alternative. And they are going
19 to argue that it is not. And Professor Pomp
20 earlier said, talking about adjustments ---

21 **THE COURT:** Well, he, he made these points earlier.
22 You're just making them more and more -- or
23 over and over again, so.

24 **MR. LUTHER:** I understand, but I think it is
25 important, because he's going to say that



1 combined reporting was not an appropriate fix
2 to the problems in this case from a good tax
3 policy. And I'm trying to lay the foundation
4 to show that, actually, he thinks it's the best
5 fix.

6 **THE COURT:** You say, he's going to? He's did ---

7 **MR. LUTHER:** I'm sorry. He alrea- -- he testified.

8 **THE COURT:** Yeah.

9 **MR. VON LEHE:** Your Honor, I would have correction
10 on that. He said that, you don't change
11 methods just because the transfer price is not
12 correct.

13 **THE COURT:** Yeah. That's ---

14 **MR. VON LEHE:** He did not say what counsel here says
15 he said.

16 **MR. LUTHER:** I think what his, what his ---

17 **THE COURT:** I agree with Von -- Mr. Von Lehe on that
18 one, well, as to ---

19 **MR. LUTHER:** I think his quote was, the use of
20 combined reporting as the alternative method
21 was a "broad-sweeping approach".

22 **THE COURT:** Well, that's -- yeah. And then he went
23 further to make his point that it would be a
24 better approach to focus in on the transfer
25 pricing.



1 **MR. LUTHER:** Correct. And what I'm trying to lay
2 the foundation, and we're going to get to, is
3 that his entire career he's actually said the
4 opposite, combined reporting is the better
5 approach.

6 **THE COURT:** Well, he -- okay.

7 I'll -- on one hand, Mr. Von Lehe, you
8 opened the door in having him testify about
9 this. On the other hand, he made it quite
10 clear that the combined approach is much better
11 from a legislative standpoint. But, I would
12 rather stick with facts of this case, and ---

13 **MR. LUTHER:** And I can -- I will do that, Your
14 Honor.

15 **THE COURT:** Yeah. Because it almost sounds like
16 you're about to convince me that I need to just
17 leave the -- leave this hearing and go over to
18 the General Assembly and get the law changed.
19 But, but as far as my decision in this case, I
20 -- I'm actually going to honor the law. And
21 the law is, that we are a separate reporting
22 State, unless -- and then, there's the
23 exceptions under 12-6-20 ---

24 **MS. GEER:** 320.

25 **MR. LUTHER:** Under 320-A(4).



1 **THE COURT:** And so, I'm going to follow the law as
2 it is. So, all this greatness about combined
3 reporting is not going to convince me
4 otherwise.

5 **MR. LUTHER:** I understand. And I, I think the
6 relevance of it is this. He has, in his
7 earlier testimony, has -- and one of his
8 opinions is that, from a good tax policy
9 perspective, the use of an alternative
10 apportionment method should be, I think his
11 word was limited or in narrow circumstances.

12 **THE COURT:** Well, let's get there.

13 **MR. LUTHER:** And that's where we're headed. And --
14 and ---

15 **THE COURT:** Okay.

16 **MR. LUTHER:** And, and he has also said throughout
17 his career, though, that combined is the way to
18 fix those circumstances. So, where we're
19 heading, is to show that the circumstances that
20 he's talked about has a connection to this
21 case.

22 **MR. VON LEHE:** Your Honor, instead of adopting
23 combined, by a legislature is a way to fix this
24 ---

25 **THE COURT:** I understand. I agree with you, sir.



1 And that's what his testimony has been. I --
2 but I -- and we've gotta lan- -- wide latitude
3 on cross-examination, so. I'm going to let Mr.
4 Luther go a little further.

5 **MR. VON LEHE:** All right, sir.

6 Q: Professor Pomp, you use the term, bigger
7 accounting firms, here. What are some samples
8 of bigger accounting firms?

9 A: Well, at the time I wrote this, maybe, they
10 were the big eight, you know, today they're the
11 Big Four.

12 Q: PricewaterhouseCoopers is one of them?

13 A: Yes.

14 **MR. LUTHER:** All right. Next slide.

15 Q: All right. And this goes to the sorts of
16 situations in which you believe, from a good
17 tax policy perspective, alternative
18 apportionment would be appropriate, even in
19 separate entity state.

20 So the quote is; Indeed. One of the
21 standard simulations a tax planner performs is
22 to determine the tax consequences in a separate
23 entity states of corporate restructuring. Do
24 you agree with that?

25 A: Of course. If you didn't, it would be



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1 malpractice, so.

2 **MR. LUTHER:** Next slide. Skip this one. Next
3 slide.

4 Q: All right. Here's some examples I believe you
5 had given in the past of -- well, we'll just
6 let it speak for itself.

7 Tax planners have developed numerous
8 techniques to exploit the weaknesses of a
9 separate reporting system. One popular
10 strategy for a corporate group is to isolate
11 nexus creating activities and property of its
12 unitary business in one corporation. That
13 corporation is taxable by the state on an
14 apportioned share of its taxable income. Other
15 members of that group, however, have no nexus
16 creating activities or property in the state,
17 are there -- thereby insulated from tax by that
18 state on any part of their unitary income. As
19 a result, the state gets to tax only that
20 portion of the income of the unitary group that
21 appeared on the books in account of the
22 corporate -- corporation having nexus with the
23 state, even though all of the members of the
24 corporate group are engaged in the same unitary
25 business. Correct?



1 A: Right. This is one of the consequences of
2 being a separate entity state. You tax only
3 corporations that have nexus with you.

4 Q: And you agree, that if it's an abusive
5 structure, that would be a situation in which
6 alternative apportionment could be invoked,
7 correct?

8 A: Well, I don't know what abusive structure is,
9 is the problem.

10 **MR. LUTHER:** Next slide.

11 Q: Another technique used by multistate corporate
12 groups to minimize their income taxes in a
13 particular state is to create an intragroup
14 expense, such as a management fee on the books
15 of the corporation having nexus with that state
16 that is payable to another member of the
17 unitary group located outside the taxing state.
18 Correct?

19 A: (Reviews document.) I'm, I'm reading this.

20 I'm not sure, in isolation, I understand
21 this. Because, if we're creating an intragroup
22 expense on the books of a corporation having
23 nexus with the state that is payable to another
24 member of the unitary group, and if it's a
25 combined report state -- this doesn't tell me



1 the context. Are we talking combined reporting
2 state, separate entity state? What, what did
3 -- what is the part of? I mean, it's all taken
4 out of context. What's the context of this?
5 What page, so I can look at this?

6 Q: I'll give you ... This is actually a different
7 article.

8 A: Oh.

9 Q: But you wrote an article called Ruminations on
10 Reforming Aspects of Connecticut's Tax
11 Structure, correct?

12 A: Yeah.

13 Q: All right. I believe this is page 656.

14 A: Page 656.

15 Q: Let's see. And under Section 3, that is on ---

16 A: I see.

17 Q: And your context is combined reporting protects
18 against tax avoidance.

19 A: Oh, I see. Okay.

20 Q: And you were -- correct me if I'm wrong, it
21 looks like you're talking about different
22 examples that -- and how tax planners have
23 exploited separate entity reporting.

24 A: I think probably -- right. This is 17 years
25 ago and I'm happy to tell you, the legislature



1 has changed the rules in Connecticut, as I hope
2 one day South Carolina will do.

3 Q: Okay.

4 **MR. LUTHER:** Next slide.

5 Q: Another technique -- this is from that same
6 page -- is for the members of the unitary group
7 to set the prices charge for the transfer,
8 transfer or provision of goods and services to
9 related persons in a way that allows them to
10 shift income outside of the taxing state?

11 A: Well, this is exactly where a transfer price --
12 transfer pricing report comes into play.

13 Q: Exactly.

14 **MR. LUTHER:** Next slide.

15 Q: Combined reporting fairly and effectively
16 responds to most of these common tax avoiding
17 techniques. Correct?

18 A: Well, again -- what, what page is this from, so
19 I see what the reference to common tax
20 avoidance techniques is?

21 Q: This is from your Louisiana article that you
22 referenced earlier.

23 A: Oh, yet another article.

24 Q: Hard to keep with all of them.

25 A: Yeah, I know. Well, that makes about four



1 people total who read this then, because I had
2 some family members. Okay. So, what page?

3 Q: I think, 700.

4 A: 700. I was pretty prolific in my youth. I
5 don't know what's happening, so.

6 All right. Where exactly ---

7 Q: Now, Louisiana -- let me just ask you this.
8 Louisiana was a separate entity state, correct?

9 A: Yes.

10 Q: It still is?

11 A: I, I think it still is. I think that's right.

12 Q: And so, you were writing an article advocating
13 that they move from separate entity reporting
14 to combined reporting, right?

15 A: Yes.

16 Q: Okay.

17 A: And you can see, not everyone listens.

18 *(Laughter.)*

19 Q: And so -- I believe, it's the first paragraph
20 of your article, and you talk about how the
21 separate entity method there in Louisiana is
22 subject to abuse. And then, you say; combined
23 reporting and effectively responds to most of
24 these common tax avoidance techni- --
25 techniques.



1 A: Uh-huh. If, if you're going to read more from
2 this, let me just draw your intention to a
3 footnote.

4 Q: Footnote two?

5 A: Let's see. Footnote two -- no.

6 Q: Or, Footnote one?

7 A: It's not that -- it's a -- I don't know how you
8 would even describe that footnote with -- it's
9 sort of a cross footnote. It says; Indeed, in
10 some instances, the views do not necessarily
11 represent the unanimous views of the individual
12 authors. There were three of us.
13 Notwithstanding their common commitment to the
14 major reform goals advocated here, in some
15 instances they fashioned mutually acceptable
16 compromises to reach a consensus position.

17 So, just keep that in the background as we
18 go through this.

19 Q: Fair enough. Was the fact that combined
20 reporting fairly responds to tax avoidance
21 techniques, one of the mutually agreed upon
22 opinions or is that your own ---

23 A: I, I would, I would own this.

24 Q: Okay.

25 A: I'm not looking to hide behind the two others.



1 I mean, it's a true statement.

2 Q: All right. You mentioned transfer pricing. In
3 many cases of related-person transactions,
4 market prices cannot be determined with
5 reasonable accuracy. Correct?

6 A: Yeah. All facts and circumstances.

7 Q: Okay. And market prices are particularly
8 difficult to obtain for the value contributed
9 through use of intangible property such as,
10 trademark, patent, trade secret, franchise,
11 customer list, copyright, unique management
12 system and know-how. Correct?

13 A: Yeah. Correct. These are the harder to value
14 assets.

15 Q: Okay.

16 **MR. LUTHER:** Next slide.

17 **OBJECTION:**

18 **MR. VON LEHE:** Your Honor, I'd -- I, I would like to
19 just simply make sure that our objection
20 continues through all of this. This is -- this
21 -- and its irrelevancy, it's whether it is
22 relevant or not. All of these, all of these
23 things as to why -- or combined is better than
24 separate, that's just not in front of the --
25 it's, it's not in front of the Court, so it --



1 I wanna make sure objection is cumulative.

2 **THE COURT:** Okay. Any response?

3 **MR. LUTHER:** I think we've, we've moved on from,
4 what I understood, Your Honor thought was
5 cumulative. We're not talking about his
6 opinions on transfer pricing and adjustments.
7 And, earlier, I believe he said an adjustment
8 to a transfer pricing says -- transfer pricing
9 report was better than combined reporting.

10 **MR. VON LEHE:** Your Honor, he said -- yes, he did
11 say that. I don't see that here.

12 **THE COURT:** I overrule your objection on this.

13 **MR. VON LEHE:** Okay.

14 **MR. LUTHER:** Okay.

15 Q: Okay. Administratively, determining the arm's
16 length transfer price is difficult, if not
17 impossible, in many cases. And I -- I've
18 skipped down to later in the paragraph. The
19 State Department does not have the resources to
20 police the large number of corporations engaged
21 in cross-border transactions.

22 A: Yeah. I don't know if that's still true,
23 today. And you heard the MTC talk about its
24 project on transfer pricing. So, you know, I
25 don't, I don't know if this still -- when was



1 this article published? What's the year on
2 this?

3 Q: That would've been from your Connecticut -- so
4 ---

5 A: Well, wait, this is ---

6 Q: --- 2004.

7 A: We're reading Louisiana, or not? I thought ---

8 Q: I'm back on the Connecticut article.

9 A: Oh, you're -- (laughter) ---

10 Q: 2004.

11 A: All right. Back to Connecticut. And what page
12 in Connecticut?

13 Q: 652.

14 A: Six -- I -- six?

15 Q: 652.

16 A: 52.

17 Q: We can also look at the Wisconsin one. It's
18 got the verbatim quote in that, as well.

19 A: 652. Yeah. Well, that's certainly true about
20 Connecticut, which has a very thin staff and
21 not very active with the Multistate Tax
22 Commission, so -- but they did change to
23 combined reporting. Hopefully, that helped
24 some.

25 Q: Okay. Let's go onto the next one. In a



1 unitary business, a corporation's overall
2 profitability is attributable to activities
3 that are interdependent, integrate or
4 synergistic. Correct?

5 A: Yes.

6 Q: Okay. In the case of a unitary business, each
7 activity of the unitary business contributes to
8 the business as a whole and reasonable efforts
9 in imputing a transfer price for a transaction
10 might fail to capture the inherent transfer in
11 the value.

12 A: Yeah. All facts and circumstances.

13 Q: Okay. All right. I think you've already
14 testified to this earlier, so we'll just move
15 on.

16 A: Wait -- oh, oh. I ---

17 Q: Oh, you want me to read it to you?

18 A: Well, I ---

19 **MR. LUTHER:** Go back.

20 A: I want to see what it is.

21 Q: All right. Multistate corporations often
22 oppose combined reporting as an apportionment
23 method because it is a fair, better method of
24 taxation that converts a state's corporate
25 income tax from a voluntary one into a real



1 one.

2 A: Yep. That's why they like separate entity
3 states.

4 Q: All right. This last one was the a minute
5 edition because of your kind comments about
6 Nikki yesterday. So, I'm going to get this on
7 the record.

8 A: I'm sorry. Comments about what?

9 Q: About Ms. Wooten, afterwards.

10 A: What were my comments?

11 Q: The first line -- well, you just asked me --
12 you can just tell me if you'd agree with this
13 or not. The first line of defense against this
14 common tax avoidance schemes is the State Tax
15 Department. Many in such departments can go
16 head-to-head with their counterparts in the
17 private sector. But most state departments are
18 understaffed, overworked and plagued by
19 turnover. State salary structures cannot
20 easily accommodate the marketable skills and
21 higher opportunity costs to those in
22 specialized areas like taxation and State Tax
23 Departments often lose valuable personnel to
24 the private sector. The surprising thing is,
25 how much the state's managed to accomplish with



1 so few resources.

2 A: We, we should tell His Honor, when you say my
3 comment about Nikki, he might think I made a
4 negative comment about Nikki.

5 Q: No, it was a good comment.

6 A: It was a compliment to Nikki.

7 Q: And now I've got on the record. That's an
8 expert opinion. All right. That ---

9 *(Laughter.)*

10 **MS. WOOTEN:** Much appreciated.

11 Q: We can -- that's a -- that's the end of the
12 quotes I'll read you.

13 A: All right.

14 Q: But that's a fair reflection of your long-held
15 views on corporate -- combined reporting,
16 correct?

17 A: As I mentioned in my direct, so.

18 Q: Okay. All right. Let's talk about some of the
19 opinions that you've offered here.

20 You talked in length about -- well, you
21 talked about UDITPA and how you view that as
22 good tax policy.

23 A: As I -- view it as what?

24 Q: You talked about it -- I'm sorry, in the
25 context of what you believe is good tax policy,



1 correct?

2 A: I don't think I was endorsing UDITPA as good
3 tax policy.

4 Q: Okay. But you believe that UDITPA requires
5 that an alternative apportionment method be
6 applied in a limited fashion?

7 A: A judicious fashion for unusual cases, not
8 intended -- or not to be understood as intended
9 by a legislature. That would be, kind of, my
10 op- -- operating premise.

11 Q: Okay. Is that language contained in the
12 statute?

13 A: No. No. Of course, not.

14 Q: Does the statute use the term sparingly?

15 A: No.

16 Q: Idiosyncratic?

17 A: No.

18 Q: Unusual?

19 A: Pierce's article uses the word unusual.

20 Q: But the statute doesn't.

21 A: No.

22 Q: Okay. Eccentric?

23 A: No.

24 Q: Narrow?

25 A: No.



1 Q: Nonrecurring?

2 A: No.

3 Q: Quirky?

4 A: What was the last one? Quirky?

5 Q: Quirky?

6 A: No.

7 Q: Okay. Sparingly?

8 A: No.

9 Q: Limited circumstances?

10 A: No.

11 Q: Okay.

12 A: This is the -- this is sound tax policy for
13 interpreting the statute.

14 Q: Okay.

15 A: And I think on the direct I said, otherwise,
16 the exception will swallow the rule.

17 Q: I thought ---

18 A: And I think as you look at the cases, it's
19 consistent with ---

20 **OBJECTION:**

21 **MR. VON LEHE:** Your Honor, that's -- I'm gonna
22 object. He's now -- he's non-responsive, but
23 he's also starting to getting into what the law
24 is.

25 **MR. LUTHER:** He's not non-responsive, Your Honor.



1 He's directly answering the question, number
2 one.

3 **THE COURT:** Well -- hold on. Well, you're not -- I
4 -- it's -- your objecting that he's -- that's
5 an odd situation to me. The bottom, the bottom
6 line is, I'm gonna allow him to respond to the
7 question.

8 **MR. VON LEHE:** Okay.

9 A: That, when you look at the cases, you will see
10 it is consistent with what I am suggesting is
11 good sound policy.

12 Q: South Carolina is not a UDITPA state, are we?

13 A: No.

14 Q: And we have not adopted -- let me rephrase.
15 The General Assembly has not adopted the model
16 regulations published by MTC, correct?

17 A: Well, I don't think you have. But, again, I
18 wasn't testifying on South Carolina law, so I
19 really haven't looked.

20 Q: All right. Let's, let's talk about this
21 exception swallowing the rule. I want to
22 understand what you mean that.

23 From a good tax policy perspective, if the
24 Department used an alternative apportionment
25 method on 50 than fewer -- on fewer than 50



1 percent of the taxpayers who filed corporate
2 tax returns here, would that be judicious?

3 A: What number? I'm ---

4 Q: Less than 50 percent.

5 A: Less than 50.

6 Q: Or half.

7 A: Well, the -- you know, that's a range between
8 .1 and 49.9. Where are we in less than 50?

9 Q: Let's just 49 percent.

10 A: Oh, you're using an alternative apportionment
11 rule for 49 percent of the taxpayers. Yes.
12 You -- that calls for a statutory change or a
13 regulation.

14 Q: What about ten percent of the taxpayers?

15 A: Again, yeah, that's a line drawing problem, but
16 ten percent could be a large number, too. I
17 would say if, if you are singling out an
18 industry, for alternative apportionment, that's
19 exactly the kind of situation that the
20 legislature should be involved in, having a
21 special rule for a particular industry.

22 Q: What if it's less than one percent?

23 A: Yeah. That's a line drawing rule.

24 Q: Okay. All right. In your deposition you gave
25 some examples of sit- -- situations where you



1 believe alterative apportionment method would
2 be appropriate, even if you are a separate
3 entity state.

4 A: Yes.

5 Q: Do you recall that?

6 A: Yes.

7 Q: One of those would be the abuse of a holding
8 company, right?

9 A: Right.

10 Q: All right. What if two taxpayers were abusing
11 a holding company and the Department decided to
12 invoke alternative apportionment, would that
13 fit within your good tax policy?

14 A: It fits within the word abuse.

15 Q: So, you think if they, if they asserted -- I --
16 let me make sure I got this right.

17 So, if there were two taxpayers using a
18 Delaware Holding Corporation, and the
19 Department invoked alternative apportionment
20 against both of those taxpayers, that would be
21 within the good tax policy ---

22 A: Well, you dropped the word abuse just now.

23 Q: Okay. What if it ---

24 A: So, if we had a really abuse situation like the
25 SYL case out of Massachusetts, which I'm, I'm



1 going to sketch this for His Honor because this
2 is a nice example of an abuse case.

3 So, this person, SYL is a men's apparel
4 store of some sort, and the owner picks up the
5 phone and gets pitched an idea by some outside
6 consultant. It was not one of the Big Four
7 accounting firms, and he listened to it. And
8 it had to do with the Delaware holding company.
9 And the proposal was -- and they were going to
10 do it on a contingency. Always suspect. And
11 what we're going to is, we're going to create
12 this holding company in Delaware and we want
13 you to transfer your trademarks to that holding
14 company. And the president of the company --
15 or the owner said, why would I do that? Well,
16 you see you're really not going to do that
17 because you're going to get them back, you're
18 going to license them back. Well, then why am
19 I doing all this? Because you're going to put
20 -- pay a royalty to the holding company. I
21 don't want a holding company. Well, don't
22 worry, you're really not going to have a
23 holding company, you see, we have people in
24 Delaware that will do this all for you. Oh,
25 they'll be a part-time employee and they'll



1 handle all the paperwork and whatnot. And the
2 owner says, I can't believe this really works.
3 I'm not going to pay you, I'm going to escrow
4 what your amount might be 'cause this doesn't
5 sound like it's going to work. And they set it
6 up, and then, the owner of the trademark
7 transfers -- or doesn't transfer, starts taking
8 royalty deductions prior to even transferring
9 the trademarks. So, the whole thing's a sham.
10 Well, that's a pretty abusive situation. I'd
11 say, go for it. And if you got a bunch of
12 people to do it, audit all of them. That's
13 exactly what you should be doing for that kind
14 of abuse.

15 Q: Well, I guess, my point is this. In some ways,
16 it doesn't matter the number, right? If the
17 situation is abusive, you could go after
18 everybody, whether that's two or 500, right?

19 A: Well, I have a feeling you and I wouldn't agree
20 on what's abusive, so.

21 Q: All right. Some other instances you say would
22 be proper for the Department to invoke altern-
23 -- alternative apportionment, even in the
24 separate entity state, abusive REITs?

25 A: Again, REITs was an example of setting up some



1 Real Estate Investment Trust, that what REIT
2 stands for? Yeah. Real Estate Investment
3 Trust. And you would transfer your real estate
4 to the REIT, and then you would pay a rent to
5 use it. And you would deduct the rent. The
6 REIT would then pay a tax exempt dividend. And
7 so, you would get your rent back in the form of
8 a tax exempt receipt, so to speak. So, with
9 one hand, you took a deduction, with the other
10 hand, you got the money back, and there was no
11 reason for doing this except for the tax
12 consequences.

13 Again, in the world without taxes, you
14 wouldn't have done this, you know. Which is a
15 nice litmus test for, oh, is this is a shelter
16 of some sort? So, yes. I would, I would agree
17 that that is the kind of thing that should be
18 litigated.

19 Q: All right. The situation, as it lacked
20 business purpose or economic substance, would
21 also be an appropriate time for the Department
22 to invoke alternative apportionment, right?

23 A: Yeah. Under the right circumstances,
24 absolutely.

25 Q: Abuse of tax savings would also be an



1 appropriate situation?

2 A: Correct.

3 Q: Okay. And a tax haven doesn't have to be in --
4 where did you describe earlier, Bermuda?

5 A: Nauru.

6 Q: Nor- -- Nauru.

7 A: N-A-U-R-U.

8 Q: Okay. It could be another state, could --
9 can't it?

10 A: Well, I mean, it could be. Sure.

11 Q: In fact, you've talked about Vermont at one
12 point being a tax haven, right?

13 A: I did?

14 Q: Yeah. Did you?

15 A: Where? I'm sure you've read it somewhere.

16 Q: Vermont.

17 A: Yeah. No, I know where Vermont is, but where
18 did you read this?

19 Q: Do you recall the captive insurance situation
20 in Vermont in the early 2000s?

21 A: Ah. So -- okay. We're into captive insurance
22 now, a whole nother area.

23 Q: I'm just asking, do you recall the tax havens
24 that Vermont had become, right?

25 A: It certainly became a home to captive insurance



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1 companies.

2 Q: And you got into a little bit of a squabble
3 with the Governor there about it there, didn't
4 you?

5 A: Oh -- (laughter) -- yeah, that made the Boston
6 Globe, I believe.

7 Q: Is this quote accurate? Dean, being Howard
8 Dean, the Governor, apparently, has no problems
9 with tax havens as long as they're in the State
10 of Vermont. You can't have it both ways
11 because Vermont is acting like a little
12 Bermuda.

13 A: Uh-huh.

14 Q: Does that sounds right?

15 A: That was a colorful phrase. Yeah. I must say.

16 Q: And just to make sure we're clear. What was
17 happening there, you correct me if I'm wrong,
18 you set up a captive insurance company in
19 Vermont, right?

20 A: Uh-huh.

21 Q: You then pay your premiums to that insurance
22 company. They get to invest the premiums,
23 correct?

24 A: Yeah.

25 Q: Premiums are not taxed, correct?



1 A: Well, I mean, under Vermont law? There, I
2 think they may have been taxed at a very low
3 rate.

4 Q: Okay.

5 A: But ---

6 Q: I think that's correct.

7 A: Yeah.

8 Q: They lowered the rate. And then, the profits
9 from those might not be subject to corporate
10 tax in the home state.

11 A: Yeah. But, you know, even under combined
12 reporting, we tend not to combine insurance
13 companies. So, even combined reporting
14 wouldn't have dealt with that problem.

15 Q: That's correct.

16 A: So, you ---

17 Q: But, my point is this. At one point, everybody
18 was setting up with captive insurance company
19 in Vermont, right?

20 A: It did -- yes, initially.

21 **OBJECTION:**

22 **MR. VON LEHE:** Your Honor, I'm going to object to
23 this. This has no relevance.

24 **MR. LUTHER:** And I'm -- It's really not ---

25 **THE COURT:** I would agree with that, right now. I



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1 don't get the relevance of this.

2 Q: Well, let me ask this question then, and I
3 think this will answer it, and we'll move on.

4 **THE COURT:** You're gonna cure relevancy?

5 **MR. LUTHER:** Yes, Your Honor.

6 **THE COURT:** Okay.

7 Q: All of the companies that were setting up those
8 entities in Vermont, followed all of the normal
9 corporate form and structures, right?

10 A: I assume.

11 Q: There was nothing illegal about how they set it
12 up, right?

13 A: I assume, that's right.

14 Q: But Vermont, in your opinion, was still an
15 abusive tax haven under that set up?

16 A: Well, I don't -- you know, I'd have to look at
17 the entire context in which I said that. I
18 mean, they certainly have the right to have a
19 low rate on insurance premiums. I have a
20 feeling it's more complicated than that. I
21 have feeling that the insurance regulators were
22 in bed with this whole thing, in terms of how
23 much capital they required of the companies.
24 You know, I think it gets a little bit more
25 nefarious. But, my memory is foggy. This goes



1 back to a couple of decades when Dean was
2 running for President. I mean ---

3 Q: Isn't, isn't that the point, that you can have
4 -- that's the whole point of what you've been
5 talking about with combined reporting for your
6 career, what we just read earlier. That it's
7 not about whether they set up a proper
8 corporate form or structure that's perfectly
9 normal, it's about the results of that when you
10 go to allocate income. And you can have a
11 perfectly normal corporate structure,
12 completely legal, perhaps, even with various
13 other business reasons, that completely
14 distorts the income of the businesses that are
15 in -- or the corporations that are in a
16 separate entity state, right?

17 A: I, I couldn't really follow that. And, I mean,
18 I ---

19 Q: My point is this. The corporate structure
20 doesn't matter, it's the substance. Right?

21 A: In, in what context are we talking about?

22 Q: In terms of apportioning income.

23 A: Yeah. Well, the structure matters if you're a
24 separate entity state.

25 Q: But if it results in a distortion of income in



1 a separate entity state, that's important for
2 determining whether to invoke alternative
3 apportionment.

4 A: Oh, if, if you can prove the factual predicate,
5 that the standard formula does not fairly
6 represent business activities in the state, if
7 you pass through that threshold, then you're
8 entitled to move on to the next set of
9 requirements.

10 Q: Okay. Let me ask you, since you talked earlier
11 about good tax policy, and over my objection,
12 separation of powers. A legislature can
13 delegate powers through an executive branch,
14 right?

15 A: I don't know. I mean, there are states that
16 say you, you can't delegate your tax powers to
17 an administrative agency and say to them, well,
18 you set the rates. So, I -- you know, I'm not
19 sure. Now, that would be a matter of South
20 Carolina law. And I have no idea what -- I
21 didn't even know you had anything in the
22 Constitution on separation of powers, so.

23 Q: Well, I agree with you it's a matter of South
24 Carolina law.

25 A: Yeah.



1 Q: Let me ask you this. From a good tax policy
2 perspective, can a state legislature adopt
3 separate entity reporting as the standard
4 method with combined reporting as an
5 alternative?

6 A: I think with a properly drawn statute, they
7 certainly could.

8 Q: Okay.

9 A: You know, in a delegation, I've elected my
10 representatives to make these hard decision,
11 and when they delegate, it seems to me that
12 just undemocratic.

13 Q: Let me ask you, going back to the transfer
14 pricing studies. If a transfer -- if a -- and
15 you, you -- I think you talked about it, that
16 you could come up with your own report. You
17 can lower the charge or, essentially, make an
18 adjustment if there was some defect in transfer
19 price, correct?

20 A: Yes.

21 Q: Okay. If the adjustment got you to the same
22 place as combined reporting does, is there
23 anything within good tax policy that requires
24 you to use an adjustment, rather than combined
25 reporting?



1 A: So, you mean, if it was a coincidence that when
2 you made a proper adjustment in the transfer
3 price and ran the numbers, what a coincidence,
4 it just turned out to be the same as if you had
5 gone down a combined reporting route?

6 Q: We can assume that for this hypothetical.

7 A: I guess, you just have a coincidence here. But
8 you've done it right.

9 Q: But there's nothing in tax policy that requires
10 you to make the adjustment rather than
11 asserting combined reporting, right?

12 A: Oh, no. I think there -- it does. I thought
13 that was my exchange with Mr. Van [sic] Lehe.

14 Q: I'm sorry. I'm not sure ---

15 A: I, I think that's what I said to him, that that
16 is the preferred approach.

17 Q: Is the adjustment?

18 A: Is the adjustment. Just like we adjust many
19 things, many deductions.

20 Q: So, even if it gets you to the same place, your
21 preferred -- you think good tax policy requires
22 the adjustment?

23 A: It, it would be sheer coincidence if you got to
24 the same place. And if it turned out we have
25 this remarkable coincidence, well, there's



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1 still the right way to do it. You can't build
2 tax policy around a coincidence.

3 Q: So, even in a light of all of your opinions,
4 that adjustments are -- can be difficult to
5 capture the value, that transfer pricing can be
6 defective at times, that it's expensive to do
7 all of that, you still think an adjustment is
8 the better tax policy than combined reporting?

9 A: Yes. All facts and circumstances.

10 Q: Okay.

11 **MR. LUTHER:** Your Honor, if I may have just a
12 second?

13 *(Whispering.)*

14 Q: Professor Pomp, I think that's all the
15 questions I have. Thank you, very much.

16 A: You're welcome. I'll see you at the hearing
17 before the legislature.

18 **MR. VON LEHE:** Just one final question, Your Honor.

19 **PROFESSOR POMP - RE-DIRECT EXAMINATION BY MR. VON**
20 **LEHE:**

21 Q: Professor Pomp, you've spoken about the
22 alternative provision, which in our law, which
23 we have agreed is, is the same as that in
24 UDITPA. Our is at 12-6-2320(A)(4) of the South
25 Carolina Code. And it reads, allocator --



1 Allocation and Apportionment -- this is the
2 title. I'll assume you don't have a copy up
3 there in front of you and I'll give -- if you
4 need one.

5 A: I have a copy of UDITPA.

6 Q: Yeah, it's the same -- the language is the
7 same.

8 A: Yeah.

9 Q: But the title is this, allocation and
10 apportionment of taxpayer's income when
11 provisions unfairly represent taxpayer's
12 business activity in this state.

13 When the apportionment provisions of this
14 Chapter do not fairly represent the extent of
15 the taxpayer's business activity in this State.
16 So, based on that, from a tax policy
17 standpoint, are we not looking at the
18 taxpayer's business activity in this State?

19 A: We are. We're looking at 150 million dollars
20 generated by 42 stores in South Carolina. I
21 was so curious, looking at all of the auditor
22 and the process, all the documents, what is the
23 argument for this not fairly representing the
24 taxpayer's activities? I saw nothing. And the
25 fact that combined reporting raises more money,



1 that's not a principled response. I mean, what
2 we have here, you stand back, we have a
3 retailer doing business like so many retailers
4 with multiple entities and intercorporate
5 transactions, and we're basically -- the State
6 is basically trying to impose a combined report
7 contrary to South Carolina being a separate
8 entity state.

9 **OBJECTION:**

10 **MR. LUTHER:** Objection, Your Honor.

11 A: That's the bottom line.

12 **MR. LUTHER:** He's making a legal conclusion.

13 **THE COURT:** And, now ---

14 **MR. LUTHER:** Contra- -- I believe he said, contrary
15 to South Carolina law.

16 A: Being -- no, South Carolina being a separate
17 entity state.

18 **THE COURT:** Well ---

19 **MR. VON LEHE:** Don't argue with him. Let, let me do
20 that.

21 **THE COURT:** Well, he cleared that up. Did ---

22 **MR. LUTHER:** As long as he clarifies that, that's
23 fine.

24 **THE COURT:** Okay.

25 Q: And even though I said the last question, I do,



1 I do want to ---

2 **THE COURT:** You said last question, and one
3 question.

4 **MR. VON LEHE:** I believe I said one. Thank you,
5 Your Honor. Thank you. I do, I do believe I
6 said one.

7 *(Laughter.)*

8 Q: And, under UDITPA, and I'm sure my colleagues
9 here would agree with this for South Carolina
10 purposes. If not, we've got a real problem,
11 but. Whose burden of proof is it to prove that
12 these business activities are not being fairly
13 reflected in their standard formula?

14 A: The, the burden of proof is on the party that
15 is invoking the alternative apportionment. So,
16 under the facts of this case, it would be on
17 the DOR.

18 Q: Thank you.

19 **MR. VON LEHE:** Thank you, Your Honor.

20 **QUESTIONS BY THE COURT:**

21 **THE COURT:** Professor.

22 A: Yes.

23 **THE COURT:** From a tax policy standpoint -- and
24 object, anybody, if you don't like this
25 question. From a tax policy standpoint, if it



1 costs the state a significant amount more money
2 to pursue an understanding about whether the
3 transfer pricing is appropriate, rather than
4 seek to use it a combined approach, would that
5 be impro- -- would it be improper for this use
6 of combined approach because that's a cheaper
7 appro- -- or a cheaper method for the state to
8 accomplish their goal?

9 A: I'm not sure where in the statute you would be,
10 because first ---

11 **THE COURT:** Well, that's why I'm asking you.

12 A: Yeah. First, you would have to pass through
13 the threshold requirement, that the standard
14 formula doesn't fairly represent the business
15 activities of the taxpayer in South Carolina.
16 And so, you have 150 million dollars from 42
17 stores, I don't know how you ever get past
18 that.

19 **THE COURT:** But when you say that -- when the
20 statute says it doesn't fairly represent, but
21 you're adding extra emphasis to the extent of
22 the taxpayer's business activities in the
23 state.

24 A: Uh-huh.

25 **THE COURT:** Well, I can't ask that that's a



1 statutory construction.

2 **MR. LUTHER:** I'd rather not object to your question.

3 *(Laughter.)*

4 **THE COURT:** Well, I, I don't have a problem with
5 people objecting to my questions.

6 I'm -- I'm going to pass on -- I would
7 like to hear your analysis, but I'm, I'm
8 passing on it, though.

9 A: Okay.

10 **THE COURT:** Thank you.

11 A: Can I respond?

12 **THE COURT:** No.

13 *(Laughter.)*

14 **THE COURT:** I withdraw my own question.

15 A: All right.

16 **THE COURT:** You may step down. Thank you.

17 A: All right.

18 **MR. VON LEHE:** Your Honor, I wonder if we could take
19 a ten-minute break at this point?

20 **THE COURT:** You may.

21 **(Off the record 3:39 p.m. to 4:02 p.m.)**

22 **MR. STREISEL:** Your Honor, Tractor Supply would like
23 to call Dr. David Andrade.

24 **THE COURT:** Okay.

25 **COURT REPORTER:** If you'll raise your hand for me?



1 DR. ANDRADE: (Witness complies.)

2 COURT REPORTER: Do you swear to tell the truth, the
3 whole truth, and nothing but the truth, so help
4 you God?

5 MR. ANDRADE: I do.

6 COURT REPORTER: Thank you.

7 DR. DAVID ANDRADE, having been duly sworn, testifies
8 as follows:

9 DR. ANDRADE - DIRECT EXAMINATION BY MR. STREISEL:

10 Q: Please, state your full name for the record.

11 A: David Fernando Andrade.

12 Q: And is it all right if I call you David
13 throughout this?

14 A: Sure.

15 Q: All right. And, David, so what do you do for
16 a living?

17 A: I'm a -- an economist consultant.

18 Q: And Tractor Supply hired you in this matter to
19 serve as an expert, correct?

20 A: Correct.

21 Q: And what were you asked to do, generally, in
22 this matter?

23 A: I was asked to evaluate whether the income
24 earned by Tractor Supply of Texas is
25 commensurated with the income that would be



1 suggested by the arm's length standard.

2 Q: Okay. And for what time period did you
3 evaluate?

4 A: 2014 to 2016.

5 Q: Okay. And before we get into your, your
6 opinions, I want to just discuss your
7 background and qualifications a little bit.

8 If you would turn to Exhibit 28, which is
9 your CV.

10 **MS. STREISEL:** And I don't know ---

11 **MS. GEER:** It's on the screen.

12 Q: Yeah. Yeah. It's on the screen. I don't --
13 there's a binder behind you, if you would like
14 it, but I don't know ---

15 A: I don't need it.

16 Q: --- if you'll need it.

17 A: I can see it.

18 Q: Okay. All right. Is this a -- so, it's --
19 yeah, Exhibit 28. And is this a current
20 version of your CV?

21 A: This is the most current version. Yes.

22 **(Joint Exhibit Number 28 was introduced into the**
23 **record at this time.)**

24 Q: Okay. Does it accurately summarize your
25 educational and employment background?



1 A: It does.

2 Q: Okay. And can you just, kind of, briefly run
3 through your educational background for us?
4 And then we'll get into your employment
5 history.

6 A: So, I received a Ph.D. in economics from
7 University of California. And I also received
8 a Master's degree in economics from the
9 University of California, and an undergraduate
10 degree in economics from California State
11 University.

12 Q: Okay. And how about your employment history?
13 Well, start with the, start with the beginning
14 and we'll just, kind of, you know, run through
15 everything.

16 A: Okay. So in 1998, I believe, I joined Coopers
17 and Lybrand in the transfer pricing
18 international tax practice. And from there --
19 I spent a few years there, and then I went to
20 Law and Economics Consulting Group, also known
21 as LECG, as a principal for a few years. And
22 from there, I went out on my own as, as an
23 expert in transfer pricing and valuation. And
24 I -- it was Andrade Economic Consulting, was by
25 boutique business name, but I went under the



1 name of Transfer Pricing Valuation Experts.
2 And along the way, during that, I had also
3 taught at the University of Washington Business
4 School. And I taught at the University of
5 Washing School of Law in the LM Tax Program, as
6 well as the IP specialized program. And then,
7 about two years -- no, I'm sorry -- maybe, a
8 year and a half ago, I joined Grant Thornton as
9 a Managing Director.

10 Q: Okay. And are you still employed by Grant --
11 Grant Thornton?

12 A: I am still employed by Grant Thornton, yes.

13 Q: Okay. And can you, can you give me just an
14 estimation of the number transfer pricing
15 reports that you have prepared throughout your
16 career?

17 A: Several hundred. I don't know. 500-ish. It's
18 hard to count because it's been a long time.

19 Q: Okay. And has that -- have you been doing that
20 since, I think, 1998 you started? Or is it,
21 you know, more heavily focused in a certain
22 time period?

23 A: Well, it actually started before then 'cause I
24 started doing independent consulting, probably,
25 in the mid-1990s, although I wasn't issuing a



1 high volume of reports, I issued a couple
2 reports. And then, when I joined Coopers and
3 Lybrand, it started to become high volume, a
4 number of reports per month. Sometimes, over
5 the course of a year, it could've been 15, 20,
6 25 on a busy year, maybe more. Just depends on
7 the year.

8 Q: Okay. And so, can you give me -- I mean, I'm
9 just trying to get a sense of, you know, how
10 many, you know, reports were prepared for, you
11 know, one client repeatedly versus total. And
12 so, kind of, with that background, you know, it
13 -- let's just, let's just say 300 reports, how
14 many clients -- how many different clients
15 would you -- let me just back that up. Yeah.

16 All right. So, give -- approximately, how
17 many reports have you -- did you say you think
18 you, you have prepared in your career, roughly?

19 A: A few hundred. I mean -- I don't know, you
20 know, it could be four or five hundred. I
21 think it's over 300, though.

22 Q: Okay. And, I mean, can you give me just a
23 ballpark estimation of the number of clients
24 that these have been for?

25 A: Probably, you know, 150 to 200. Maybe, maybe



1 a little over 200. I'm not sure.

2 Q: Okay. And so, so some would've been repeat
3 clients, but not all?

4 A: Not all. No.

5 Q: Okay. And have you ever, you know, prepared
6 any reports for companies that form -- that
7 perform the collective activities of
8 procurement, distribution, retailing, product
9 development, you know, just generally the
10 things that are at issue in this case?

11 A: Yes, I have.

12 Q: Can you give me ballpark estimate of, you know,
13 how many reports you've prepared, just covering
14 that type of subject matter?

15 A: Maybe, 20-ish. You know, something in the 20
16 to 25 range is probably about right.

17 Q: Okay. And, I mean, if you could give me like
18 a rough approximation, you know, how much of
19 your experience in preparing these reports
20 would be preparing, you know, reports from like
21 a fresh start for the first time versus you
22 evaluating somebody else's work, who had
23 already prepared a report?

24 A: Evaluating someone else's work, might've been
25 about a third of the time, maybe, a fourth to



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1 a third. Hard to say.

2 Q: And so, would the rest of that have been, you
3 know, preparing reports, you know, from the
4 client that -- a fresh start report, so to
5 speak?

6 A: Yeah. Fresh start reports, or a client in
7 fresh start operations or fresh start new
8 structure.

9 Q: Okay. And can you tell us a little bit about
10 the work you've done for the IRS, just briefly?

11 A: When I was at LECG, I was brought in to help
12 review transfer pricing arrangements, and as
13 well as other tax arrangements that involved
14 transactions that needed economic expertise to
15 analyze. And so, I was part of teams of
16 experts where we would do the analysis for the
17 IRS and they would hire us as, as independent
18 experts.

19 Q: Okay. And can you give me a general estimation
20 of the percentage of your transfer pricing
21 experience that involves, you know,
22 global/international companies, as opposed to,
23 you know, domestic companies?

24 A: I would say, 90 percent is global/international
25 companies, and then the remainder would be



1 domestic companies. But many of the
2 global/international companies do have domestic
3 operations that we advise on.

4 Q: Okay. And is there any particular reason why
5 you just have a lot more, you know, work with
6 international clients than domestic?

7 A: More common. They're, they're just much more
8 numerous, especially, when it comes to hiring
9 my type of expertise, you'll find that the
10 internal companies are much more active in
11 hiring economists to do transfer pricing.

12 Q: Okay. And, and, generally speaking, are you
13 just saying there's more work, you know,
14 transfer pricing comes up a lot more in an
15 international context, as more workflow type of
16 thing?

17 A: Yeah. There's a lot more work in the
18 international context for transfer pricing.

19 Q: Okay. And, you know, your experience in
20 international, are the same types of concepts
21 and principles as they generally apply in the
22 domestic work as well?

23 A: Yes. In general, it's similar. I mean, the,
24 the overarching issue is that your trying to
25 provide estimates of value or profit, and the



1 boundary is whether it's state line or
2 international boundary, it's all similar.

3 Q: And did you say you have a Ph.D. in economics?

4 A: I do.

5 Q: All right. What, what specific areas of
6 expertise do you have within the field of
7 economics?

8 A: My three fields of specialization were
9 industrial organization, financial economics,
10 and econometrics. And then, within industrial
11 organization, I spent a lot of time focused on
12 pricing and understanding determinants of
13 pricing, and also including regulatory pricing
14 and transfer pricing.

15 Q: Okay. And so, you know, tell us a little more
16 about the -- well, I was going to ask you to
17 tell us a little more about the sub-fields of
18 pricing, but did you just do that -- or have
19 you not covered that already?

20 A: I think I did it. I mean, unless you want to
21 know more.

22 Q: No. That -- that's fine. Did you mention
23 econometrics?

24 A: Econometrics. Yes.

25 Q: Okay. So, can you tell us a little bit about



1 what that means?

2 A: Econometrics is the statistical analysis of, of
3 economic data using quantitative empirical
4 methods. I mean, that sounds like a bunch of
5 fancy terms, but really, what we're doing is,
6 we're studying data. We're studying data
7 that's generated by people, by firms, by
8 individual groups. And so, econometrics is a
9 specialized area within economic science where
10 we spend a lot of time trying to understand the
11 issues that economist encounter with data
12 analysis.

13 Q: Okay. And how did, how did your experience --
14 your experience with data science and
15 econometrics come into play into this case in
16 helping you to form your opinions?

17 A: I was looking at -- in, in some of the data
18 that I requested, I was looking at transaction
19 level data that involved SKUs, or what we call
20 stock keeping units. And to analyze that type
21 of data, we're -- we, typically, want to get
22 involved with doing work in, in -- it's a
23 combination of computer science and
24 econometrics. We work with arrays, 'cause
25 they're very large data sets, sometimes, you



1 know, hundreds of thousands of rows of data.
2 So, in order to summarize it quickly and to
3 transform it into -- and to plot it, it helps
4 to have that background in econometrics and
5 data science.

6 Q: Okay. And have you been retained as a text --
7 as a testifying expert before, like DOR in this
8 case?

9 A: I have.

10 Q: Approximately, how many times, not counting
11 this case?

12 A: Three.

13 Q: So, this would be the fourth time then?

14 A: Yes.

15 Q: Okay. And have you ever refused to serve as a
16 testifying expert?

17 A: Yes, I have.

18 Q: Okay. I mean, approximately, how many times
19 would you say?

20 A: A dozen times.

21 Q: Okay. And, you know, what -- why might you
22 refuse to serve as an expert when asked to do
23 so?

24 A: A variety of reasons. One would be, that I
25 don't feel qualified to testify on the subject



1 matter. Another may be, that the travel
2 involved is difficult for me, 'cause sometimes
3 I was asked to fly to New York when I was
4 practicing in California and I had bunch of
5 work to do in California, and it wasn't going
6 to happen. Or in other cases, I just decided
7 that the -- that there would be another expert
8 that would be better suited for the, the case
9 and I would recommend those experts to the
10 client or the law firm.

11 Q: Okay. And anything else in particular about
12 your qualifications that you want to go through
13 now at this point, other than what we've
14 already covered?

15 A: No.

16 Q: Okay.

17 **OFFER AS EXPERT:**

18 **MR. STREISEL:** Your Honor, Tractor Supply would move
19 to have Dr. David Andrade admitted as an expert
20 in economics and specifically, in the sub-
21 fields of pricing valuation with a focus on tax
22 transfer pricing.

23 **THE COURT:** Qualified, as an expert.

24 **MR. STREISEL:** Thank you.

25 **MS. WOOTEN:** Do I get a say?



1 **THE COURT:** No. I was -- he said admitted and I was
2 saying ---

3 **MS. WOOTEN:** Right.

4 **THE COURT:** --- qualified.

5 **MS. WOOTEN:** Sorry. It was a joke. Sorry.

6 **THE COURT:** Okay.

7 **MS. WOOTEN:** Can you repeat that last part again?

8 **MR. STREISEL:** I'll have to read it. Expert in
9 economics and specifically, in the sub-fields
10 of pricing valuation with a focus on tax
11 transfer pricing.

12 **MS. WOOTEN:** Maybe -- Your Honor, I'm not sure I
13 heard anything about tax in any of the
14 qualifications or discussions that he, that he
15 discussed.

16 **THE COURT:** I don't think I did either.

17 **OBJECTION:**

18 **MS. WOOTEN:** So, I would object to that -- that
19 phraseology. I believe I'm okay with
20 everything else.

21 **MS. GEER:** Take out tax ---

22 **MR. STREISEL:** All right. I will take out tax then.
23 Should I reread it without it?

24 **MS. WOOTEN:** Please.

25 **MR. STREISEL:** All right. Move to have Dr. David



1 Andrade admitted as an expert in economics and
2 specifically, in the sub-fields of pricing
3 valuation with a focus on transfer pricing.

4 **THE COURT:** So qualified.

5 **MS. WOOTEN:** Thank you.

6 **MR. STREISEL:** All right, Bryson?

7 **MS. GEER:** Yeah.

8 **MR. STREISEL:** Pull up the Regulation real quick.
9 You got, you got it already.

10 **MS. GEER:** Oh, I do?

11 **MR. STREISEL:** Yeah.

12 **MS. GEER:** All right.

13 **MR. STREISEL:** It's on the PDS already.

14 **MS. GEER:** I, I went too far on the PDS.

15 **MR. STREISEL:** Back to the PD- -- the ---

16 **MS. GEER:** All right. Yep.

17 **MR. STREISEL:** --- other tab.

18 **MS. GEER:** Sorry. Sorry. All right.

19 Q: All right. David, can you just tell us, you
20 know, in general terms, what's the arm's length
21 standard?

22 A: The arm's length standard is a standard that
23 imposes market pricing on intercompany
24 transactions. So, another way of saying that
25 is, that the trans -- that -- that the, the



1 prices and the financial results that
2 independent parties would have negotiated
3 should be similar to the prices that
4 intercompany transactions between later parties
5 would negotiate.

6 Q: Okay. And do you see a Regulation in front of
7 you on the screen?

8 A: I see the Code.

9 Q: Or the, the ---

10 A: I'm sorry. Wait. No. No, it's the regu- --
11 Regulations. Yes, this is the Regulations. Go
12 ahead.

13 Q: I guess, is the arm's length standard in there?

14 A: Yes, at the bottom.

15 Q: Okay. Could you just read the section? I just
16 want to, want to orient ourselves to what
17 you're talking about with the arm's length
18 standard. It's what section of that -- of the
19 Regulation is that?

20 A: It's Section -1(b)(1).

21 Q: Okay. And could you tell us what the -- what,
22 what does it mean when someone's talking about
23 the arm's length result in the context of 482?

24 A: The arm's length result refers to the financial
25 outcome or the financial results that



1 summarizes the transactions that we're
2 interested in. For example, two parties engage
3 in a transaction where one sells a product to
4 another. We look at the financial results that
5 the -- Party A, the seller reports, and we look
6 at the financial result of Party B, the buyer
7 reports, and we check those to see if they're
8 consistent with the results that would've
9 occurred at arm's length between independent
10 parties.

11 Q: Okay. And, I guess, does it matter what method
12 is used to align with those results?

13 A: It doesn't matter so much on the method. What
14 matters is that the result is consistent with
15 the arm's length results.

16 Q: Okay. And could you just give us a general
17 description of what, what the -- the
18 quote/unquote best method rule is, you know, in
19 the context of these §482 Regulations?

20 A: Best method rule is the recipe for people to
21 follow that allows them to look at some data,
22 make some assumptions and confirm that those
23 are reliable in the context of applying Section
24 §482. So, it's a recipe for people to apply a
25 way of using the methods.



1 Q: Okay. And so, I wanna, kind of, orient
2 ourselves with some terminology here. Just
3 Tractor Supply Company of Texas, Tractor Supply
4 of Michigan, and then Tractor Supply Company
5 the parent, you know who I'm referring to when
6 I talk about those three entities?

7 A: Yes, I do.

8 Q: Okay. And so, what -- could you tell us what
9 your opinion is in this case?

10 A: My opinion is that the income reported by
11 Tractor Supply of Texas during the audit years
12 is consistent with the income that they would
13 report if they were independent of the parent
14 company.

15 Q: Okay. And the audit years, what years are
16 those?

17 A: 2014, 2015 and 2016.

18 Q: Okay. And so, could you say that one more
19 time, your opin- -- or not, not the years, but
20 your opinion is -- is what?

21 **OBJECTION:**

22 **MS. WOOTEN:** Objection. Asked and answered.

23 **THE COURT:** He's answered.

24 **MR. STREISEL:** Huh?

25 **THE COURT:** He's already answered that question.



1 **MR. STREISEL:** I didn't ---

2 Q: Could you rephrase your opinion for me, 'cause
3 I missed it?

4 **MS. WOOTEN:** Objection. Asked and answered still.

5 **THE COURT:** Yeah.

6 **MR. STREISEL:** Okay.

7 **THE COURT:** I sustain the objection.

8 **MR. STREISEL:** All right.

9 Q: Okay. So, have you reviewed the PwC transfer
10 planning study that was, you know, been
11 discussed this week in this case? I think it's
12 July 11th, 2014.

13 A: I did review it, yes.

14 Q: Okay. And what, what method did that report
15 use?

16 A: The primary method that they applied and
17 selected was the comparable profits method, or
18 what's known as the CPM.

19 Q: Okay. And can you just, just give us a very
20 brief general overview of the, of the
21 comparable profits method, you know, what are
22 some of the benefits and detriments of it at a
23 high level?

24 A: So, the comparable profits method is -- it's a
25 method that will analyze one side of the



1 transaction. As Dr. DeRamus referred to it as
2 a one-sided test. So, it's looking at whether
3 it's the buyer or the seller or, you know, one
4 side of the transaction. It looks at the
5 profits with a -- through a profit ratio or a
6 profit level indicator to determine whether
7 that transaction was conducted consistent with
8 the arm's length standard.

9 Q: Okay. And did you use the comparable profits
10 method in your analysis in this case?

11 A: No.

12 Q: Okay. What method did you use?

13 A: I used the profit split method.

14 **THE COURT:** You used the what method?

15 A: Profit split method.

16 **THE COURT:** Profit split.

17 A: Yeah.

18 Q: Okay. So, why did you not use the comparable
19 profits method in this case as part of your
20 analysis?

21 A: Primarily, because the comparable profits
22 method is not appropriate when either party to
23 the transaction makes significant non-routine
24 contributions or provides significant functions
25 that are of high value, that are hard to



1 benchmark in comparability.

2 Q: Okay. And so, I guess, can you, can you give
3 an example, give an example as to what you mean
4 by that, with respect to, we'll start with
5 Tractor Supply of Texas?

6 A: Yeah. So, the idea is that if you have
7 transactions between TSC Texas and TSC parent,
8 that those transactions involve both those
9 entities contributing things of significant
10 value and making non-routine contributions.
11 So, the CPM is not appropriate. In those
12 situations, it would be unreliable.

13 Q: Okay. And so, are you saying that it's hard to
14 find comparables or that it's hard to
15 benchmark? Just can you ---

16 A: I'm, I'm ---

17 Q: --- elaborate a little bit more on why -- I'm
18 sorry. Just elaborate a little bit more on
19 why, why that was not appropriate in this case.

20 A: Well, what you said was true, that it's not
21 easy to benchmark comparable companies that
22 would be used as evidence. It's also true
23 that, the fact that these two entities are
24 highly unique and making a lot of contributions
25 that are just not typical to find, makes it --



1 the whole exercise of trying to benchmark those
2 activities difficult. And so, the CPM, it
3 would not be the first choice. But, however,
4 what you could do, is you could use a CPM
5 method as a way to figure out what functions
6 were performed that were routine and were
7 simple and set that aside, and then try to
8 analyze the difference as, what we call,
9 residual profit. So, in essence, what I'm
10 saying is that the comparable profits methods
11 is a special case of the residual profit split
12 method. That's what I'm saying.

13 Q: Okay. And so, can you, you know -- what, what
14 is about Tractor Supply of Texas that makes it
15 hard to find good comparables? And, and to
16 clarify, you know -- and I'm talking about the,
17 the functions that are the, the functions that
18 are the subject of the PwC Study dealing with
19 the procurement, product development ---

20 A: Yeah.

21 Q: --- and so, with respect to that, what makes
22 Tractor Supply of Texas a hard company to find
23 good contare -- comparables for with respect to
24 those functions?

25 A: There's two reasons. One, the procurement



1 functions performed are much more evolved and
2 complex and of higher value than you'd
3 typically find in comparable companies that are
4 doing this on a routine basis. And also,
5 because procurement functions are related to
6 the product development functions that Texas is
7 also performing, so those are connected. So,
8 that's one reason.

9 The second reason is that, Tractor Supply
10 of Texas is a combined entity of retail
11 distribution operations, as well as procurement
12 and product development. So, it's a complex
13 entity. It has multiple things going on. It's
14 not easy to find comparables for it.

15 Q: Okay. And so, why are you able to find
16 comparables for the parent side of that
17 transaction -- or, why aren't you able to find
18 good comparables for the parent side of that
19 transaction?

20 A: Okay. So, you're inferring that, if you can't
21 find comparables for Tractor Supply of Texas,
22 then you might look to the other side of the
23 transaction, which is the parent side and say,
24 can we find comparables for the parent? I
25 think for the same reasons, you're not going to



1 find good candidates for comparability for TSC
2 parent because it's also involved in some
3 contributions in highly valuable functions.

4 Q: Okay. And could you just give just a, you
5 know, general overview of the stuff the parent
6 does?

7 A: Parent's involved in strategy, corporate
8 strategy, which includes marketing, it includes
9 other things. It's involved in data analytics.
10 It's involved in continuous process
11 improvement. It's involved in merchandising,
12 which it shares with TSC of Texas. The -- that
13 right there dilutes it to the point where
14 you're just not likely to find clean
15 comparables for either side.

16 Q: Okay. And -- all right. So, can you tell me,
17 what are some of the benefits that you were
18 able to enjoy when you were trying to price
19 this transaction that PwC would not have been
20 able to do when they were doing their study?

21 A: Okay. I want to clarify that PwC didn't do a
22 study. They did what's called a Planning Memo.
23 It's a shor- -- abbreviated exercise. It's
24 forward looking, and it's limited in scope,
25 typically.



1 So, what I did, is I analyzed looking back
2 in time, with hindsight, the transactions
3 during years 2014 and 2016, and I had the
4 luxury of, not only the time that had elapsed
5 between those transactions and when I did the
6 work, but also, the benefit of a substantial
7 amount of data that I had access to, a lot of
8 information that I was provided, I had access
9 to company personnel. So, there were --
10 there's quite a long list of things that I had
11 access to that I don't think PwC had the same
12 access to. I'm speculating, but I suspect
13 that's true.

14 Q: And so, you mentioned hindsight was one of
15 those things. Could you elaborate a little
16 more on what that means?

17 A: So, I was doing an analysis that was looking
18 back in the years 2014 and 2016. I was doing
19 it during the year 2022. So, I had, you know,
20 a good six years of hindsight that helped me in
21 my approach to the, to the analysis, whereas
22 PwC didn't have that. They were doing
23 something that was trying to provide guidance
24 on setting a transfer price or a policy that
25 would apply going forward. So, that's a



1 distinct difference between the two approaches.
2 Q: Okay. And then, tell us about -- I think you
3 mentioned access to facts and data. Tell us a
4 little more about what you mean by, you had
5 more access to facts and data than ---

6 **OBJECTION:**

7 **MS. WOOTEN:** Are you -- sorry. I would, again,
8 object. I think the witness stated earlier
9 that he would be speculating as to what he had
10 compared to what PwC -- the information they
11 had.

12 **MR. STREISEL:** Well, I think he -- I mean, I don't
13 want to answer for him, but I'm thinking he
14 would have access to data that didn't exist
15 when PwC did their study. And I just want to
16 -- I'm asking about stuff that would not have
17 existed when PwC did the study to elaborate on
18 that type of facts and data.

19 **THE COURT:** Ask the question again. I don't know
20 even know exactly what the words were, but.

21 Q: You mentioned that you had access to facts and
22 data that helped you with your analysis,
23 generally speaking, can you tell us more about
24 what type of facts and data that you have
25 access to and how it helped form your opinion



1 in this case?

2 **THE COURT:** If you don't have to speculate about --
3 or if you're not testifying about anything you
4 speculated existed.

5 A: Yeah. The only, the only thing that I'm
6 describing when I say speculating, is about
7 what PwC would have done or what that access
8 to. I can't, I can't speak for them. I can
9 only speak for what I did.

10 Q: All right. Well, can I rephrase the question
11 then?

12 A: Go ahead.

13 Q: Tell me about the access to facts and data that
14 you had as part of performing your analysis.

15 A: I had access to trial balance data. I had
16 access to management and financial reports. I
17 had access to -- including -- I had access to
18 third party comparable data. So, I had access
19 to public -- publicly available data, including
20 filings of -- by the SCC, so 10-K annual
21 filings. And I also had access to transaction
22 level data, which I ended up using extensively,
23 which allowed me to investigate a number of
24 different ways of approaching the transfer
25 pricing analysis in order to confirm whether



1 the transactions that I was analyzing were
2 consistent with the arm's length standard. So,
3 I had a number of things.

4 Q: Okay. And tell us a little bit, you know, the
5 type of factual infor- -- the type of factual
6 investigation that you did into the company as
7 part of forming your opinions?

8 A: I interviewed a number of people, and I -- for
9 example, talked to Margie, the Tax Director.
10 I talked to some people in the supply chain
11 group, I believe, and pricing group, as well as
12 someone else in the finance group. So, I think
13 a total of four individuals, including Margie.

14 Q: Okay. And -- so, supply chain group. What --
15 he hadn't that yet.

16 All right. Supply chain group. Can you
17 tell us a little bit about, you know, what you
18 learned -- or why were you talking to somebody
19 in the supply chain group, and what did it help
20 you -- with respect to your opinions in this
21 case?

22 A: So, I think they were labeled as supply chain
23 group, but the person was essentially a buyer,
24 and although they -- I do recall the supply
25 chain group being mentioned as part of the



1 Department, they helped me understand the
2 functions they perform for buying with the
3 Tractor Supply of Texas entity. And they
4 helped me understand the different types of
5 products that they would routinely get involved
6 with, either recommending for new products or
7 researching for a possible -- possible products
8 that could be added to certain regions of the
9 country. So, that was what the supply chain --
10 or the buyer person, allowed me to understand.
11 The other person that was interviewed was a
12 pricing person, was a senior level executive,
13 I believe, in the pricing group. And he gave
14 me a lot of good information about how the
15 Company will analyze pricing data, will use
16 third party consulting firms to help them
17 estimate prices that should be charged and,
18 just a number of things that were very helpful
19 to me to understand. And then, the finance
20 person gave me an overall vision of how that
21 all integrated up to the finance plans for the
22 company.

23 Q: Okay. And you also mentioned Margie. Would
24 you tell us a little bit about your
25 interactions with Margie and how it help- --



1 helped you in forming your opinions?

2 A: Yes. Margie was in the tax department, so she
3 had a lot of good information that was tracked
4 from, from her department's perspective on the
5 transactions, the entities, the costs that were
6 incurred, both at the direct level, the cost of
7 goods sold and also at the operating expense
8 level. So, I relied on her for a number of
9 insights and interpretations of the data that
10 I reviewed.

11 Q: Okay. And let's see -- so, you -- do you have
12 any estimation about the number of hours you
13 spent on this case, and we'll start with you
14 individually?

15 A: I don't really -- I, I don't keep track of
16 those things in my head, so I wouldn't have a
17 good -- I wouldn't have a good estimate of
18 that, no. I mean, I could speculate it's
19 something like one -- 100 to 200. I don't
20 know. I'm not sure.

21 Q: Would that ---

22 A: That would just be me.

23 Q: Okay.

24 **OBJECTION:**

25 **MS. WOOTEN:** Objection, Your Honor. If he's going



1 to speculate, I would ask that that be
2 stricken.

3 **THE COURT:** Well, I'll sustain that.

4 **MS. WOOTEN:** Thank you.

5 Q: Okay. We'll just ---

6 **THE COURT:** Well, I sustain that and strike his
7 answer.

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

9 Q: Okay. So, I don't want you to speculate, but
10 if you had to give an estimation of the number
11 of hours that you're comfortable with, what
12 would that be?

13 **OBJECTION:**

14 **MS. WOOTEN:** Your Honor, I think we just -- he asked
15 that question and Dr. Andrade said that he
16 would have to speculate to come up with that
17 answer.

18 **MR. STREISEL:** I ---

19 **THE COURT:** Which makes your question suspect.

20 **MR. STREISEL:** I asked what's an estimation that he
21 would be comfortable with, meaning he's not
22 speculating.

23 **THE COURT:** Okay. (To Dr. Andrade) Can you answer
24 that if you don't have to speculate? Although,
25 is not an estima- -- estimate somewhat of a



1 speculation?

2 **MR. STREISEL:** Not if you're comfortable with it.

3 **THE COURT:** Well.

4 A: I'm going to guess 200.

5 **THE COURT:** If you ---

6 **MS. WOOTEN:** Your Honor, I would -- I would still
7 object to that. That's nearly identi- ---

8 **THE COURT:** And he just said, I guess.

9 **MS. WOOTEN:** Yeah. He guesses, and it's nearly
10 identical to the answer that we had just -- I
11 requested to have stricken.

12 **THE COURT:** I'm going to strike that. I get -- his
13 answer was, I guess, which is under my previous
14 scenario about, what is an estimate? I know
15 one thing, an estimate should be -- should not
16 be best on -- based on a guess.

17 Q: Are you able to give an estimate that is not
18 speculation and is not you guesting [sic] a
19 number of hours you've spent, that you are
20 comfortable is true?

21 A: 200.

22 **OBJECTION:**

23 **MS. WOOTEN:** Your Honor, I'm going to object and ask
24 that that answer be stricken. It is the same
25 exact answer for the previous two questions.



1 **MR. STREISEL:** I mean, if it was in here before --
2 I'm not gonna stay on the subject though.

3 **MS. GEER:** Just, just move on.

4 **MR. STREISEL:** Yeah. We'll keep moving on.

5 **Q:** Did you have others helping you in this case?

6 **A:** I did.

7 **Q:** Okay. And those were other people that were
8 at, at your firm?

9 **A:** That's right.

10 **Q:** Okay. And so, could you -- you mentioned a SKU
11 level data or, I think you called it
12 transactional level data as well. Are those
13 the same things when you're using those terms?

14 **A:** They are in this context, yes.

15 **Q:** Okay. And so -- so, tell me a little bit more
16 about that. What, what is, what is it?

17 **A:** Most of these larger companies will generate a
18 lot of data through their enterprise resource
19 planning, ERP systems. And here in the 2020s,
20 we have the fortunate situation of having a
21 tremendous amount of data being generated on an
22 hourly basis, not just even a daily basis, and
23 Tractor Supply is not unique in this regard.
24 So, they generate a lot of transaction level
25 data that is tracked by product line, product



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1 category and a number of other different
2 categorizations. It all goes back to if, if a
3 sale occurs in their POS system, or their point
4 of sale system, it gets tracked in its ERP
5 system. So, that data rolls up into various
6 levels of aggregation, which you can then
7 review, analyze, look for trends, try to
8 understand relationships, and that's exactly
9 what I did. I asked Margie for that data. She
10 had access to it. She sent it to me and I was
11 able to analyze it and begin to look for trends
12 and information that I wanted to understand for
13 purpose of my analysis.

14 Q: Okay. And -- and so, so what -- what was the,
15 you know -- well, how would you describe the
16 quality of that SKU data that you had and were
17 able to review?

18 A: In general, it was very good quality. It was,
19 it was -- first of all, it was timely. So, it
20 was contemporaneous with those years, there
21 were no lapses in the data. I was able to
22 answer a lot of questions myself by looking at
23 the data. I did go back to Margie for a few
24 clarifications in, you know, certain spots
25 where I needed to understand what was being



1 reported, but it was largely self explanatory.

2 Q: Okay. And so, I guess, help, help me/us
3 understand. I mean, I mean, good -- what is
4 the difference between good SKU data and, and
5 da- -- and SKU data that's, you know, not as
6 good of quality. I mean, what is the
7 difference and what does good quality SKU data
8 allow you to do?

9 A: Well, in this case, it allowed me to get a
10 clear estimate of two things. One is the cost
11 of acquisition of the products from the
12 vendors, directly. The second is the price
13 that was sold to the customers at the retail
14 stores. Those, those two an- -- answers,
15 whether it's the cost acquired or price sold,
16 were important for me to have at a level that
17 was pure, meaning there were no adjustments, no
18 -- for example, in generally accepted
19 accounting principles, you typically have a
20 number of adjustments that work their way into
21 financial reports. And I prefer to work with
22 the data from the raw source, and that's what
23 this was. So, it was superior to what I'm used
24 to working with. And that gave me the ability
25 to track the different product lines, how they



1 generate value for the Company, the
2 relationships between those product lines, as
3 well as the relationships across time, between
4 four -- 2014, 2015, and 2016, and also across
5 regions because we had 11 regions in the United
6 States that Tractor Supply keeps track of. And
7 I had access to different regions' data to
8 compare those regions.

9 Q: Okay. And you mentioned earlier, you talked to
10 I think you said, finance -- someone in
11 financing, pricing and supply chain. Did you
12 talk to the individuals in those departments
13 for, for as much time as you needed to be
14 comfortable that you had the information you
15 were seeking?

16 A: Yes, I did. And the general idea is that, if
17 I had that data, that I -- that was received
18 about the transaction level in the SKU data, I
19 had a lot of information that allowed me to
20 understand the Company and I didn't have to
21 spend as much time with each of those
22 individuals. So, it helped tremendously in, in
23 funneling my work to what was important for my
24 analysis and less time spent interviewing
25 people at the company.



1 Q: Okay. All right. And so, this SKU, this SKU
2 data, how does it play into you deciding to use
3 the method that you used in this case?

4 A: When you look at a transfer pricing method and
5 you try to evaluate whether it can be applied
6 in a reliable way, you're always going to be
7 interested in, what is the data that you have
8 to work with.

9 In this case, I had the SKU data, the
10 transaction level data, so that influenced my
11 decision to explore the methods that would be
12 able to take advantage of that data. So, for
13 example, if I was to apply a comparable profits
14 method, which I couldn't in this case
15 technically because the parties were providing
16 things of significant value and that would be
17 -- that would get in the way, but if I were to
18 apply the comparable profits method then I
19 would look to try and define the tested party.
20 If I define the tested party as one of the
21 entities involved in the transaction, I'd have
22 to have some data that summarizes that tested
23 party. Ordinarily, that's gonna be at an
24 entity level. The fortunate thing about having
25 the SKU and the, the transaction level data was



1 that I was able to go in much deeper into
2 product department groupings to try to
3 understand the value of those departments and
4 those product lines as opposed to just looking
5 at only the value that would've been associated
6 with one of the tested parties.

7 Q: Okay. And, and, you know, allowing you to go
8 into, to better understand the value of, of
9 different product lines, I think you said, you
10 know, what, what did that allow you to do, you
11 know, in terms of using this method that you
12 used?

13 A: It allows you to identify comparable evidence
14 that is better suited to the data that you're
15 working with for the company. So, it gives you
16 more flexibility in adapting the comparable
17 evidence to the situation, so that it's
18 actually a better match. So, it's actually
19 more similar. So, that's, that's going to
20 increase the reliability. So, under the best
21 method rule, I'm looking for increasing
22 reliability, given the data and assumptions, I
23 saw that this was helping me achieve that, so
24 I chose the residual profit split method as my
25 most reliable method, or the best method.



1 Q: Okay. And so, tell me a little bit, you know,
2 in your own words, just what, what to view as
3 the activities that are being performed by
4 Tractor Supply of Texas under this, this
5 intercompany transaction we've been talking
6 about that involves procurement, distribution
7 and other things. Just describe that for me,
8 you know, from the perspective of what Texas
9 does.

10 A: I'm sorry. Can you repeat the question?

11 *(Laughter.)*

12 Q: Yeah. Just, just -- so, I don't, I don't want
13 to shorthand it and call procurement. I want
14 to understand, you know, the functions that
15 Tractor Supply of Texas is performing for the
16 group. Could you just, you know, tell me in
17 your words, what are those functions?

18 A: Yeah. Tractor Supply of Texas is responsible
19 for a number of things. Let's start with the
20 more routine, typical things.

21 It's responsible for distribution. It's
22 responsible for retail operations in the State
23 of Texas, not outside. And it's also -- and,
24 and related to that, it's responsible for some
25 mixing operations in -- to a mixing center, but



1 let's not get into the details of that now. In
2 addition to that, it's responsible for the
3 procurement function, as well as the product
4 development function. And at Tractor Supply,
5 those functions are the secret sauce of the
6 business. If you were to look at an analogy,
7 such as R&D performed by Microsoft or R&D
8 performed by Apple Computer, that is how
9 important the procurement function and the
10 product development functions are for Tractor
11 Supply.

12 **OBJECTION:**

13 **MS. WOOTEN:** Objection, Your Honor. I'm going to
14 object to him talking about Apple or other,
15 other clients and what they think is important
16 as compared to this case.

17 **THE COURT:** Any response?

18 **MR. STREISEL:** He was giving an analogy. He wasn't
19 talking about other clients.

20 **MS. WOOTEN:** He was discussing Apple. I mean,
21 that's, that's another corporation that's not
22 at issue here. And what they think is
23 important.

24 **MR. STREISEL:** I mean, that would mean we can't talk
25 about any comparables, in this case. We can't



1 talk about other companies ---

2 **THE COURT:** Well, you can talk about comparables if,
3 if that -- that is something that an expert in
4 his field would commonly rely upon, but right
5 now, he's just referencing them. I'll sustain
6 the objection. It's, it's -- to this point,
7 but it -- at this point, he just referenced
8 them as what, what they would do. You can --
9 if you want to explore that question, you just
10 lay the foundation. In order to explore that
11 answer, you would -- lay the foundation.

12 **MR. STREISEL:** I mean, I don't need to lay the
13 foundation just for that, it was just analogy
14 he was using.

15 **THE COURT:** Well, then proceed.

16 **MR. STREISEL:** Okay.

17 Q: So, can you continue describing the functions
18 that Texas is performing that you were
19 describing before that?

20 A: So, these functions of procurement and product
21 development are related. They're, they're
22 integrated to the extent that they, they do
23 them in a way that is beneficial for both,
24 including things like qualifying vendors and
25 buying products that are helping the stores



1 move material through to sales. There's -- the
2 product development also spends a lot of time
3 trying to understand gaps in the product lines.
4 Gaps as perceived by customer. And all this
5 discussed in the SEC filings. This is public
6 information, so I'm not saying anything new.

7 Q: And, you know, then, I guess, anything else
8 about, you know, the val- -- the value that,
9 that Texas is generating for this group that
10 you want to speak of?

11 A: Well, in my case, I discovered that the -- you
12 know, at first I came in thinking, procurement
13 service, okay, fine, I'm used to seeing
14 procurement services performed. Not a big
15 deal, it's just -- fairly common. But the way
16 they're being performed here at Texas is
17 extraordinary. The company has a significant
18 built-up knowledge of how to do this, and do it
19 well. And the performance speaks for all that
20 effort because they're really showing
21 significant results from their
22 procurement/product development functions.

23 And that was something that I knew right
24 away it would make it difficult for me to go
25 out and find benchmarks for Texas. So, I had



1 to find an alterative method for transfer
2 pricing.

3 Q: Okay. And -- and so, tell us again, what's the
4 method that you used?

5 A: Residual profit split method.

6 Q: Okay. And did you create a Demonstrative to
7 assist the Court in walking through that method
8 a little bit?

9 A: Yes.

10 Q: Okay.

11 **MR. STREISEL:** Bryson, would you pull up that
12 PowerPoint?

13 **MS. GEER:** (Whispering.)

14 **MR. STREISEL:** Yeah. Yeah.

15 **MS. GEER:** Oh, I'm sorry. I'll put it down so
16 you've got it. Is it ... Here you are.

17 **MR. STREISEL:** Here's ...

18 **MS. WOOTEN:** All right. Thank you.

19 **MR. STREISEL:** You'll be okay with us putting it --
20 oh, okay.

21 **MS. WOOTEN:** Yeah. I mean, as long as it's --
22 you're not offering it yet. It's just a
23 Demonstrative?

24 **MR. STREISEL:** Right. Right. Yeah. Yeah.

25 **MS. WOOTEN:** Do you need this copy or is this my



1 copy?

2 **MR. STREISEL:** No. No. You can ---

3 **MS. WOOTEN:** Okay.

4 **MR. STREISEL:** --- frame it if you want to.

5 *(Laughter.)*

6 **MS. WOOTEN:** Take a step back. I'm just kidding.

7 Thank you.

8 **MR. STREISEL:** Okay.

9 Q: David, is this the, the Demonstrative that you
10 prepared?

11 A: Yes.

12 **(Petitioner's Exhibit Number 1 was introduced into**
13 **the record at this time.)**

14 Q: Okay. All right. All right. So, let's, let's
15 talk a little bit about, you know, the residual
16 profit split method and how it works.

17 Can you just, generally at a high level,
18 walk us through your method and how it works?

19 A: So, the, the way to understand this method is
20 that it's, it's similar to a joint venture
21 where the parties involved come together and
22 they decide they want to combine their, their
23 functions and activities into a single
24 business. Whether it's a transaction or a
25 business, or whatever you want to call it, they



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1 combined themselves. And then, the question to
2 ask is, well, how they are going to take
3 payment for their contributions? That's what
4 the profit split method is all about. It, it
5 tells you a way that you reliably estimate how
6 much each party to the joint venture should get
7 out of this arrangement. So, it's nothing more
8 than just a way of dividing up the value.

9 And, in particular, when you look at
10 companies like Tractor Supply, we have to
11 define what it is -- the activities that we're
12 trying to divide up the value from. So, for
13 example, we know that Texas is involved in
14 procurement and product development, but it's
15 also involved in retail distribution and mixing
16 activities. So, I think the idea here is, you
17 have to acknowledge that if there is several
18 activities involved, that we're going to have
19 to figure out a way to estimate the value for
20 each of those activities that's involved, not
21 just one or two. And the same goes for the
22 other side of the transaction.

23 So, whereas, I said -- before I said that
24 the CPM, or the comparable profits method is a
25 one-sided test, the profit split method is a



1 two-sided analysis. It looks at both sides of
2 the transaction, not just one. So, same
3 reasons for analyzing Texas and all the things
4 that it does, you've got to go to the parent
5 side and analyze all the things that it does.
6 And that includes it's routine activities, as
7 well as some of the activities which are more
8 valuable and non-routine. So, that's what this
9 first, this first slide is trying to explain.
10 That you start out with the parties, in this
11 case, the legal entities, that are in the
12 supply chain or in the transactions that you
13 want to, that you want to estimate the value
14 for. And then, you identify all the combined
15 functions that generate value, and then you
16 decide which of those combined functions are
17 routine or -- routine, meaning that you might
18 be able to outsource those, you might be able
19 to reproduce, reproduce those internally versus
20 the ones that are not likely to be outsourced
21 -- or not easily outsourced and certainly not
22 easily reproduced. And that divides between
23 routine, functions and non-routine functions.
24 And the method then goes through ways of
25 assigning value to each of those pieces. Can



1 we go to the next slide?

2 Q: Okay. And yeah. So, so tell us -- you know,
3 let's, let's walk through your method at a high
4 level and just, you know, what you did and how
5 it works. So, what's the first thing you did?

6 A: So, ordinarily, when you apply a profit split
7 method, you might do it a slightly different
8 way. But given the data that we had in this
9 case, and given that I had a lot of information
10 that helped me understand the functional
11 capabilities of each side of the transaction,
12 I did it in this particular way. So, I -- in
13 step one, part one -- there's two parts, by the
14 way. The part one is, you determine gross
15 profit. Part two is, you reconcile gross
16 profit to operating profit. We're going to
17 start with part one.

18 Let's stay at the gross profit level only.
19 And there's five steps generally involved. The
20 first is to try to identify the functions that
21 are contributing value. I already talked
22 through that in the previous slide, but in
23 practice, that involves interviewing the
24 company, looking at the data that they provide,
25 trying to understand the relationships between



1 the functions performed by the entities and the
2 people -- the skilled people that are involved
3 in those functions. So, after you assimilate
4 all the data, you walked away with what's
5 called a functional analysis. This is kind of
6 the, the foundation of any transfer pricing
7 analysis. The functional analysis then points
8 you in the direction of where you should look
9 for comparable -- what we call comparable
10 evidence. So in this case, step two is, you
11 would go out and you identify comparable
12 evidence based on step one. Based on what you
13 understand to be true about the company in
14 terms of the functions performed.

15 After you identify comparable evidence,
16 then you're in position to figure out what
17 comparable evidence will work for this method
18 -- or for this transaction that you're trying
19 to value. And that's where you select
20 comparables. And when you select comparables,
21 you're really focused on, what are the routine
22 functions being performed and what are
23 comparables that are suitable for those routine
24 functions. In the process of -- and that's, by
25 the way, jumping from step three to step four.



1 So, I -- I'm -- it kind of works in a way that
2 doesn't really mean that you stop each place
3 along the way. But in terms of me explaining
4 it to the Court, this is probably a better way
5 to have it articulated.

6 **THE COURT:** It seems to me that step four would come
7 before step three. I -- I'm missing the point.

8 **MR. STREISEL:** Yeah. So, I was gonna ask -- or, you
9 want him to answer? I was going to ask follow-
10 ups.

11 **THE COURT:** Okay.

12 Q: Okay. So, so, yeah. So tell us, you talked
13 about breaking up between routine and non-
14 routine. So, what's the purpose of breaking it
15 up between routine and non-routine?

16 A: Okay. Let's, let's back up even further. Step
17 one is where we do that. Step one in the
18 functional analysis is where we identify the
19 routine functions performed versus the non-
20 routine function. So, we already have an idea
21 of that going down into step two and three.
22 Maybe, it's not well-stated in the slide. I
23 had to brief, so I couldn't elaborate much.
24 But, by step four, we already know what those
25 routine and non-routine functions are. That --



1 what we're doing in step four is, we're
2 actually calculating the amount of gross profit
3 that is attributable to those routine and non-
4 routine functions because ---

5 Q: And, and ---

6 A: Go ahead. I'm sorry.

7 Q: I'm sorry. I thought you were done.

8 A: What I was going to say is that, we, we have
9 the comparable data from step three, we know
10 from step one what those functions are, routine
11 and non-routine. So, in step four, we simply
12 merge those two things together and we come up
13 with a calculation for routine and non-routine
14 gross profit.

15 Q: Okay. And so, so, let's back up a little bit
16 to -- so, rou- -- routine functions, first,
17 first, what -- generally speaking, what do you
18 mean by routine functions?

19 A: These are functions that are generally simpler,
20 they're outsourceable, they're easier to
21 identify in third party comparable data.
22 Generally, they're easier to identify. So,
23 that's what we mean by routine functions.

24 Q: Okay.

25 A: These are -- in this case, there are



1 distribution, there'll be retail operations and
2 centralized headquarter administrative sur- --
3 services -- or support services.

4 Q: And when you say find comparable evidence, you
5 know, does that mean that it's easier to find,
6 you know, benchmarkable companies for these
7 type of activities or does it mean something
8 else?

9 A: Well, it really means what it -- what I'm
10 saying, is that comparable, comparable data
11 means that I'm looking for a comparable of
12 something, like what we're trying to price.
13 For example, if I know that I have a
14 distributor function being performed, and I can
15 go out and find a third party company
16 performing the identical distribution function,
17 that would be an ideal comparable.

18 Q: Okay. And so -- and then -- so that's the
19 routine side you just described. And then,
20 non-routine, I think you already covered this,
21 but just briefly tell us what, you know, what
22 are non-routine functions?

23 **OBJECTION:**

24 **MS. WOOTEN:** Your Honor, I'm going to object to
25 asked and answered, if he's already covered it.



1 **MR. STREISEL:** Okay.

2 **Q:** What, what are the non-routine functions in
3 this case, with respect to Tractor Supply?

4 **THE COURT:** I'll let him -- I'll let him proceed on
5 that.

6 **MS. WOOTEN:** I'm sorry?

7 **THE COURT:** I'll let him proceed on that.

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

9 **A:** So, a non ---

10 **Q:** Do you want me to re-ask it because I was
11 talking ---

12 **A:** Go ahead. Yeah, please. Please do.

13 **Q:** So, what are the non-routine functions with
14 respect to Tractor Supply Company that, that --
15 what did you determine to be the non-routine
16 functions in this case?

17 **A:** We'll start with Tractor Supply of Texas. So,
18 we have procurement and product development.
19 And then we also have merchandising activity
20 that's, that's blurred or shared between both
21 Tractor Supply of Texas and Tractor Supply
22 parent. And then, we get over into Tractor
23 Supply parent and we've got merchandising,
24 which is shared with Texas. We have corporate
25 strategy, which in general, is things like



1 marketing strategy, long-term financial
2 strategy and things like that. And then, we
3 have, we have the, the data analytics side of
4 the business, which is the -- you, you collect
5 all this data from the ERP system, well, you
6 have to have a team of analyst to work with
7 that data, to use it productively, to help
8 answer questions and help company function.
9 And then, we have this interesting area where
10 they, they use that data as well as feedback
11 from customers and team members of the Company,
12 which essentially, means all the personnel, to
13 apply what's called continuous process
14 improvement. So, that's another non-routine
15 function that's being performed here by the
16 parent.

17 So, you combined all this together, and
18 the idea is that you're going to allocate the
19 gross profit to each of these functions in a
20 way that is commensurate with what they bring
21 to the arrangement.

22 Q: Okay. And then -- so the, the routine
23 functions, I think you mentioned retail and
24 distribution and headquarters administration.
25 Is that, is that accurate, the three things



1 that you mentioned?

2 A: Yes.

3 Q: Okay. And, and is retailing, you know,
4 typically, always going to be a routine
5 function or is it just something that's
6 specific to Tractor Supply in this case?

7 A: It's not specific to Tractor Supply. In most,
8 in most of -- virtually, all the ones I've
9 examined, we find that retailing tends to be
10 one of the more routine activities.

11 Q: Okay. And so, once you broke it out between
12 routine and non-routine, what, what did you do
13 next?

14 A: My next step is simply to allocate the profit
15 to the routine part. That leaves some amount
16 left over. And that amount leftover is going
17 to be, what we call, the premium profit or the
18 residual profit, hence the residual profit
19 split method. And then, we're stuck with
20 figuring out, well, of all the contributions
21 that each side brings to the table, how much of
22 that residual profit, or premium profit, should
23 be allocated to Texas, and how much of it
24 should be allocated to the parent.

25 Q: Okay. And so, backing up just a little bit,



1 when you're determining how to -- so, just --
2 could you just briefly tell us, you know, what
3 you did to determine the routine profit that
4 was allocated?

5 A: Yeah. The routine profit is determined by
6 comparable data that you select to be similar
7 to the routine functions performed. So, I went
8 out and identified companies that perform
9 distribution services, that are independent,
10 that performed retail market -- retail
11 operations, as well as some that performed
12 administrative headquarters functions --
13 although, I didn't focus on that, but I did
14 wanna, at least, look what that might be.

15 Q: Okay. And so, you allocated profit to the
16 routine functions and that left with, I think
17 you said, premium profit, is that how you
18 described?

19 A: I've described it a number of different ways.
20 I described it as residual profit, premium
21 profit, excess profit, it's all the same thing.
22 It really is just profit that is in excess --
23 or greater than the profit that you would have
24 expected to observe, given the routine
25 activities that were being performed.



1 Q: Okay. And what -- what's the purpose of trying
2 to determine this premium profit or excess
3 profit?

4 A: The purpose to try to understand which entity
5 deserves what portion of that premium profit.
6 And that's the idea of the residual profit
7 split method is you're trying to split residual
8 profit between the parties involved in a way
9 that's reliable based on the evidence you have.

10 Q: Okay. And so, when you got to -- at this point
11 in your analysis, where you have the premium
12 profit, what did you -- how, how did you split
13 the premium profit in this instance?

14 A: In this instance, I examined all the facts and
15 all the data that I had access to, and I
16 determined that a conservative estimate for the
17 routine -- for the -- sorry, residual or the
18 premium profit for the Texas side would be 50
19 percent. So, I split it right down the middle
20 between the parent and Texas. 50 percent for
21 one, 50 percent for the other.

22 Q: And why do you think that's a conservative
23 estimate in this case?

24 A: I think there's evidence to support that you
25 could go higher than 50 percent.



1 Q: Okay.

2 A: But I didn't, I didn't pursue that in this
3 matter.

4 Q: Okay. And what do you mean, you didn't pursue
5 that in this matter? Will you elaborate on
6 that?

7 A: I did not go through the extra steps of trying
8 to determine a narrow range of what that split
9 should be, given that it may have been 60, it
10 may have been 58 percent for Texas, it may have
11 been 55, may have been 65. I'm -- I don't have
12 to know the answer, I simply just backed it
13 down to 50 percent and said that's good enough
14 for me. It turns out that, when I did that
15 calculation based on 50/50, that the results
16 were falling into place and I concluded, after
17 this whole part of what we're calling part one,
18 that the income reported by TSC of Texas was
19 consistent with the arm's length standard. So,
20 I was essentially done at this point with my
21 inquiry.

22 Q: Okay. And -- all right. And so -- well, we
23 just discussed part one, this is at the gross
24 profit level. Is that accurate?

25 A: Yes.



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1 Q: And, and how -- where -- what is the gross
2 profit level? I mean, where is that on the
3 balance sheet or -- it's probably right -- but
4 what's the gross profit?

5 A: The gross profit is simply profit that's after
6 cost of goods sold, or in some ways of
7 describing it, you'd say, it's after the direct
8 costs are incurred. So, think of a simple
9 financial statement. You have revenue at the
10 top, you incur direct costs, which are costs
11 that are more directly associated with the,
12 with the products that are being sold or the
13 functions being performed, and then you have it
14 -- subtraction that gets you to gross profit.
15 And then, that's gross profit. Now, you could
16 go further, but you need to put in indirect
17 costs or, what we call, operating expenses. And
18 after subtracting operating expenses, or
19 indirect costs, from gross profit, you get to
20 what's called operating profit, which is a more
21 comprehensive profit measure for the entire
22 business, but you had to decide between direct
23 and indirect costs in order to those
24 calculations.

25 Q: Okay. And so, why did you do part one at the



1 gross profit level instead of down at --
2 operating income is what I'm doing it as, but
3 you called it something else. What did you
4 call it?

5 A: Operating profit. Operating income.

6 Q: Operating. Okay.

7 A: Same thing.

8 Q: Operating profit. So, why, why did you do your
9 analysis in part one at the gross profit level
10 rather than the operating profit level?

11 A: The primary reason was because I had access to
12 transaction level data, or SKU level data, that
13 was tracking pure gross profit for each product
14 line, each department, and a number of other
15 categories that were tracked. So, I had that
16 data. So, it allowed me to get a very
17 transparent visibility into the value creation
18 for each of those products, each of those
19 categories or products. So, I stayed with the
20 gross profit level because the quality of the
21 data was so good at the level, so I did all my
22 analysis, all the way down to gross profit to
23 determine what would be the residual gross
24 profit that should be allocated to TSC of
25 Texas, and I stopped. And then, I went an



1 additional level of analysis called part two,
2 in this case, where I tried to reconcile that
3 gross profit that I just estimated down to a
4 level of operating profit.

5 Q: And so, why did you do this at part two?

6 A: I was interested in knowing that -- if there
7 was -- certainly, it looked like there was
8 enough gross profit to explain the, the income
9 that was reported by TSC of Texas. I was, I
10 was comfortable with that. But I wanted to
11 know, well, is it really in the arm's length
12 range? It is it, is it in the interquartile
13 range of the operating profit that I would
14 expect from TSC of Texas. And in order to
15 answer that question, I had to go to this part.
16 So, I went through and I, with discussions with
17 Margie, I had to get her help because we had to
18 allocate -- or she allocated operating
19 expenses, and I had to review it in order to
20 understand how you would take the total
21 operating expenses that Tractor Supply
22 Corporate, or parent, incurs and take a piece
23 of that and assign it to TSC of Texas. So,
24 after that calculation, then I get an estimate
25 of the operating profit for TSC of Texas. And



1 that's what I then compared to comparable
2 evidence for operating profit ratios as opposed
3 to gross profit ratios.

4 Q: Okay. And what about for the parent side, were
5 you also able -- did you also take that down to
6 the operating profit for the parent in this
7 part two?

8 A: I did. And the, the nice thing about having
9 the total operating expenses was, what whatever
10 you allocated to Texas, the remainder was
11 either at the parent or Michigan. So, I had
12 the data.

13 Q: Okay. And so, did, did you create, create
14 another Demonstrative to help show, you know,
15 the calculations of this part two and the
16 results that you reached?

17 A: Yes, I did.

18 **MR. STREISEL:** This, this is one Excel sheet ---

19 **MS. WOOTEN:** Sure.

20 **MR. STREISEL:** --- with two documents. I switched
21 it up for it.

22 **MS. WOOTEN:** Okay.

23 **MR. STREISEL:** You have to look there.

24 **MS. WOOTEN:** So, both of these are in all of these?
25 I'm just making sure I understand everything



1 all of -- everything. So, just one, you're
2 saying?

3 **MR. STREISEL:** This -- this is, this is one Excel
4 file and the source document ---

5 **MS. WOOTEN:** I got you.

6 **MR. STREISEL:** --- should be -- and I think they are
7 identical. I just put it on two to avoid
8 confusion. There, there related to each other,
9 they connect.

10 **MS. WOOTEN:** Okay. I'll wait to hear, hear how ---

11 **MR. STREISEL:** Okay.

12 **MS. WOOTEN:** --- how it comes together.

13 **MR. STREISEL:** Yeah.

14 **MS. WOOTEN:** Okay.

15 **MS. GEER:** There are two tabs.

16 **MS. WOOTEN:** I got you. In the same file?

17 **MS. GEER:** In the same ---

18 **MR. STREISEL:** Yeah.

19 **MS. WOOTEN:** And is the Excel on here of which one
20 it is?

21 **MR. STREISEL:** As a Demonstrative.

22 **MS. GEER:** The sources are on the last page, I
23 think.

24 **MR. STREISEL:** Yeah.

25 **MS. WOOTEN:** I got you. I just didn't -- you said



1 that it was one Excel spreadsheet, so I was
2 trying to understand. You're putting all the
3 information from all of these sources onto one
4 Excel?

5 **MS. GEER:** Uh-huh.

6 **MS. WOOTEN:** I got it. Okay.

7 **MR. STREISEL:** Yes.

8 **MS. WOOTEN:** Got it.

9 **MR. STREISEL:** Printing Excel's are a pain.

10 **MS. WOOTEN:** I got -- no, I got it.

11 **MR. STREISEL:** Too many -- too many of the ---

12 **MS. WOOTEN:** I just want to make sure I understood.

13 **MR. STREISEL:** Too many Excels in this case.

14 **Q:** All right. David, is this, is this the
15 Demonstrative that you prepared?

16 **A:** Yes.

17 **(Petitioner's Exhibit Number 2 was introduced into**
18 **the record at this time.)**

19 **Q:** Okay. And do you have the source materials of
20 what you used to prepare this in it?

21 **A:** Do I have the source materials? Oh, you mean,
22 the, the list of the ---

23 **Q:** The materials you used to prepare this, are
24 they listed in this?

25 **A:** Yeah, they're listed at the bottom.



1 Q: Okay. And -- yeah, so we're on this first tab
2 here. So, could you just talk us through what
3 this first tab is, you know, and where -- and
4 show the -- explain what this first tab is
5 showing for us.

6 A: Oh, there's the list of the sources down there.
7 Rows 39 through 42.

8 Q: Okay.

9 DR. ANDRADE: Can you go up further, whoever has
10 control?

11 MS. GEER: Yeah, I am. All right.

12 DR. ANDRADE: To the -- try row one. Here we go.

13 A: So, the -- what we're looking at here, is a
14 summary of data that I looked -- that I
15 prepared with my team. And in column B, you
16 see there's two numbers in cells B, as in boy,
17 10 and B, as in boy, 11. In bell B-10, you see
18 the intercompany inventory markup of 9.7
19 percent, and in the -- row 11, you see a 50
20 percent. So, I -- those numbers were used in
21 the analysis. The 9.7 percent was imbedded in
22 some of the calculations that Tractor Supply
23 management performs on how they price inventory
24 between TSC of Texas and TSC parent and TSC of
25 Texas, and TSC of Michigan. So, we'll set that



1 aside for a moment.

2 But, if you look at row seven, you'll
3 there's, there's different columns. There's
4 column B, there's column C, there's column D
5 and column E. Column C through E are simply
6 the, the years 2014, 2015 and 2016, and column
7 B was a weighted average of those years. So,
8 in general, that's how all the data is lined
9 up. It's weighted average first, then 2014,
10 then 2015, then 2016. So, we have quartiles of
11 results here. So, this is in interquartile
12 range that was generated from comparable data,
13 and you can see that generally, the lower
14 quartile for row seven there is showing,
15 approximately, 12 to 13 percent for the -- it's
16 called a gross margin -- gross profit margin
17 ratio. And the upper quartile, in row eight
18 it's showing, generally, between 21 and 22
19 percent.

20 So, these numbers are used to figure out
21 what the routine gross profit amounts are,
22 which help allow me to calculate the non-
23 routine, or the premium gross profit amounts.
24 Now, if we go down below, you'll see that there
25 is, in Table B ---



1 **MR. STREISEL:** Scroll down just a little bit.

2 A: You'll see the ... Sorry.

3 You see Texas and you see parent separated
4 out. Where, in the case of Texas, the data
5 there is showing at the operating profit level,
6 what's called a markup on total costs, MTC.
7 So, that would be something that would be
8 comparable to the 9.7 percent markup that PwC
9 had recommended. And then, for the TSC parent,
10 you'll see I have something called O-M, that
11 stands for operating margin, and that's going
12 to be the operating profit divided by net sales
13 ratio. So, those are two different ratios that
14 are used to evaluate whether it's Texas or the
15 parent at the operating profit level.

16 Q: And is that the operating profit level that is
17 basically the result of your residual profit
18 split method? Is that where we are here in
19 table ---

20 A: No, no. Table B would be ---

21 **OBJECTION:**

22 **MS. WOOTEN:** Objection. Leading.

23 **MR. STREISEL:** How, how ---

24 **THE COURT:** Well, go ahead and rephrase it if you
25 want.



1 **MS. WOOTEN:** Okay.

2 **Q:** Help ---

3 **THE COURT:** I was going through the ---

4 **Q:** Help us orient ourselves between Table B and
5 Table C ---

6 **A:** Yeah.

7 **Q:** --- and what, what they are.

8 **A:** Table B is the arm's length evidence. It's the
9 interquartile range, but at the operating
10 profit level. So, it's going to be the, the
11 ratio of operating profit to net sales in the
12 case of the parent, TSC parent, in rows 20 and
13 21, or the ratio of operating profit to total
14 costs for TSC Texas in rows 16 and 17. That's
15 just the evidence from the arm's length
16 comparable data.

17 So, we have that evidence and now the
18 question is, what are the results that reported
19 for each of the tax years that under the audit
20 here, as well as the weighted average. And if
21 you look now, down at rows 28 ---

22 **THE COURT:** When you say, when you say evidence from
23 this arm's length data, this is verifiable? Or
24 is this still your estimations?

25 **A:** It's both. It's ---



1 **THE COURT:** Okay.

2 A: We, we go out and find we find the comparable
3 datas.

4 **THE COURT:** I was just trying to ---

5 A: Yeah.

6 **THE COURT:** --- understand the weighted evidence.

7 A: No, it's a good question. Good question. So,
8 it -- what, what it is, is you go out and find
9 your comparable data of evidence, which is a
10 list of companies that are similar ---

11 **THE COURT:** Yeah.

12 A: You then calculate profit ratios for that --
13 for those companies and you come up with a
14 statistical summary of those -- of that
15 company's set, we call comparable set. And
16 that's what you see here is a, is a summary --
17 a statistical summary of that comparable set
18 data. And that's used then, to figure out what
19 would be an arm's length range, or an
20 interquartile range.

21 **THE COURT:** Okay.

22 A: And the idea is that, we're using a range
23 because the, the tax Regulations under Section
24 §482 specify that it's appropriate to use a
25 range of results. So, that's how we get that,



1 that data. And we present here in rows -- in
2 Table B, in row 16 through 21. Down in Table
3 C, we then figure out, well, what did the
4 company actually report? And we see that on
5 rows 28 for TSC of Texas, we have something
6 called E-B-I-T. I should've defined it. But
7 it's, earnings before interest and taxes, it's
8 equivalent to operating profit -- or operating
9 income. It's just another way of, of saying
10 the same thing.

11 And so, the earnings before interests and
12 taxes, or the operating income, are those
13 amounts that you see on line 29 -- I'm sorry,
14 28, for TSC of Texas, for each of the years and
15 then the weighted average. And then, I have
16 this calculations on line 30 showing you the
17 markup on total cost that is reflective of TSC
18 of Texas, overall. That's including its
19 retail, distribution, and its procurement and
20 product development functions, all combined.
21 So, you can see that each of those numbers in
22 row 30 that are labeled MTC, those correspond
23 to the numbers that you see in rows 16 and 17,
24 where the numbers in row 16 to 17, together
25 make up a range and those numbers in row 30 are



1 in the range. That's for Texas.

2 We move down the parent, we also see that
3 there's the same exact theme of calculations.
4 We have rows 20 and 21 showing a range of
5 operating profit ratio results. And down in
6 row 37, we have the operating margin that's
7 reported by the parent across those years, and
8 the weighted average, and then you see that
9 those are also consistent, they're fitting the
10 numbers. And that's, that's the best summary
11 I have of showing that my method was completed.

12 Q: Okay. And so, Table B, that is what you
13 determined to be the arm's length range at the,
14 at the end of the method that you've been
15 describing for us?

16 A: Yeah, it's the step two. It's the operating
17 profit reconciliation arm's length range and
18 not the gross profit part, which we already
19 talked through before.

20 Q: Okay. And then, Table C, you said, reported
21 operating results by entity. Is that the
22 amounts that were actually reported by these
23 entities during those tax years or something
24 else?

25 A: They are the exact -- the amounts that they



1 reported during the tax years, as presented to
2 us in the trial balance data that we received.

3 Q: Okay. And so -- line 30, you're saying, that's
4 for ...

5 A: That's going to be the markup on total cost for
6 TSC of Texas for each of the years, as well as
7 the weighted average. W-A stands for weighted
8 average. And then, line 37 is going to be the
9 operating margin, O-M, short for operating
10 margin, for the TSC parent for each of the
11 years, as well as the weighted average.

12 Q: Okay. And so, we'll start with the, the markup
13 on total cost, line 30. What, what does it
14 tell you -- or what does, the fact, that the
15 falls within the range identified in Table B,
16 tell you?

17 A: What that tells you, is that the -- applying
18 the residual profit split method and
19 reconciling all the way down to the operating
20 profit, the results that were reported by both
21 TSC of Texas and TSC parent, are consistent
22 with the arm's length standard. They're
23 consistent with the results that you would've
24 predicted if they were independent, operating
25 and arm's length. That's what that tells you.



1 Q: Okay. And those results in Table C, that's --
2 are those the -- so, you said those were the
3 actual reported results by the entities, so is
4 it fair to assume that those are what the
5 results would -- I'm going to rephrase that
6 question -- (laughter).

7 Table C, the -- those are the res- -- ah
8 ...

9 MS. GEER: What are they?

10 MR. STREISEL: Huh?

11 MS. GEER: Ask him what they are.

12 Q: And those are done -- and, and they apply the
13 transfer pricing -- excuse me. Those are the
14 results when they applied the transfer pricing
15 the PwC report prepared?

16 A: I'm sorry ---

17 MS. GEER: Slow down -- (laughter).

18 A: --- you'll have repeat that question.

19 Q: The -- ah, as I read it -- I think you already
20 told us, we'll just move on from that one.

21 All right. Let's go to the outer tab,
22 real quick.

23 A: I'm sorry. Before you go there ---

24 Q: Yeah?

25 A: I just want to -- I mean, I can -- I -- I've



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1 been a teacher of economics and transfer
2 pricing for a number of years, so I anticipate
3 your confusion, so let me see if I can help,
4 and maybe the Court will also benefit from
5 this.

6 **THE COURT:** You're now ---

7 **OBJECTION:**

8 **MS. WOOTEN:** I would object, because now he's adding
9 a narrative with the -- what he's already
10 testified ---

11 **THE COURT:** Well, now he's adding a narrative.

12 **MS. WOOTEN:** Well ---

13 **THE COURT:** He hasn't even been asked a question.

14 **MS. WOOTEN:** Well, he has asked a question ---

15 **MR. STREISEL:** No, no, no.

16 **THE COURT:** (Laughter.)

17 **MS. WOOTEN:** --- and he's responding.

18 **MR. STREISEL:** That's all -- that's all right. We
19 can ---

20 **THE COURT:** You're ---

21 **MR. STREISEL:** --- connect the dots.

22 **THE COURT:** (To Dr. Andrade) You don't get to teach
23 on your own.

24 (Laughter.)

25 A: Okay. All right. Fine.



1 **THE COURT:** Yeah.

2 Q: Yeah. And let's just, just briefly go to that
3 other tab really quick, and just tell us what
4 that, what that tab is.

5 **MS. GEER:** Hold on.

6 A: So, this tab simply walks through each of the
7 many steps that are involved to get to the
8 other tab's results.

9 Q: Okay. And are you're talking about the gross
10 profit level down to the operating profit level
11 that you described earlier?

12 A: Right. It, it -- what it does is, it starts
13 with sales then calculates gross profit, and
14 then calculates operating profit in a way
15 that's consistent with everything I've
16 explained thus far.

17 Q: And then, that first tab were just the final
18 summary of the ---

19 A: Yeah.

20 Q: --- conclusions, is that accurate?

21 A: That's accurate. The first tab is a more
22 useful summary because it condenses everything
23 down into just some simple tables. This, this
24 here is a series of tables. If someone is
25 interested, they're more than welcome to look



1 at it, but for now, I think we reviewed already
2 the way it works.

3 Q: Okay. And I -- I can't remember if I asked
4 this at the beginning, but you prepared this
5 tab, as well, correct?

6 A: Yes.

7 Q: Okay. And the source documents, the stuff you
8 used to prepare this, you listed them at the
9 bottom?

10 A: The very bottom.

11 Q: Okay. All right.

12 **MR. STREISEL:** Your Honor, we request to move this
13 into evidence as Tractor Supply's Exhibit 1.
14 **(Petitioner's Exhibit Number 1 was offered into**
15 **evidence.)**

16 **MS. WOOTEN:** Your Honor, I have two questions. One,
17 were these submitted as part of his work
18 papers?

19 **MS. GEER:** No, he prepared these for trial. They're
20 the -- this is all for ...

21 **MS. WOOTEN:** But this was not prepared ---

22 **MS. GEER:** Well ---

23 **MS. WOOTEN:** Or this was not given to us prior to
24 today?

25 **MR. STREISEL:** I think ---



1 **MS. GEER:** Actually, I think it ---

2 **DR. ANDRADE:** It was.

3 **MS. GEER:** It was.

4 **DR. ANDRADE:** Yeah.

5 **MR. STREISEL:** I think it was something that -- I
6 don't know. I can't remember.

7 **THE COURT:** Okay. I got a, it is wha- -- it was,
8 and I got a, I can't remember.

9 *(Laughter.)*

10 **THE COURT:** So ---

11 **MS. WOOTEN:** That's my confusion.

12 **MR. STREISEL:** Yeah. Well, a lot of it -- a lot of
13 it -- a lot of Excel charts created, and ---

14 **THE COURT:** And I've got a, it was a Demonstrative
15 Exhibit, so.

16 **MR. STREISEL:** Yeah.

17 **THE COURT:** I've got one statement that it was a
18 Demonstrative Exhibit, which -- and then,
19 maybe, a summary -- (laughter). So, I'm not
20 sure where to go on this.

21 **MR. STREISEL:** Oh, well it was prepared for a -- to
22 be a Demonstrative Exhibit. It was, it was
23 narrowed down from this stuff to prepare a
24 Demonstrative Exhibit, and he's got the source
25 documents used to come up with this, just to



1 summarize it to walk through here.

2 **MS. WOOTEN:** So, I guess, my first question is, is
3 it being offered as de- -- Demonstrative or is
4 being offered as ---

5 **THE COURT:** Well, a ---

6 **MS. WOOTEN:** --- as an Exhibit?

7 **THE COURT:** --- Demonstrative is not offered, it's
8 just ---

9 **MS. WOOTEN:** Okay. Well, I guess, that's my
10 confusion, 'cause it's being -- it's referred
11 to a Demonstrative, but then, I think he was
12 trying to offer it. So, I'm confused.

13 **MR. STREISEL:** Oh, yeah. We were trying to offer it
14 as Tractor Supply's Exhibit 1.

15 **THE COURT:** What's your position?

16 **MS. WOOTEN:** I don't know that we have seen this
17 information. And that's what I'm trying to
18 understand is, were we ever provided it,
19 because I don't think we were.

20 **THE COURT:** At this point, I sustain the objection,
21 but I will allow y'all ---

22 **MS. GEER:** I, I think, I think it was. But we will
23 confirm that.

24 **MS. WOOTEN:** Okay.

25 **MS. GEER:** But I ---



1 **THE COURT:** And if you ---

2 **MS. GEER:** Definitely, we will hold off until we are
3 able ---

4 **MS. WOOTEN:** Sure. And I'll put ---

5 **THE COURT:** And if you confirm it, it'll come in.

6 **MS. GEER:** Okay.

7 **THE COURT:** But even though -- we're still at
8 another problem, and that is, it's a summary of
9 the evidence that you've, apparently, you've
10 already presented -- or did you actually give
11 ---

12 **MS. GEER:** Well ---

13 **THE COURT:** --- during this particular ---

14 **MS. GEER:** Before I -- let me look. I don't' want
15 to say anything that's incorrect.

16 **THE COURT:** Okay. Well, then ---

17 **MS. GEER:** So, let me look.

18 **MS. WOOTEN:** Okay.

19 **THE COURT:** I'll tell you what, I'll address this
20 later.

21 **MS. GEER:** Yep.

22 **MS. WOOTEN:** Okay. And I will say for, for the
23 Court and for the record too, we had some
24 difficuly with ---

25 **MS. GEER:** Yeah.



1 **MS. WOOTEN:** --- discovery production with Dr.
2 Andrade's file. So, it could be that we got
3 it, but it was given to us segmented.

4 **THE COURT:** I'll address it later.

5 **MS. WOOTEN:** Okay. I -- I don't want it ---

6 **THE COURT:** Even if it's ---

7 **MS. WOOTEN:** I don't want there to be the impression
8 that we ---

9 **MS. GEER:** No, no. We're not ---

10 **MR. STREISEL:** No ---

11 **MS. WOOTEN:** We're just ---

12 **MR. STREISEL:** --- there was a lot of stuff.

13 **MS. WOOTEN:** There was ---

14 **MR. STREISEL:** That's why I don't know.

15 **MS. WOOTEN:** --- a lot of stuff, and so I just -- I
16 don't know that we got this. It doesn't look
17 familiar, but we could've gotten it at some
18 point it. It -- I ---

19 **THE COURT:** At this ---

20 **MS. GEER:** I think you did, but I want to confirm,
21 so.

22 **MS. WOOTEN:** Okay.

23 **THE COURT:** There ---

24 **MS. WOOTEN:** One more -- oh, I'm sorry.

25 **MS. GEER:** Yeah.



1 **MS. WOOTEN:** One more question.

2 **MS. GEER:** Yeah.

3 **MS. WOOTEN:** There's a source for 37, we think
4 that's supposed to be 6107 instead of 6117
5 because that's not an admitted exhibit. So, I
6 just want to clarify that so we ---

7 **MS. GEER:** Say, say what you think it should be.

8 **MS. WOOTEN:** 6107.

9 **MS. GEER:** Yes, that's what it should be.

10 **MS. WOOTEN:** Okay. It's 6117 on there.

11 **MS. GEER:** Okay. Yeah, that needs to be changed.
12 And I will ---

13 **MS. WOOTEN:** Okay.

14 **MS. GEER:** --- add, that I know one change from what
15 I think we produced to you, was to add the
16 source documents. So, I think we produced --
17 but I'm gonna confirm ---

18 **MS. WOOTEN:** Okay.

19 **MS. GEER:** --- that those -- that Excel file, and
20 that all we did between then and now is add the
21 source documents at the bottom.

22 **MS. WOOTEN:** Okay. Okay.

23 **THE COURT:** All right. With that said, keep moving.

24 **Q:** All right. Let's move on real quick.

25 Okay. What are your thoughts on Tractor



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1 Supply's business structure and the fact that
2 it's not operating as a single entity?

3 A: Something I've seen numerous times with other
4 clients of mine. So, nothing looks usual from
5 that perspective.

6 Q: Okay. And just tell us some of the common
7 reasons that, that companies operate through
8 multiple entities.

9 A: Common reasons that -- from my world, would be
10 things like tracking financial performance and
11 making it easier to produce financial summaries
12 of segments of the business. There's also
13 legal liability reasons that are -- that seem
14 to be relevant here. And then, in addition to
15 that, I would say that, the separation of legal
16 entities also allows you to separate
17 operations, physically. So you could look at,
18 you know, some people that may be working over
19 this group, some people working in this group,
20 and having separate legal entities keeps them
21 separate from each other.

22 Q: Okay. And, and in your profession, you know,
23 preparing transfer pricing reports, is it, is
24 it typically that you're seeing the same type
25 of organizational structures over and over



1 again, or are, are there a lot of unique
2 different types?

3 A: It's both. You do see similar tax structures
4 that are repeated in, in, sort of -- in one
5 way, meaning that they have a parent, they have
6 subsidiaries and those subsidiaries have
7 subsidiaries, so it's like a pyramid type of
8 structure. But then, another way, it depends
9 on the company, because some companies may have
10 types of activities they want to move into a
11 certain legal entity group, and so they may
12 take a subgroup of their overall org chart and,
13 and let it be focused on an area of operations
14 that's different. So it really varies, but
15 both are, are true.

16 Q: And so, I'm going to move on. Shifting gears
17 a little bit here.

18 So -- all right. We've been through your
19 method -- hold on one second.

20 **MR. STREISEL:** Can we take a two-minute break?

21 **THE COURT:** Uh-huh.

22 **MR. STREISEL:** A quick break. It -- I guess, it
23 could be, it could be more if anyone wants
24 more.

25 **MS. GEER:** Is that okay, Your Honor?



1 **THE COURT:** The two-minute break is ---

2 **MS. GEER:** Do you want ---

3 **THE COURT:** Is ---

4 **MS. GEER:** Okay. We can either have two-minute or
5 if people need a restroom break, we can take
6 more, or just whatever suits everybody else.

7 **THE COURT:** Well, are we -- are you finishing up
8 your re-direct -- I mean, your direct?

9 **MR. STREISEL:** It's going to be a few more minutes.
10 It shouldn't be too long.

11 **MS. GEER:** Probably, ten.

12 **MR. STREISEL:** Yeah.

13 **MS. GEER:** Ten more minutes.

14 **THE COURT:** All right.

15 **MS. GEER:** So, we can either take a two break --
16 two-minute or ten-minute and come back and
17 finish.

18 **THE COURT:** I would like to do two-minute, finish,
19 and then ---

20 **MS. GEER:** Yeah.

21 **MR. STREISEL:** All right.

22 **THE COURT:** --- decided what we do after that.

23 **(Off the record 5:32 p.m. to 5:34 p.m.)**

24 **THE COURT:** Proceed.

25 **Q:** David, do you -- were you here the other day



1 when Dr. DeRamus was testifying?

2 A: I was.

3 Q: Okay. And so, I was going to ask you a few
4 questions about, you know, some of his
5 testimony the other day. And just, big
6 picture, what, what is -- what's your response
7 to the argument that retail is driving value in
8 this organization?

9 A: In this organization, I disagree. I think
10 what's happening, is that value is being
11 created by the parent and Texas through their
12 non-routine functions performed, and that is
13 driving demand, which feeds its way back into
14 the restail -- retail stores as sales, which
15 then funnels down. So, I think the causality
16 is wrong. So, my interpretation of all that
17 is, retail picks up all the revenue but it's
18 not caused by retail creating all the value.

19 Q: And so, what, what is it caused by?

20 A: Well, it's, it's all the things that I pointed
21 to earlier, which are those non-routine
22 functions. For example, the procurement, the
23 product development, the activities of the
24 parent, combining all of that, that what's
25 driving the value.



1 Q: Okay. And ---

2 **THE COURT:** So, what you're saying is what's driving
3 the value is wh- -- is the products they
4 create?

5 A: That's, in part, what I'm saying, is that ---

6 **THE COURT:** Well then, I don't -- what's the other
7 part?

8 A: The other part is gonna be the way in which
9 they make those products available through
10 their retail stores. So ---

11 **THE COURT:** That's ---

12 A: --- the placement of those products at the
13 store level, the selection of the products,
14 the, the decision on what products to even put
15 in the stores. I mean, those, those are all
16 things that are helping drive the value and
17 helping create demand. So, demand is -- isn't
18 created independent of the Company. And I'm
19 saying that, the functions that are performed
20 are directly responsible for that demand.

21 **THE COURT:** All right. So, it sounds to me like
22 you're saying, it's the product they create and
23 the way that they merchandise them in the
24 stores. Would that be ---

25 A: That's one way of saying it.



1 **THE COURT:** All right. Now, would that not be true
2 about almost any retailer?

3 A: I think that's true of a lot of retailers. But
4 in this case, they've been able to
5 significantly grow demand -- or significantly
6 increase sales well beyond what other retailers
7 could even hope to get, just because they're
8 successful at doing it very well.

9 **THE COURT:** All right.

10 Q: And just to clarify. When you were talking
11 about retailers, are you talking about just the
12 retailer stores or are you talking about
13 everything that the Tractor Supply organization
14 is doing?

15 A: I ---

16 Q: Is, is ---

17 A: I'm talking about -- when I say retail, I'm
18 talking about the retail stores, not everything
19 that the Company is doing, just the retail
20 stores. Even though they are in the business
21 of speciality retail, I'm specifically singling
22 out the retail stores as -- when you asked the
23 question about retail, I'm talking about retail
24 stores being the source of value and I'm
25 saying, I disagree, and the source of value is



1 coming from the product selection, product
2 development, procurement side, merchandising,
3 all the stuff I talked about before, that's the
4 source of value and it works it way back
5 through the retail stores.

6 Q: Okay. And, and tell us your thoughts on the
7 role of passive association benefits as it
8 applies in this matter.

9 A: Passive association benefits. Things like
10 economies of scale and other concepts that
11 appear to be external concepts, but are being
12 experienced here. My general understanding is
13 that, those are, again, driven causality-wise,
14 they're driven by actions the company takes.
15 So, that means that the source of that is
16 ultimately coming from within, not from the
17 outside or the, or the retail store network.
18 It's the performance of the product selection,
19 the product development, procurement, the
20 merchandising and all the things that I've
21 talked about earlier.

22 Q: Okay. And do you know what I'm talking about
23 when I reference the 2001 restructuring in this
24 matter, where Tractor Supply underwent a
25 restructuring that involved the formations of



1 Michigan and Tractor Supply of Texas?

2 A: I do.

3 Q: Okay. And how come no part of your analysis
4 discusses the 2001 restructuring?

5 A: It's not relevant to my analysis.

6 Q: Okay. Why is that?

7 A: It's just too far -- long ago. It's, you know,
8 it's -- it -- well, first of all, it's 20 --
9 over 20 years ago from today, and during the
10 audit years, it's 13 years plus. I think, over
11 that time period, there was so much change in
12 the procurement function, in the product
13 development functions, in the merchandising
14 functions, that they may have started out with
15 a skeleton, but they put a lot of meat on the
16 bones over the years. So, that became a very
17 highly evolved activity of the company. So, I
18 don't view the 2001 restructuring as being
19 really relevant for my purposes of analyzing
20 whether in 2014, '15, and '16, they earned
21 enough income that's consistent with the arm's
22 length standard.

23 Q: And what are your thoughts on the usefulness of
24 earnings calls and analyst reports when doing
25 a transfer pricing analysis with intercompany



1 transactions?

2 A: In general, not going to be useful. However,
3 there are some types of reports that -- and,
4 and projects that I get involved in, where I'm
5 valuing the company in totality. I'm
6 estimating the enterprise value of the
7 business. Now, that is where I find those
8 useful, typically, because those reports and
9 those summaries are focused on Wall Street,
10 public investor perceptions of the company and
11 how successful it is. And, also, in the cash
12 flow that the company can generate to support
13 its valuation and stock price. But that is far
14 removed from transfer pricing. So, in general,
15 we wouldn't -- in my practice and many other
16 experts like me would say, we don't look at
17 analyst reports, we don't look at summaries of
18 earnings calls because they have little to do
19 with transfer pricing.

20 Q: And so, how does that type of evidence compare
21 to, you know, the SKU data you were talking
22 about earlier, in terms of understanding the
23 functions of the company?

24 A: Well, I think it's, like I just said, it's
25 fairly obvious to me that, I wouldn't go out to



1 summaries of earnings cause or summaries of
2 analysis reports to understand a company, I
3 would go within the company. I would talk to
4 the individuals in the company. I would try to
5 understand their roles in the company, how
6 significant those roles are. What the company
7 itself says to me is much more important than
8 what an analyst on the outside of the company
9 says.

10 And part of this is because I know that
11 business, I've done a lot of valuation work and
12 I've worked with a lot of analysts, and in
13 general, you get a certain approach toward the
14 business that is focused on earnings per share,
15 focused on stock price, focused on value in
16 totality, but not necessarily the intra-value,
17 or the, the value that's being created by
18 individual entities within the group. So, that
19 answers your question, I hope.

20 Q: Okay. And so, what, what are your -- you know,
21 tell us your thoughts on the way Dr. DeRamus
22 was discussing the need to, the need to look at
23 realistic alternatives of the Tractor Supply
24 Company.

25 A: I think realistic alternatives -- or, I should



1 say, realistic available alternatives, which is
2 typically how I refer to it, it's important and
3 it is, it is a relevant concept. It's -- it
4 really is the arm's length standard viewed in
5 a different way. The idea that, if I engaged
6 in a transaction with another company, that I'm
7 going to evaluate my alternatives to that
8 transaction. I'm not just going to go in and
9 agree to something, unless I kind of know what
10 my alternatives are. It -- the concept of
11 opportunity costs is related. However, I would
12 say that, what was missing from all the
13 discussion, was that Tractor Supply of Texas,
14 equally, could go through an analysis of its
15 realistic available alternatives. And, in
16 fact, that arguably is more important in this
17 case because, if Tractor Supply of Texas were
18 to decide to work with another company, they
19 could take all that specialized knowledge, all
20 that specialized skill set, all those
21 specialized people and put them to work in
22 another setting, it'll generate a lot of a
23 value for the other setting. So, it goes both
24 ways. Realistic alternative is important, but
25 you have to look at it from both sides.



1 Q: And so, what are your thoughts on the point
2 that Tractor Supply and Texas are independent
3 of one another? How does that play a role in
4 your analysis?

5 A: Can you repeat the question?

6 Q: Yeah. What are your thoughts with respect to
7 the point that Tractor Supply Company and
8 Tractor Supply Company of Texas are inter- --
9 are interdependent?

10 A: Okay. That's what I thought you said.
11 Interdependent is something that is very common
12 with all companies I work with. I can't think
13 of a single company example of a client I've
14 worked with in the last 25 years where there
15 was not an independency. The question is, how
16 do you interpret it, and how relevant is it for
17 transfer pricing. And I would go further to
18 say that, I have clients that are involved in
19 retail operations that are very sophisticated
20 here in the year 2023, where they actually use
21 outsourced supply chain companies. They are
22 not all part of the group, some of them are
23 outside the group, but they have effectively
24 become interdependent with those outsource
25 supply chain solutions, to the point where it's



1 indistinguishable from some of their own
2 affiliates. So, the concept is, it's, it's
3 ubiquitous here in 2023 and it probably was
4 back in the audit years, but I don't think it's
5 anything special about what Tractor Supply has
6 versus what I've seen elsewhere.

7 Q: And then, I'll just -- just what are, what are
8 your thoughts about the relevance of the lean
9 -- of Li -- of Li Fung [sic] and how that, you
10 know, can be comparable to what Tractor Supply
11 in Texas does?

12 A: Li Fung [sic] is -- we're going way back, you
13 know, 25 years when that was a common Company
14 that everybody knew in this business, that I --
15 and to apply as a procurement comparable in
16 Asia. In general, we have a problem -- or a
17 tradeoff that we have to grapple with. When
18 you're looking for procurement and you're
19 trying to single it out as a service that needs
20 to be priced as a service, we've got to look
21 at, what are the available evidence that we
22 could apply here? One is, you can look at
23 procurement companies that are very, very
24 separated from, from other activities. So,
25 they just procurement only or -- you know,



1 that's their focus. Do you see any of those in
2 the United States? No. Do you see any of
3 those in Europe? Not really. But there are
4 some in Asia, and Li Fung [sic] is probably the
5 most celebrated one of that.

6 On the other hand, you could approach
7 procurement by looking at a distributor and
8 trying to figure out how much of the
9 distribution functions involve procurement, or
10 is there, is there enough procurement being
11 performed to say that this company is
12 potentially a comparable for procurement. And
13 that's a trade-off that a transfer pricing
14 expert will have to make. And so, my general
15 feeling is that Li Fung [sic] could work,
16 especially, if you have a company that has
17 procurement operations in Asia and they're part
18 of a group where those Asian procurement
19 operation are performing services that the
20 members of the group are benefitting from, then
21 I think it could be appropriate. Certainly,
22 not in the case of a U.S. procurement
23 operation. And I would go further to say that,
24 Li Fung [sic] is not even close to being
25 comparable to what TSC of Texas does in the way



1 of procurement, they're very far apart.

2 (*Whispering.*)

3 **MR. STREISEL:** I think that's all I've got.

4 **THE COURT:** All right. I'm thinking about breaking
5 for the -- today. I don't know how long your
6 cross is gonna go.

7 **MS. WOOTEN:** Your Honor, I would prefer that. I
8 think I could probably organize and get through
9 it quickly if we break for tonight and start
10 back tomorrow.

11 **THE COURT:** Okay.

12 **MS. WOOTEN:** To -- if we do go tonight, I don't know
13 how long it'll be.

14 **QUESTIONS BY THE COURT:**

15 **THE COURT:** All right. Before we break, when you
16 tell me about the complexity of, of Tractor
17 Supply's procurement operations, that's based
18 on your analysis -- your interview of two
19 people?

20 A: Not solely, no. It's based on ---

21 **THE COURT:** Okay.

22 A: --- a number of things.

23 **THE COURT:** Or what are -- what's it based on? That
24 -- I ...

25 A: It's based on my review of the annual SEC



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1 filing, 10-K, and understanding what they ---

2 **THE COURT:** Okay.

3 A: --- what they made available to the public.
4 It's based on my interviews with more than two
5 people, probably, three.

6 **THE COURT:** Okay.

7 A: It's based on my analysis of the data that I
8 was given, all the SKU data and the transaction
9 level data, and understanding the -- how the,
10 the products that they currently select in all
11 the stores are featured in the stores, and over
12 time, the new brands that I have come into
13 existence, and that whole effort of filling out
14 the product line. It's, it's really all that
15 combined that allows me to conclude that this
16 is something that I haven't seen performed as
17 well as it is here. And I have a lot of other
18 clients that are involved in sophisticated
19 retail operations. So, it's -- it -- it's
20 something that it took a number of different
21 sources for me to understand.

22 **THE COURT:** All right. All right. What time do we
23 want to start tomorrow?

24 **MS. GEER:** (To Ms. Wooten) How, how lo- -- I don't
25 know how long y'all's rebuttal is. I mean,



1 you're the one that has folks left to go.

2 **MS. WOOTEN:** Your Honor, if we could start earlier,
3 that would be our preference.

4 **THE COURT:** 9:00?

5 **MS. GEER:** Can we do 9:30?

6 **MS. WOOTEN:** We would prefer -- we've got our whole
7 rebuttal case and his cross, and redirect. So,
8 I mean, we would prefer 9:00. But if we do
9 9:30, I would ---

10 **MS. GEER:** 9:15.

11 *(Laughter.)*

12 **MS. WOOTEN:** What is this? I'm just kidding.
13 That's fine, Your Honor. If we're -- if that's
14 what the Court wants to do.

15 **MS. GEER:** Dr. Andrade is coming in from the west
16 coast and I'm sure he would appreciate the --
17 I don't know -- yesterday, he was still feeling
18 jet lag, so I think all of us would appreciate
19 as much time as possible.

20 **THE COURT:** I would like to start earl- -- even
21 earlier, but I -- I'll go with 9:12.

22 *(Laughter.)*

23 **MS. WOOTEN:** That's fine.

24 **MS. GEER:** That's ---

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



1 **THE COURT:** Thank y'all.

2 **(DAY FOUR of the hearing adjourned at 5:50 p.m.)**

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DAY FIVE - FRIDAY, JANUARY 27, 2023

THE COURT: All right. We've got -- you, take the stand again. You're still under oath. Andrade?

MR. ANDRADE: Andrade. That's right.

THE COURT: Say that again.

MR. ANDRADE: Andrade.

THE COURT: Andrade. And you apparently have questions, or not.

MS. WOOTEN: I do have some questions, Your Honor.

THE COURT: Okay.

MS. WOOTEN: Thank you. Your Honor, may I take care of a housekeeping matter before we do the cross?

THE COURT: Yep. Oh, Lord.

ADMINISTRATIVE MATTERS:

MS. WOOTEN: There have been some discussions this past week over Respondent's Exhibit 33. It was the Exhibit from Dr. DeRamus' testimony. We have cleaned up the Demonstrative, so now that it has the correct slides in it, and the one slide that was not admitted we have taken out, so if I may present this to the court reporter and Ms. Buckner?

(Respondent's Exhibit Number 33 was referenced at



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1 this time.)

2 **THE COURT:** Okay.

3 **MS. WOOTEN:** Thank you. Oh, I'm sorry. Thank you.

4 **DR. ANDRADE - CROSS-EXAMINATION BY MS. WOOTEN:**

5 Q: Good morning, Dr. Andrade.

6 A: Good morning.

7 Q: Did you adjust the east coast time, yet?

8 A: I have.

9 Q: Good.

10 **MS. WOOTEN:** Also, for the record, Your Honor, we
11 had a chance to review what was offered
12 yesterday as Petitioner's 1. We ---

13 **THE COURT:** I figured that was coming.

14 **MS. WOOTEN:** We were able to source the information
15 based on the information we had. The
16 Department would just like to put some of that
17 in context. So, we don't have an objection, as
18 long as we can put some of the background of
19 this particular document in context.

20 **THE COURT:** Well, what does that mean?

21 **MS. WOOTEN:** We, we don't object to it coming in.

22 **THE COURT:** Okay.

23 **MS. WOOTEN:** I would just like to ask some questions
24 of the witness about it, if I could.

25 **THE COURT:** Oh, okay. Well, that's fine. It's



1 admitted.

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

3 (Petitioner's Exhibit Number 1 was admitted into
4 evidence.)

5 **MS. GEER:** I mean, of course, I'll have to hear the
6 exact question to know ---

7 **MS. WOOTEN:** Of course.

8 **MS. GEER:** --- whether or not I object to it or not,
9 but.

10 **MS. WOOTEN:** Of course. Of course.

11 **MS. GEER:** But yeah, that's fine.

12 **MS. WOOTEN:** I just wanted to make that clear for
13 the record. We had discussed this with couns-
14 -- counsel last night.

15 Q: Okay. Do you have a copy of the Petitioner's
16 Exhibit 1 up there? We can put it on the
17 screen if you need to ---

18 A: I don't have one with me, no.

19 **MR. STREISEL:** I've got it on ---

20 **MS. WOOTEN:** Okay.

21 **MR. STREISEL:** Which -- probably, the one from
22 yesterday?

23 **MS. WOOTEN:** Just either of them, or both of them.

24 Okay. They're together, right, as one exhibit?

25 **MR. STREISEL:** Yeah. Yeah. Yeah.



1 **MS. GEER:** It's just two different ---

2 **MS. WOOTEN:** All right.

3 **MS. GEER:** --- stapled pages.

4 **MS. WOOTEN:** May I approach, Your Honor?

5 **THE COURT:** Uh-huh.

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

7 A: Okay. Thank you.

8 Q: Thank you.

9 Dr. Andrade, the calculations provided in
10 that spreadsheet are hardcoded numbers,
11 correct?

12 A: Yes.

13 Q: And the formulas are not a part of that
14 spreadsheet, correct?

15 A: That's what I understand. Yes.

16 Q: Okay. And there's no links to other
17 spreadsheets, so there's been no other evidence
18 offered with those spreadsheets that would
19 allow the Court to trace through the series of
20 calculations that you did in order to reach the
21 numbers on Petitioner's Exhibit 1, correct?

22 A: For this file, that's correct, but there is
23 other, other items that are were provided
24 previously that should have those calculations.

25 Q: Okay. So, let's talk about that for a second.



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1 Your deposition was originally scheduled, I
2 believe in October, correct?

3 A: Yes.

4 Q: And that deposition had to be rescheduled
5 because we did not pro- -- or the Department
6 did not receive your file in time in advance of
7 that deposition, correct?

8 A: I think that's right, yes.

9 Q: Okay. So, we rescheduled it for November,
10 correct?

11 A: Yes.

12 Q: And the Department received your file,
13 approximately, 24 hours before your deposition,
14 correct?

15 A: I'm not exactly sure how -- when you received
16 it.

17 Q: Okay.

18 A: I wouldn't know.

19 Q: Okay. And as part of your file, there are
20 computer codes, or files, that only your firm
21 or you can read, correct?

22 A: I wouldn't describe it as that. I would say
23 that it could be read by anybody.

24 Q: Okay. Did you pro- -- does -- what software
25 are you referring to when you say it could be



1 read by anybody?

2 A: If it's an Excel file, the formulas can be read
3 by anybody.

4 Q: Okay. Not talking about the Excel file --
5 files. There were other files that you
6 provided that had a extension, I believe it
7 started with the letter I, and there were five
8 letters generally attached to those files. Do
9 you recall the files that I'm referring to?

10 A: I don't recall what you're describing, but I do
11 know there were some files with extension JL.

12 Q: Okay.

13 A: Is that what you're referring to?

14 Q: I believe so. There were some others, but I
15 think that's in the same category of the files
16 that I'm talking about.

17 A: Okay.

18 Q: You would agree that you have to have special
19 software to view those files, correct?

20 A: No. You can read those files in a text editor
21 that's on any Mac or PC ---

22 Q: Okay.

23 A: --- computer.

24 Q: What does those files look like if you don't
25 have the specific software that you have to



1 loo- -- to view ---

2 A: Just ---

3 Q: --- those files?

4 A: Ascii text.

5 Q: It just looks like gibberish, correct?

6 A: No. There's, there's words and instructions in
7 there. It's Ascii text. So, there's going to
8 be symbols, words and instructions, and
9 numbers.

10 Q: Okay. If you're not a transfer pricing expert,
11 are you going to understand those symbols,
12 formulas and text?

13 A: Transfer pricing is really not what you need to
14 have to understand that. It would be someone
15 who would be proficient in, maybe, programming
16 or data science or data information systems.

17 Q: Okay. And if you are not proficient in those
18 or an expert in those, in data programming,
19 computer science, etcetera, would you be able
20 to read and understand those files?

21 A: You could understand some of it, but not all of
22 it.

23 Q: And those files were used as the formula or
24 calculations that are the result of those
25 calculations in Petitioner's Exhibit 1,



1 correct?

2 A: Yes and no. Yes, from the standpoint that the
3 first version of all these calculations was
4 done in code. And, no, in the standpoint that
5 subsequent to that, all of this done using
6 Excel spreadsheets.

7 Q: Okay.

8 A: So, there's two versions of it.

9 Q: Okay. Again -- but going back to the Excel
10 spreadsheet, those were all hardcoded, correct?
11 You couldn't -- we couldn't -- the Department
12 wasn't able to tran- -- or trace back the
13 calculations from those Excel spreadsheets.

14 A: My understanding is that some of the files that
15 were sent over included the Excel formulas and
16 Excel workbook that had all the tabs. So, I
17 think that was sent over.

18 Q: But not for every Excel spreadsheet?

19 A: No. Some Excel spreadsheets were presented
20 without links because it was very confusing to
21 follow all those links and formulas for someone
22 who wasn't familiar with it. And some were
23 sent over with the links that had everything
24 that we were working on.

25 Q: Okay. Thank you.



1 When you refer to the results of TSC Texas
2 in those spreadsheets, are those just for TSCT
3 including its retail operations or just its
4 procurement function as it relates to Tractor
5 Supply Company?

6 A: It should be labeled, which I'm referring to.
7 But in some cases it's the former, in some
8 cases it's the latter.

9 Q: Okay. Let's go through your, your Exhibit, and
10 can you tell me what you just said? Can you
11 describe which it pertains to TSC and which
12 ones it does not?

13 A: Can you put ion the screen, please? I want to
14 see what you're referring to, which one.

15 **MS. GEER:** Did you want ---

16 Q: I, I can put it on the Elmo, if you ---

17 **MR. STREISEL:** I, I can pull it up right now if you
18 want me to.

19 **MS. WOOTEN:** That would be my preference, so I can
20 add it to do questions. Thank you.

21 **MR. STREISEL:** Yeah.

22 **MS. WOOTEN:** I appreciate that.

23 **MR. STREISEL:** Do you want that first tab or was
24 that the second?

25 Q: Which, which spreadsheet do you need to have



1 that information, Dr. Andrade?

2 A: Can you put this one up first?

3 Q: Thank you.

4 **MS. GEER:** Are we on the right one, David?

5 **DR. ANDRADE:** Yes. That -- that's the one on the
6 left, right?

7 **MR. STREISEL:** Yes.

8 **DR. ANDRADE:** Just to make sure.

9 **DR. ANDRADE:** Okay.

10 A: I can see that. So, you want me to -- can you
11 explain your question?

12 Q: Sure. I'll ask the question again. When you
13 refer to the results of TSC Texas in these
14 spreadsheets, are these just for TSCT,
15 including the retail operations, or is just the
16 procurement functions as it relates to TSC?

17 A: It depends. This particular worksheet in this
18 workbook is providing gross profit margin
19 ratios that would apply to -- as it's clear
20 labeled on line seven, retail distribution.
21 So, it would apply to the retail distribution
22 segment of Tractor Supply of Texas, as well as
23 the retail distributor segment of the parent.
24 Does that answer your question?

25 Q: What about with regards to the procurement



1 function?

2 A: Everything that's on this particular worksheet,
3 if there's a reference to Texas, it's either
4 going to be referencing the retail distribution
5 segment, only, or it's going to reference a --
6 the entity in totality or the consolidated TSC
7 of Texas. And in that case, I wouldn't be
8 distinguishing between procurement and retail
9 distribution, I would combine it altogether and
10 that would be applying to the entire entity.
11 I have made it clear so you can see when I'm
12 applying it to just the retail distribution and
13 when I'm applying it to the entire entity.

14 Q: So, just to make sure I understand. There is
15 nothing on your spreadsheets as it relates
16 solely to the procurement function?

17 A: There is. On line 10, it, it specifically
18 says, intercompany procurement markup rate.
19 So, that would be the transfer pricing policy
20 that applies to TSC of Texas inventory
21 purchasing sales.

22 **THE COURT:** What do you mean by -- I'll tell you,
23 sir, when you say -- you used the phrase clear
24 on all this, I would -- I'm trying to figure it
25 out myself, and clear would not be what word I



1 would use regarding what's been presented. But
2 when you say the trans- -- transfer pricing
3 policy, what's that?

4 A: Sorry, sorry. Let me provide the context.

5 So, in this spreadsheet, there is -- there
6 are numbers that are provided that are
7 comparable evidence for retail distribution and
8 they're labeled as such. For example, line
9 seven and line eight. And on line 10, there's
10 a number that was -- is mentioned there that is
11 the markup on the inventory that we're calling
12 the intercompany procurement markup rate and
13 that ---

14 **THE COURT:** I see.

15 A: --- would be part of the transfer pricing
16 policy. So, that assumes that, that the
17 company had that markup rate in advance and it
18 was able to apply that markup rate on the
19 inventory purchased by Texas and sold to the
20 parent. So, that's what I mean by the transfer
21 pricing policy. So that number, 9.7 percent,
22 is the number that's -- that was used by the
23 company during ---

24 **THE COURT:** I recognize that.

25 A: Yeah.



1 **THE COURT:** I just don't -- I'm trying to figure out
2 how it's in here.

3 A: It's just trying to set the context for how the
4 company had applied that particular inventory
5 purchase and what they used. And they used the
6 9.7 percent rate.

7 **THE COURT:** Okay.

8 Q: Back to your -- in that same vein, you're
9 assuming that the 9.7 is correct?

10 A: Correct in what way? Can you be more specific?

11 Q: Well, you're applying in your analysis and I
12 don't see any other info- -- and, I guess,
13 that's what I was trying to understand, is the
14 procurement side of it. And I don't see that
15 on here. So that's what I'm trying to
16 understand. Are you applying that policy
17 because you assume it's correct and that's the
18 end of the analysis?

19 A: No. The 9.7 percent was applied by the, by the
20 company itself in its trial balances. The
21 numbers that -- when you draw from the trial
22 balance and you look at how they were
23 calculated, they use a 9.7 percent markup rate
24 on the inventory. So, that was in there data.

25 Q: Okay. And where did they get that from? That



1 9.7 ---

2 A: The 9.7 percent?

3 Q: Yes. Where did they get the 9.7 markup?

4 A: Our understanding is that it was from PwC's
5 advise. So, they applied the 9.7 percent as a
6 policy that they applied for those tax years in
7 the open -- 2014 through 2016.

8 Q: All right. Are you calculating a routine
9 return on TSCT's own retail operations?

10 A: Yes.

11 Q: Where is that?

12 A: The routine return for the TSC retail
13 distribution is on line seven and line eight.
14 That's the interquartile range, the lower and
15 the upper, for -- that's applicable to the TSC
16 Texas retail industries. It's all applicable
17 to the parent. So, it's, it's applicable in
18 general to retail and distribution.

19 Q: And are you allocating a portion of TSCT,
20 Texas, premium profits from its retail
21 operations to TSC, given that you have split
22 the profit between TSCT and TSC?

23 A: You're going to have to repeat that again.

24 Q: Sure.

25 A: I didn't follow you.



1 Q: Are you allocating a portion of Texas premium
2 profits from its retail operations to Tractor
3 Supply Company, given that you have split the
4 profit between TSCT and TSC?

5 A: I wouldn't describe it as that.

6 Q: How would you describe it?

7 A: You're al- -- what we're doing here is we're
8 allocating the routine profit for the routine
9 distribution and retail operations. That's
10 done first. Then, whatever is remaining, we
11 allocate right down the middle, 50/50 between
12 TSC Texas and TSC parent. That's the, that's
13 the residual or the premium profit we're
14 calling it. So, the retail distribution
15 operations are always getting a routine return,
16 they're not getting a premium profit. Did that
17 answer your question?

18 Q: What about from the perspective of Michigan?
19 So, we look at -- you just talked about Texas.
20 Now, from the perspective of Michigan.

21 A: Michigan is simple. It doesn't have any
22 premium prof- -- it doesn't have any residual.
23 It performs only routine distribution and
24 retail operations, so it's not assigned any
25 premium or residual profit.



1 Q: So, you're not allocating a portion of TSCM's
2 premium profit to TSC?

3 A: No, that's not true. The TSC premium profit
4 for the group is allocated 50/50 between the
5 parent and TSC of Texas. So, that's, that's
6 important to understand. There's only two
7 entities involved in that allocation. On the
8 retail distribution side, all three entities
9 are involved in that activity. So, they will
10 be getting a routine return for retail and
11 distribution.

12 Q: What comparables are you using to benchmark
13 TSC's, so called, routine functions?

14 A: There are two approaches that I took. The
15 first approach was using five different product
16 groupings, farm, feed, pet, miscellaneous and
17 tools and garden, those are the five
18 categories. And those categories had their own
19 comparable companies. So, each one had the --
20 had their own. And in getting those
21 comparables, I was able to line them up so that
22 there was a, a match or a similarity. And
23 those comparables would've have given you one
24 answer. That was my first approach at doing
25 this, using those five different groupings.



1 Then I subsequently went back and decided to
2 try an alternative way of selecting
3 comparables. I did two approaches. One was --
4 -

5 **THE COURT:** She, she wasn't asking you about how you
6 selected them. The comparables are not even in
7 here anywhere, she was asking you ---

8 **MS. WOOTEN:** What they ---

9 **THE COURT:** --- what they are. They're -- I mean,
10 we ---

11 A: Oh, what, what the specific companies are?

12 Q: Yeah. What indus- -- are they retailers, dis-
13 -- distributors, both?

14 A: No. The ones that are reflected in this
15 particular workbook are going to be farm retail
16 comparables. And that's shown in the second
17 tab where it says, using farm comps. So,
18 that's where the comparables are coming from,
19 farm ---

20 Q: But you don't provide the detail of which farm
21 comps you're us- ---

22 A: Not in this workbook. They're provided in
23 other documents and other files that we sent,
24 but ---

25 Q: So, no ---



1 A: --- not in this one.

2 Q: So, no distributors, correct?

3 A: Not in this one, no.

4 Q: Okay. And you're applying these to TSC not
5 TSCT, correct?

6 A: It's being applied to both because the farm
7 dis- -- the farm comparables are applicable --
8 the farm retail comparables are applicable to
9 both TSC parent and TSC of Texas because they
10 both have retail and distribution operations,
11 so we have to apply them to both.

12 Q: Going back to the distributors. You don't
13 consider TSCT to be appropriately benchmarked
14 against a set of wholesale distributors using
15 a CPM method like PwC did, correct?

16 A: No, that -- that's not the way I would do it.
17 No.

18 Q: Do you agree with that statement? When you --
19 I just want to make sure I'm ---

20 A: Can you repeat that statement one more time?

21 Q: Sure. You don't consider Texas to be
22 appropriately benchmarked against a set of
23 wholesale distributors using the CPM method
24 like PwC did, correct?

25 A: No.



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ROA_001660

1 Q: No, what? No, you don't agree with the
2 statement, or you ---

3 A: I just said, no, I don't. Can you repeat it
4 one more time?

5 Q: Do you consider TSCT to be appropriately
6 benchmarked against a set of wholesale
7 distributors using a CPM method like P- -- PwC
8 did?

9 A: The answers is no.

10 Q: So, you disagree with the approach PwC did in
11 this case?

12 A: Can I explain?

13 Q: Sure.

14 A: Okay. The answer is no because TSC of Texas
15 includes retail, distribution, some mixing
16 centers and the procurement and product
17 development, all combined. So, it wouldn't be
18 appropriate to just benchmark them with just
19 distribution companies. Does that help explain
20 it for you?

21 Q: If that's your answer. Is that ---

22 A: Yeah.

23 Q: --- that ---

24 A: I mean, that -- that's why.

25 Q: Okay. Okay. Do you consider Tractor Supply's



1 patents to be valuable and tangible assets in
2 your analysis?

3 A: I don't think they're significantly valuable in
4 this context. No. I, I think that they're
5 part of the overall package of non-routine
6 contributions that I've already referenced,
7 that the parent makes, but they're not
8 significant in value, no.

9 Q: Okay. How much operating profit are you saying
10 Texas should earn for the procurement function
11 it performs for TSC versus the amount of profit
12 TSCT should earn for its own retail functions?

13 A: Repeat that one more time.

14 Q: Sure. How much operating profit are you saying
15 should Texas earn for the procurement function
16 it performs for TSC, the parent company, versus
17 the amount of profit Texas should earn for its
18 own retail operations?

19 A: I'm going to have to ask you to -- when you say
20 profit, on the second part, are you meaning
21 operating profit or gross profit? You just
22 said operating profit on one part, but not the
23 other. Can you explain?

24 Q: For consistency, we'll use operating profit for
25 both.



1 A: For both? Okay.

2 Q: And then, we'll follow up with that.

3 A: So, in general, the operating profit for Texas
4 is only going to be calculated at the end, as
5 a residual for the procurement side. For the
6 distribution and retail side, that would be
7 part of the routine return part, so that's
8 going to be given to them up front. And then,
9 remaining would be coming later as part of the
10 residual or premium profit ---

11 Q: Okay.

12 A: --- application.

13 Q: I appreciate your explanation, but I'm asking
14 if you can direct me -- I asked, how much? So
15 can you direct me to how much that would be on
16 your spreadsheet?

17 A: Okay. Let's, let's be more specific. Start
18 with, what do you want me to look for -- if you
19 can describe it one more time?

20 Q: How much operating profit are you saying TSCT
21 should earn for the procurement function it
22 performs for TSC? So, let's start with that.

23 A: I don't -- that calculation is not here. That
24 calculation is part of the premium profit. So,
25 the procurement side is gonna earn from the



1 premium profit. The retail distribution side
2 is gonna earn from the routine profit. So, I'm
3 not able to tell you operating profit-wise what
4 TSC of Texas would have to earn on the
5 procurement. I would rather describe that in
6 terms of the premium profit because that's more
7 appropriate.

8 On the distribution and retail side, that
9 is -- that you can look at in a num- -- couple
10 of different ways. You could look at the
11 retail distribution gross profit ratios, which
12 are lines seven and eight to guide you in terms
13 of the amount that should be earned on retail
14 distribution. You can also look at --
15 presuming that -- I don't know if the data is
16 here, but you could also look at the operating
17 profit margins or the operating margins as we
18 call them for retail distribution as well. So,
19 you can look at either the gross profit ratios
20 or the operating profit ratios from the
21 comparables to determine whether -- or what the
22 amount should be for retail distribution at
23 both the gross and the operating profit level.

24 **THE COURT:** So, there is no number on here?

25 **A:** There -- well, in -- what she's asking for, for



1 procurement, no, there's no specific number
2 that's on this particular workbook. There is
3 ano- ---

4 **THE COURT:** I think that's what she was asking for.

5 **MS. WOOTEN:** Yes.

6 A: Yeah. It's not in this particular workbook,
7 no.

8 **THE COURT:** Okay.

9 Q: Thank you.

10 **MS. WOOTEN:** (Whispering.) Ms. Buckner, do you mind
11 switching over, please?

12 **MS. BUCKNER:** Sure.

13 Q: Dr. DeRamus provided testimony this week, have
14 you -- were you in the courtroom to listen to
15 Dr. DeRamus' testimony?

16 A: Yes, I was.

17 Q: Okay. What I have displayed is slide 33 from
18 Respondent's Exhibit 33. Do you agree with Dr.
19 DeRamus calculation of the amount of actual
20 profits that Texas earned as it pertains to its
21 retail and procurement functions, respectively?

22 **(Respondent's Exhibit Number 33 was referenced at**
23 **this time.)**

24 A: Is this diagram showing the combined operating
25 profits for all activities including retail,



1 distribution, mixing centers and procurement
2 and product development, everything?

3 Q: Were you here for Dr. DeRamus' testimony?

4 A: I was. But I want to confirm that that's true.

5 Q: If you could read the top of the slide would
6 that help you in formulating your answer?

7 A: (Complies.) (Whispering.) I'm not clear in
8 what this is measuring. I have not verified
9 any of his calculations. I only saw these
10 diagrams. I was not able to go in and double
11 check that these were done correctly. So, I
12 can't answer that.

13 **MS. WOOTEN:** Can you go to slide 28?

14 Q: Do you agree with Dr. DeRamus' calcula- -- oh,
15 I'm sorry. We're not on the same exhibit, but
16 we're looking at slide 28. Do you agree with
17 Dr. DeRamus' calculation of the amount of TSC
18 Texas' actual cost for performing its
19 procurement function? And so, for this
20 particular slide, it was 12.9 -- approximately,
21 12.9 million in 2015.

22 A: I can't agree to any calculation I haven't
23 verified independently. I'm looking at
24 something here that looks like a trial balance.
25 I see yellow highlighted sections. Are we



1 saying that that totals to, what did you say,
2 12. -- 12.9 million or something?

3 Q: It should be approximately 12.9 million.

4 A: And this is what year?

5 Q: 2015.

6 A: Is that referenced in here?

7 Q: It is. It's on the source line from Joint
8 Exhibit -- and I don't have my glasses on, but
9 it's on the source line. It's the procurement
10 trial balance from 2015. So, Joint Exhibit 52
11 at TSC-6607.

12 **(Joint Exhibit Number 52 was introduced into the**
13 **record at this time.)**

14 A: Okay. So, can you ask the question again?

15 Q: Do you agree with Dr. DeRamus' calculation of
16 the amount of TSC Texas' actual costs for
17 performing its procurement function, as
18 referenced on slide 28 of Respondent's Exhibit
19 33?

20 A: Show me where in here there's a calculation?
21 I only see numbers.

22 Q: I'm, I'm asking if you agree.

23 A: With the numbers that are presented or the
24 calculation? I don't see the calculation.

25 Q: Do you need a calculator, would that help?



1 A: What do you want me to, to do? Add up these
2 numbers right here in front of me? Is that
3 what we're asking because I just want to be
4 clear.

5 If you're asking me if the sum of these
6 numbers is 12.9 million, it's -- I -- I'm going
7 to have to ask someone to, to do the addition
8 right now because I don't have an ability to
9 check that.

10 Q: Okay. Did you perform any calculations
11 yourself to determine what Texas' costs for the
12 procurement function were -- or are?

13 A: I did a number of different calculations that
14 included looking at trial balance amounts that
15 may have included all these amounts and other
16 amounts, so I -- I'm going to say, yes, I did
17 some calculations. Yes.

18 Q: For the specific question I just asked?

19 A: I did it for each of the years. I did -- and,
20 and I put them in those documents that were
21 sent over to you in various forms, spreadsheets
22 and other things.

23 Q: So, in some -- and again, some of those Excel
24 spreadsheets, the Department cannot view
25 because of the software or programming code



1 provided to read them?

2 A: I don't believe that's true with Excel
3 spreadsheets. Everybody was able to open them
4 with no problem. I think what you're referring
5 to that can't be read are programming code
6 files that you can open with a text editor and
7 see the code. It's in English with symbols and
8 numbers, but a, but a non-expert or non-
9 programmer may not be able to fully understand
10 what's being done. So, I agree with that.

11 Q: Okay. Going back, just to make sure I
12 understand, you, yourself, performed a
13 calculation to determine what Texas' costs for
14 the procurement function is, correct?

15 A: I added up numbers that were in the trial
16 balances to figure out what the TSC of Texas
17 retail and distribution costs were, and
18 procurement. So, I did all. I combined them
19 together.

20 Q: Is that anywhere in Petitioner's Exhibit 1?

21 A: This? Can you -- okay. So, Exhibit 1, where,
22 where is Exhibit 1?

23 **(Petitioner's Exhibit Number 1 was referenced at this**
24 **time.)**

25 Q: You have -- it's the -- is your work- ---



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ROA_001669

1 A: This one, this one here? Yeah. No ---

2 Q: Is yours part of ---

3 A: --- it wouldn't be in there. It ---

4 Q: It's not in there?

5 A: It's not in there. No. It would be in the
6 separate files.

7 Q: Got it. Thank you. Do you agree with this
8 statement, a functional analysis with missing,
9 incomplete or inaccurate information will
10 reduce the reliability and usefulness of an
11 economic analysis?

12 A: I agree with it because I wrote it.

13 Q: (Whispering.) Okay. Earlier in your
14 testimony, you testified that you needed to
15 obtain significant additional information from
16 Tractor Supply, correct?

17 A: Significant and additional information, yes.

18 Q: Okay. And you needed to conduct interviews,
19 collect SKU level data, etcetera, correct?

20 A: Sounds, sounds correct. Yes.

21 Q: And you needed to collect more information that
22 was available to you by reading the PwC report,
23 correct?

24 A: Can you repeat that last statement?

25 Q: You needed to collect more information that was



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1 available to you by reading the PwC report,
2 correct?

3 A: That doesn't make sense. So you're saying, I
4 needed to collect more information that was
5 available to me by reading the PwC report? No.

6 Q: Other than reading the PwC report, you needed
7 to collect other -- additional information to
8 do your analysis?

9 A: Yeah, other than PwC report. Right.

10 Q: Okay.

11 A: Not the, not the PwC report, so.

12 Q: Okay. And you've testified that, in your
13 opinion, TSC's procurement function is unique,
14 correct?

15 A: Yes.

16 Q: And how many procurement functions --
17 companies' procurement functions have you
18 analyzed?

19 A: 20-ish.

20 Q: Okay.

21 A: More than that. I mean, it, it depends. If it
22 was a retail-based company that had significant
23 distribution and procurement, that was going to
24 be in the -- count of 20-ish. Maybe 20, 25.
25 But there a lot of companies that I've examined



1 that have procurement that weren't -- were not
2 selling at the retail level with retail stores.
3 So, that might've been, I don't know, 50, 100
4 companies.

5 Q: All right. And how is Tractor Supply's
6 procurement function unique?

7 A: Well, the first thing that stands out to me, is
8 that the procurement function performed is
9 combined with the purchasing -- I'm sorry --
10 not the purchasing, but product development and
11 there's also some, some sharing of
12 merchandising. So, I think the fact that the
13 procurement is being performed with all those
14 together, makes it, makes it unique from that
15 standpoint. Another way that it's unique, is
16 that they spent a lot of time researching
17 vendors, whereas in my other reviews of client
18 procurement activities, that was done much less
19 thorough or at a cursory level, you could say.
20 So, that -- that's another way it stands out.

21 There's, there's other aspects of how
22 they're approaching the activity that suggest
23 that they really have spent a lot of time
24 training their team to look for certain types
25 of vendors that, that are gonna provide



1 long-term continuity of supply chain, no
2 disruptions, because they had some experience
3 in the past with third parties, where those
4 third parties had financial problems and then,
5 all of a sudden, the product wasn't available,
6 so they had to, they had to spend a lot of time
7 in that. That's, that's a bit more unique for
8 them. I can go on and on. I mean, you tell me
9 when to stop.

10 Q: That's good. And in your view ---

11 **THE COURT:** Well, how can -- so, you're telling me
12 that other companies aren't interested in doing
13 in-depth research on the vendors and making
14 sure that their vendors will -- will
15 consistently pro- -- supply the product? I'm
16 just missing the ---

17 A: Yeah. I -- I'm not saying that other companies
18 are not interested in that. I think that the,
19 the level of vetting that's being done here is
20 more than what I see on average with my other
21 clients.

22 **THE COURT:** And that's based on what?

23 A: Based on seeing my other clients' procurement
24 operations and comparing what -- the people
25 involved, comparing the steps that they go



1 through versus what I've discovered here with
2 Tractor Supply.

3 **THE COURT:** Well, discovered here from what?

4 A: From a number of sources. Reading the, the SEC
5 filing. Talking to the individuals that I did,
6 the pricing individuals and the buyer. Looking
7 at the data that I was able to look at.

8 **THE COURT:** Like the individuals you referenced
9 yesterday?

10 A: Yes.

11 **THE COURT:** Okay.

12 A: Some of those individuals. There's ---

13 Q: I -- oh, I'm sorry.

14 A: Yeah.

15 Q: Please, finish. I did not mean to interrupt
16 you.

17 A: No, I was done. That's fine.

18 Q: Okay. And we'll talk about the interviews in
19 just a minute.

20 Is it your view that Tractor Supply's
21 procurement function was outsourced prior to
22 2001?

23 A: That's what I understand from -- hearing from
24 the companies representatives, that that was
25 the case. That distribution and, I want to



1 say, pro- -- procuring sourcing, that was
2 outsourced, or part of it was, not all of it,
3 maybe, but some of it was outsourced.

4 Q: Okay. All right. Jumping back to your
5 calculations for a second. How did you come up
6 with allocating 50 percent of the residual
7 profit to procurement function?

8 A: It was, it was a ...

9 So, at first, I thought I could go in and
10 try to figure out an estimate that would be --
11 you know, a calculation that would be higher
12 than 50 percent. I was thinking that I would
13 look at the total amount of activities and try
14 to do some sort of ranking of those activities,
15 and then weight them and try to do that
16 calculation. And the more I thought about it,
17 I said, you know, it's probably gonna come out
18 in the favor of TSC Texas. But to be
19 conservative, I'm just gonna back it down to
20 half/half. So, that's how I went about the
21 process of figuring out the 50 percent
22 allocation of the premium profit.

23 Q: So, let me make sure I understand. You just
24 guessed and based on your experience? There's
25 no test, guideline or principle, or calculation



1 that you used to come up with the 50/50 split?

2 A: I didn't guess. I went through a series of,
3 call it checking -- source checking and
4 rankings of the functions that I identified as
5 being valuable, and I weighed them. I look at
6 them from each side. And then, I thought, how
7 am I going to out and be able to get
8 confirmation on a number -- a specific number.
9 And I thought this would be more involved, so
10 why don't I just back it down to 50 percent and
11 say, it's conservative, but it works for this
12 case.

13 Q: All right. And just to clarify for the record.
14 The method that you're using is the residual
15 profit split method, correct?

16 A: Yes.

17 Q: Okay. And is that con- -- is what you've done
18 in this case consistent with how you've applied
19 that method in the past?

20 A: It is.

21 Q: Okay. And is the way of splitting the residual
22 profit identified in the §482 regulations?

23 A: There are some, there are some guidelines that
24 have been described in those §482 regulations.

25 Q: Has it been endorsed by the IRS?



1 A: If it's in the §482 regulations, then it's
2 guidance that the IRS is, essentially,
3 endorsing. Yes.

4 Q: And it has been upheld by a court?

5 A: I can't confirm that.

6 Q: I believe in your testimony, and if this is
7 incorrect I'm sure you will correct me, but you
8 concluded that Texas should get approximately
9 512 million during 2016 alone for its
10 procurement function, is that correct?

11 A: It's taken out of context, so I don't -- can
12 you provide me the statement where I -- that I
13 made ---

14 Q: If I'm taking it out of context, can you show
15 me in your exhibit where you are coming up with
16 how Texas should be paid for the procurement
17 function alone in 2016?

18 A: Okay. Well, let's just break down the
19 question. So, are you asking me about the 512
20 million, specifically, or are you talking in
21 general?

22 Q: We'll do both. Let's go with the 512 million.
23 Is that anywhere ---

24 A: For 2000 -- for 2016?

25 Q: For 2016.



1 A: Okay. So one way to answer that is, on Table
2 D5, there is a calculation for TSC of Texas
3 premium gross profit that ranges between 431.8
4 million to 709.5 million, so based on that, I
5 think 512 falls in there. So, I -- I'm going
6 to say, yes.

7 Q: Okay. What -- or when -- sorry. What is the
8 amount of expenses that are associated with
9 that function for 2016?

10 A: Okay. Now, we switch gears to talk about the
11 procurement function in 2016 that Texas
12 performs. Are we also talking about product
13 development? Can you be more specific?

14 Q: Sure. So, we talked earlier that -- for
15 example, in the procurement trial balances for
16 2015, the expenses were approximately 12.9
17 million. Do you recall that testimony?

18 A: That wasn't my testimony.

19 Q: Or -- I'm sorry. Do you recall that demon- --
20 our exhibit earlier?

21 A: Yeah. With the, the ---

22 Q: Okay.

23 A: Trial balance total, right.

24 Q: So, what I'm asking for, with relation to 2016,
25 what is the amount of those same expenses



1 related to that -- what Tractor Supply has said
2 is their procurement trial balance?

3 A: Well, I don't have those 2016 expenses in front
4 of me, but assuming that they are similar to
5 the 2015 expenses that it was showing on the
6 screen.

7 Q: So, you expect them to be approximately the
8 same amount in the 12 to 13 ---

9 A: In the ballpark. Yeah.

10 Q: Okay. All right. Thank you. All right. You
11 also testified that South Carolina should only
12 earn what you call is their routine return,
13 correct, for their routine function -- the
14 retail stores? I'm sorry. The South Carolina
15 retail stores should only earn ---

16 A: Can you repeat that, and start over?

17 Q: Sure. I believe you testified yesterday the
18 South Carolina retail stores should only earn
19 what you -- or -- sorry, let me back that up.

20 TSC, with respect to the retail stores,
21 should only cal- -- or should only earn what
22 you call, a routine return, correct?

23 A: I think you -- I want to rephrase what you are
24 asking.

25 Q: Okay.



1 A: You're asking, if the TSC parent entity ---

2 Q: Yes.

3 A: --- and whether all those retail stores should
4 be earning just a routine return?

5 Q: Yeah.

6 A: And, I may have said it several times
7 yesterday, but I think the answer is yes, I
8 believe that's true, that they should earn a
9 routine return for the retail part of their
10 operations.

11 Q: Because that -- all they're doing is retailing,
12 correct?

13 A: Well, they're doing more than retailing,
14 they're doing retailing and distribution, but
15 if you want to talk about the retailing only,
16 let's say that the answer is, yes. For
17 retailing, you would earn a routine return for
18 retailing. If you want to talk about
19 distribution, they'll earn a routine return for
20 that, too.

21 Q: And under your opinion, there's nothing special
22 about retailing, correct?

23 A: Nothing special from the standpoint that, it's
24 a routine function that can be outsourced and
25 you can find comparable evidence. I think



1 that's true, yes.

2 Q: Okay. Even though Tractor Supply, the group,
3 is just a trailer?

4 A: That statement doesn't follow because Tractor
5 Supply as a group is a combination of things.
6 Retailing is one aspect of their business, they
7 also have distribution. They also have
8 sourcing of products. They have -- they have
9 merchandising, they have product devel- -- I
10 mean, it's just a whole combination of things
11 that's involved in this business. But
12 retailing is the end of where the customer-
13 facing part of the business is.

14 Q: You've also stated that TSC has "a unique
15 assortment of extensive products", correct?

16 A: Okay. That sounds correct. I don't remember
17 exactly what I said, but I think that sounds,
18 roughly ---

19 Q: Would you like -- I'm happy to provide the
20 context, if you would like that?

21 A: Yes. Can you?

22 Q: Sure.

23 A: Thank you.

24 *(Whispering.)*

25 **MS. WOOTEN:** Bryson?



1 **MS. GEER:** Yeah.

2 **MS. WOOTEN:** May I approach, Your Honor?

3 **THE COURT:** Yes.

4 **MS. WOOTEN:** Thank you.

5 **Q:** Dr. Andrade.

6 **A:** Okay. Thank you.

7 **Q:** You're welcome.

8 If you could turn to what's been Bates
9 labeled as 6439. The Bates labels are at the
10 bottom.

11 **A:** Okay. I see it.

12 **Q:** Okay.

13 **A:** Okay. Where do you want to ---

14 **Q:** The second paragraph, TSC.

15 **A:** Yes, I see it.

16 **Q:** It says; TSC has a unique assortment of
17 extensive products. That's your statement,
18 correct?

19 **A:** Well, I'll be clear here, that some of this was
20 taken from their SEC filing. And, in fact, the
21 whole, the whole section entitled, Summary
22 Background of TSC, which starts on the previous
23 page, in the middle, this is largely taken from
24 their SEC filing in 2016.

25 **Q:** Okay.



1 A: So, it may come, it may come from them and I
2 may have, I have may changed a word or two here
3 and there, between it, it largely comes from
4 their SEC filing.

5 Q: Do you agree with this statement, or you don't
6 agree with the statement? It's either or.

7 A: I agree with the statement. Yeah.

8 Q: Okay.

9 A: Yeah. I mean, I just want to make sure it
10 comes -- you know, you know it's coming from
11 them, necessarily, not me. I ---

12 Q: But it was in your report that you ---

13 A: It was in -- I -- yes. It put it in here, but
14 it was coming from the filing that they put
15 out.

16 Q: Okay. How do you know that those -- that
17 they're unique?

18 A: Well, there -- there's a couple different ways
19 that I verified that this is a unique
20 assortment. I looked at the data that was
21 provided to me that had all the descriptions of
22 the products, and I had a good idea from that.
23 Then I went into a store and just examined the
24 different products that they had on all the
25 shelves. I went through the entire store row



1 by row, and that also corroborated what I saw.
2 I also feel, like based on other retail clients
3 that I have, that their assortment of products
4 is unique. It stands out as being, kind of, a
5 -- fitting that niche of a -- the hardware,
6 farm, all, all available store that's not
7 equivalent to, say, a Home Depot or a Lowe's or
8 something like that. So, I think it's true, in
9 general, through a variety of different ways
10 that I was able to verify.

11 Q: Have you ever been in a Tractor Supply store?

12 A: Yes.

13 Q: Okay. Were you wowed by their product
14 assortment?

15 A: I wouldn't say wowed. I would say, I was
16 impressed. I was, I was impressed by the
17 different types of products they had, in
18 particular, within the feed section, that there
19 was a large number of selections of brands of
20 all different types, depending on whether you
21 had, you know, hogs or chickens, or a horse, or
22 dogs, it seemed like they had about everything
23 that you'd want. And so, yeah, I was, I was
24 impressed.

25 Q: In your deposition, do you recall talking about



1 PwC's Memo?

2 A: Yes. I think, I remember a few instances where
3 I did discuss it.

4 Q: Okay. And you agree that it would not have
5 been appropriate for Dr. DeRamus to rely -- to
6 review and rely on PwC statements in their Memo
7 about their TWC functions and analysis,
8 correct?

9 A: Maybe, not rely. Can you repeat that one more
10 time, just so I'm ---

11 Q: Sure. You agree that it would not have been
12 appropriate for Dr. DeRamus to review and rely
13 on PwC statements in their Memo about TW --
14 TSC's functions and analysis, correct?

15 A: I don't know if it would be appropriate for him
16 to do it. I can't be the judge of that. So,
17 that's really not -- I'm not here to say that
18 it would be appropriate or not appropriate for
19 him to review or rely on it. I mean, I
20 wouldn't have relied on it myself. I would
21 have done my own calculations. Does that
22 answer your question?

23 Q: If you didn't rely on it, how could the
24 Department of Revenue rely on it?

25 A: In another words, I'm not relying on it as



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1 being the way that I would approach transfer
2 pricing consulting exercise for a client like
3 that. I would always have to go out and do my
4 own calculations to verify that I believe that
5 it's reasonable, after doing my own
6 calculations.

7 Q: So, I'll ask the question again.

8 If Dr. DeRamus, as an expert in 482
9 transfer pricing issues, couldn't rely on PwC's
10 Memo, how could the Department of Revenue rely
11 upon it?

12 A: I can't speak for the Department of Revenue.
13 I can only go by what people in my profession
14 do, which is to look at someone else's work,
15 then go on to decide and try to your own
16 corroboration of everything that's presented in
17 there, and make sure that it was done in a way
18 that looks reasonable.

19 Q: Do you consider the transfer pricing
20 methodology PwC used to evaluate the inventory
21 markup to be the best method?

22 A: The best method for inventory markup, I'm not
23 sure about that. I'm not sure it would be the
24 best method.

25 Q: What additional information would you need to



1 know to make that determination? Based on all
2 of the interviews that you've had, the SEC
3 filings that you've had -- that you've
4 reviewed, the data that you've gotten from
5 Tractor Supply, all of this extensive and
6 significant information that you've gotten from
7 Tractor Supply Company, what other information
8 would you need to determine if PwC's method was
9 the best method?

10 A: No. I'm, I'm gonna talk about the way I did.
11 And the way I did it was, it was the profit
12 split method was the best method. PwC, on the
13 other hand, chose the CPM as the best method.

14 Q: So, you would agree that CPM is not the best
15 method? You think the residual profit split
16 method is the best method?

17 A: Yes.

18 Q: And you performed your own independent analysis
19 of the company's transfer prices, correct?

20 A: I performed my own independent analysis of the
21 company's transfer pricing policy and the
22 transfer prices they end up charging during the
23 years in question. Yes.

24 Q: Okay. And that is contained all in this
25 Exhibit, Petitioner's Exhibit 1, is that



1 correct?

2 **(Plaintiff's Exhibit Number 1 was referenced at this**
3 **time.)**

4 A: Not all their -- it -- there's other files that
5 were sent over that had analyses that were
6 similar, but this was a version that we could
7 present to the Court that was condensed.

8 Q: Okay.

9 **MS. WOOTEN:** Ms. Buckner, may we have the computer,
10 please? Sorry. Excuse me. Beg the Court's
11 indulgence, Your Honor. (Whispering.)

12 Before you click on it, we have -- what
13 we're pulling up, can -- sorry, I don't have my
14 glasses.

15 Q: Dr. Andrade, you testified earlier that we
16 received various files from you as part of your
17 opinion and analysis in this case, correct?

18 A: Yes.

19 Q: Okay.

20 **MS. WOOTEN:** If you'll scroll down and highlight one
21 and then I'll ... All right.

22 Q: As part of that file, I'm asking -- I'm gonna
23 pull up TSC -- well, it's -- da- -- or,
24 underscore 00006556. Do you agree that that's
25 the document that we're pulling up?



1 **(Respondent's Exhibit Number 4 was introduced into**
2 **the record at this time.)**

3 A: I see a file. I'm not exactly sure why you're
4 computer is recognizing it as I-P-Y-N-B type.

5 Q: Okay. But you agree that the file that is
6 highlighted, and the one that we're about to
7 pull up is TCS underscore, a series of zeroes
8 and then 6556?

9 A: Yes. I see that.

10 Q: Okay.

11 **MS. WOOTEN:** If you could open that file, please.

12 Q: Is this the coding information that you
13 referenced earlier that we were -- we would've
14 received, but would've not been able to view
15 unless we had expertise in programming codes?

16 A: Yes, this is an example of it. I mean, you're
17 able to view it and you can see that there some
18 symbols, there's some numbers in some cases,
19 and there's some statements that are in
20 English.

21 So, I think that, in general, you can read
22 parts of it, but not other parts. I agree with
23 that.

24 **MS. WOOTEN:** Your Honor, I'm not sure of the best
25 way to do this. We would like to make this an



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1 exhibit. I don't know if it's a way for us to
2 screenshot it, or if I can add it as an
3 electronic exhibit?

4 **MS. GEER:** I don't have objection to which way you
5 do it.

6 **MS. WOOTEN:** Okay. We'd like to make it as an
7 exhibit. It would be ---

8 **(Respondent's Exhibit Number 4 was offered into**
9 **evidence.)**

10 **THE COURT:** The Court could screen ---

11 **MS. WOOTEN:** Okay.

12 **THE COURT:** We could ---

13 **MS. WOOTEN:** I'm not sure how you would -- I'm
14 sorry. I didn't mean to ---

15 **THE COURT:** We could screenshot it, but I don't know
16 how -- about printing it off or how that works,
17 so.

18 **MS. BUCKNER:** Yeah. We'll have to get Willy
19 involved and everything.

20 **THE COURT:** So ---

21 **MS. WOOTEN:** We've done the Excel spreadsheets as
22 electronic exhibits, and I would request to do
23 this the same way. I just wanted to make sure
24 that that was ---

25 **THE COURT:** That's ---



1 **MS. GEER:** I don't have any objection to that.

2 **THE COURT:** All right.

3 **MS. WOOTEN:** Okay.

4 **THE COURT:** That's fine.

5 **MS. WOOTEN:** Thank you. This will be Respondent's
6 Exhibit 4.

7 **THE COURT:** Okay. It's admitted.

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

9 **(Respondent's Exhibit Number 4 was admitted into**
10 **evidence.)**

11 **Q:** All right. So, let's talk about the interviews
12 that you had with the company TSC before -- or,
13 beginning your analysis in this case. Those
14 interviews lasted, in total, approximately 20
15 minutes, correct?

16 **A:** That doesn't sound correct. I think the, the
17 interviews were scheduled for anywhere between
18 30 minutes and one hour. In some cases, they
19 ended earlier. So, I don't think 20 minutes
20 was accurate. It may have been that some
21 interviews lasted slightly less than 30
22 minutes, but 20 minutes doesn't, doesn't sound
23 right.

24 **Q:** Okay.

25 **MS. WOOTEN:** Your Honor, I apologize. If you bear



1 with me just a moment.

2 **THE COURT:** I'm fine.

3 Q: So, in your estimation, you had a total of an
4 hour's worth of interview with TCS?

5 A: No. No, there were -- let, let me back up and
6 explain. So, there were three individuals
7 separate from the finance and accounting group
8 ---

9 Q: Okay.

10 A: --- that we talked to. Each of those
11 interviews were scheduled for between 30
12 minutes and 60 minutes. And I think in one
13 case, if I recall, the individual was late to
14 the meeting, so we didn't get the full time.
15 I don't remember the exact amount of time we
16 ended up talking to them. And then, in another
17 case, we went probably, beyond 30 minutes. So,
18 when you add it all up, I'll say in average, it
19 would be probably about an hour and a half
20 total for those three individuals, because some
21 went over, some went less than 30. In addition
22 to that, we talked to the finance person, I
23 think his name was Clayton, I don't remember
24 his last name, and that was another 30 --
25 approximately, 30-minute discussion. And then



1 we had many discussions with Margie, the Tax
2 Director. So, that would've -- my guess, is
3 that's easily going to be over several hours,
4 probably, you know, five to eight hours of
5 total discussions.

6 Q: Sure. And I'm not talking about Marjorie, on
7 the tax ---

8 A: Okay.

9 Q: I'm just talking about the procurement side.
10 So, you would say, approximately, an hour and
11 a half with those three individuals?

12 A: Yeah. I'd say about an hour and half total for
13 those, those three individuals.

14 Q: Okay. And you took notes during those
15 meetings, correct?

16 A: Sometimes I did, sometimes I -- I mean, I'd
17 just, like write down a word, but I didn't
18 really take thorough notes. I had my team
19 members follow it more carefully with note
20 taking.

21 Q: Did you provide your team members notes?

22 A: Everything was provided.

23 Q: And all of those notes were about two to three
24 pages, is that right?

25 A: I don't remember. I don't, I don't recall how



1 -- I didn't even look at them. I, I kept it
2 all in my, my head about what we talked about
3 and I knew, based on discussion, that's what I
4 needed.

5 Q: Don't all retailers perform necessary
6 procurement functions?

7 A: I guess, you could say that all retailers need
8 to perform sourcing and procurement, so I think
9 that's probably a true statement.

10 Q: So, regardless if it's a high profit or a low
11 profit margin, the retailer still needs --
12 still has to purcha- -- purchase products to
13 put in its stores, correct?

14 A: Regardless of the profit margin, yes.

15 Q: Okay. So, is it your opinion that high margin
16 -- or high profit retailers are able to earn
17 that high level of margin because -- simply
18 because they're better at procurement than
19 others?

20 A: I don't, I don't think that's true. There may
21 be other reasons why they're earning high
22 profit margins that I have -- that are not
23 exclusively because of procurement. Could be
24 product development is better. It could be that
25 they have, they have the ability to take their



1 data on their customers and take the data on
2 the interest of, of where customers prefer to
3 shop and all that information, and, and analyze
4 it in a way that allows them to be superior in
5 getting results. I mean, there's a lot of
6 different ways that that could happen.

7 Q: And on the flip-side, a retailer that has a low
8 margin, is it because they have a procurement
9 function that's doing well? Like, it -- they
10 have a bad procurement company -- or a
11 function?

12 A: We don't know. There's a lot of reasons that
13 could cause low margins, as well. There's not
14 just one.

15 Q: In your deposition, and I'm happy to provide
16 that to you if you need it for context, but it
17 said -- you said; when you read the 10-Ks, it's
18 emphasized early throughout the document that
19 there is -- that this is something that they
20 specialized in, honed, continuing to perfect.
21 They're going way beyond what I would call
22 routine procurement.

23 Is that correct? Is that a -- do you
24 believe that's accurate statement?

25 A: Can you provide the context of the statement?



1 I mean, I do recall talking about the 10-Ks and
2 all of this, this stuff, but I want to make
3 sure the last word you used was what I used.

4 Q: Routine procurement?

5 A: Yeah.

6 Q: Okay. Well ... (Whispering.)

7 And you're aware that the procurement
8 function is physically performed at the
9 headquarters location in Tennessee, correct?

10 A: Yes.

11 Q: It's not performed in Texas, right?

12 A: Right.

13 Q: And the company just restructured in 2001 to
14 make the Tennessee procurement companies to be
15 employees of TSC Texas, correct?

16 A: Can you repeat that again?

17 Q: Sure. The company restructured in 2001 to make
18 the Tennessee procurement employees to be TSCT
19 employees, correct?

20 A: That was one of the reason they did it, I
21 assume. Yes.

22 Q: And did that restructuring have any impact on
23 making these employees so exceptional, as you
24 claimed in your testimony?

25 A: When you look at -- the instant that they did



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1 the restructuring, it's just simply going to be
2 the 10 employees, but then you've got the time
3 period in which they developed that procurement
4 operation from a skeleton crew of 10, to 100.
5 So, there's a big time period in there where
6 they spent a lot of time, a lot of effort and
7 a lot of money to perfect that procurement and
8 product development activity. It wasn't just
9 the 10 that, that was after the restructuring,
10 it involves more than that. So, I think you
11 need to make sure that you consider from 2001
12 to 2014, that a lot of building up of that
13 function occurred.

14 **MS. WOOTEN:** (Whispering.)

15 Q: All right. We've got what's identified on the
16 screen as Respondent's Exhibit 5.

17 **(Respondent's Exhibit Number 5 was referenced at this**
18 **time.)**

19 **MS. WOOTEN:** Thank you. May I approach, Your Honor?

20 **THE COURT:** Yes.

21 **MS. WOOTEN:** Thank you.

22 Q: I'm going to hand you what's ---

23 A: Yes.

24 Q: --- been marked as Respondents Exhibit 5.

25 A: Okay. Thank you.



1 *(Whispering.)*

2 Q: This is one of the tabs from one of the
3 spreadsheets you produced in discovery. It is
4 from TSC00006655, and that is Joint Exhibit 42.
5 And it is from the Texas Financials tab.

6 **(Joint Exhibit Number 42 was introduced into the**
7 **record at this time.)**

8 **MS. WOOTEN:** (To Ms. Gamble) You can stop maybe,
9 right there.

10 Q: Do you recognize this spreadsheet?

11 A: Yes.

12 Q: Okay. And it was part of a file -- or a
13 spreadsheet -- it was part of a workbook in a
14 spreadsheet that you provided to the Department
15 in discovery, correct?

16 A: That's correct.

17 Q: Okay. If you will focus on the bottom section.
18 On the account column, it says; operating
19 income, E-B-I-T.

20 A: Uh-huh. I see it.

21 Q: Do you see that?

22 A: Yeah.

23 Q: And then there's two indentions, procurement
24 and retail.

25 A: Yes.



1 Q: Okay. Do you believe this is accurate?

2 A: It looks to be accurate. I'm not exactly sure
3 which version this -- of this, of this
4 presentation this is because there were
5 subsequent versions and there were earlier
6 versions, some of the which changed, so. It
7 looks to be accurate.

8 Q: Okay. You provided a lot of information in
9 discovery.

10 A: Yeah, that's right.

11 Q: Okay.

12 **MS. WOOTEN:** And can you -- (whispering.) Zoom in,
13 sorry. And scroll down.

14 Q: All right. So looking at, again, operating
15 income, procurement and retail, and we'll just
16 take column A just for an example. The
17 operating income of the group is how much under
18 column A?

19 A: Column A stands for average. That would
20 \$425,468,916, approximately.

21 Q: Okay. So, 425 million dollars of operating
22 income, correct?

23 A: For the consolidated Texas entity.

24 Q: Okay. How much of that operating income is
25 from the procurement function?



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1 A: The majority of it would be.

2 Q: Approximately, 90 percent?

3 A: I'm not exactly sure of the percentage. We'd
4 have to calculate it, but, sure. I mean, it
5 may be 90 percent, or whatever the percentage
6 is, but the majority.

7 Q: The majority.

8 A: Yeah.

9 Q: A significant amount.

10 A: A significant amount. Yes.

11 Q: Okay.

12 **THE COURT:** It would be 388 million divided 425
13 million?

14 A: That's right. Yeah.

15 Q: So, doesn't this suggest that, approximately,
16 90 percent of Texas' operating income is
17 attributable to the inventory purchasing
18 function performed by those individuals working
19 in Tennessee?

20 A: I would rephrase that to say that, it's
21 attributable to the procurement and product
22 development combined activities of TSC of
23 Texas.

24 **MS. WOOTEN:** Your Honor, may I have just a few
25 moments? I may be finishing up. Thank you.



1 *(Whispering.)*

2 **MS. WOOTEN:** All right. One -- one topic, Your
3 Honor. I think.

4 Q: Okay. We were talking earlier about the
5 allocate -- under your math -- method, the
6 allocation of 50 percent of the residual profit
7 to the procurement company, correct?

8 A: Uh-huh. Yes.

9 Q: Is the way that you have done -- or used the 50
10 percent profit split, the way that you have
11 derived that, is that consistent with the 482
12 Guidelines?

13 A: It's consistent with it, but it's not exactly
14 what they prescribed.

15 Q: And has a court allowed an expert to use a 50
16 percent figure to split residual profit the way
17 you have ---

18 A: I do not know.

19 Q: --- without any quantitative support for it?

20 A: I do not know.

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

22 **THE COURT:** Redirect?

23 **MR. STREISEL:** Can we get a ten-minute break, Your
24 Honor?

25 **MS. WOOTEN:** Oh, Your Honor, if I may, I ---



1 **THE COURT:** I wanted to take a break at the end of
2 this -- okay.

3 **MS. WOOTEN:** Your Honor, I just want to make sure
4 Respondent's 4 and 5 were admitted into the
5 record before I sit down.

6 **THE COURT:** Well, the easier way to do it is offer
7 it.

8 *(Laughter.)*

9 **MS. WOOTEN:** May I offer -- the Department is
10 offering Respondent's Exhibits 4 and 5 into the
11 record.

12 **(Respondent's Exhibit Numbers 4 and 5 were offered**
13 **into evidence.)**

14 **MR. STREISEL:** No objection.

15 **THE COURT:** All right.

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

17 **THE COURT:** It's admitted. You can -- it's already
18 admitted.

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

20 **(Respondent's Exhibit Numbers 4 and 5 were admitted**
21 **into evidence.)**

22 **THE COURT:** All right. All right. Let's take a
23 ten-minute break.

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

25 **(Off the record from 10:21 a.m. until 10:31 a.m.)**



1 **MR. STREISEL:** May I begin?

2 **THE COURT:** Yeah.

3 **DR. ANDRADE - RE-DIRECT EXAMINATION BY MR. STREISEL:**

4 Q: David, can you tell us about the use of
5 unspecified methods as described in the §482
6 Regulations?

7 A: In general, they're allowed ---

8 **OBJECTION:**

9 **MS. WOOTEN:** Your Honor, I'm going to object. I
10 didn't go into -- I don't believe I went into
11 unspecified methods in cross.

12 **MR. STREISEL:** Oh, I believe -- let's see ... Okay.
13 Let me try it this way.

14 Q: David, can you explain what you mean about how
15 your method is consistent with the §482
16 Regulations, although not prescribed, I believe
17 is the word you used?

18 A: Yes. So, in general, the -- we have two
19 things, we have the Section §482 Internal
20 Revenue Code, which is the law. And then we
21 have the Section §482 Regulations that are
22 issued as guidance through that section of the
23 law. The guidance is a significant number of
24 pages or hundreds. The code is only three
25 sentences. And so, in general, the Section 482



1 Regulations list out methods that transfer
2 pricing experts and practitioners can apply
3 that are suggested as, as ways to proceed with
4 an analysis that everybody understands, but
5 they're also -- in there are some unspecified
6 methods that, as long as they are consistent
7 with an arm's length result, or that the --
8 that the data and assumptions have been met and
9 qualified as the best method, then they're
10 permissible under those regulations. Does that
11 explain it?

12 Q: Yes.

13 **MR. STREISEL:** (To Ms. Wooten) What's that exhibit
14 you just added with like code stuff? The ---

15 **MS. WOOTEN:** I believe that was admitted as
16 Respondent's Exhibit 4.

17 **MR. STREISEL:** I need to put that up.

18 **MS. WOOTEN:** Sure.

19 **(Respondent's Exhibit Number 4 was referenced at this**
20 **time.)**

21 Q: I guess, while we wait, David, did you provide
22 your entire file to the Department in this
23 case? Or let me rephrase that, did you provide
24 your entire file to Nelson Mullins in this
25 case?



1 A: Yes.

2 Q: Okay. Do you see this document on the screen

3 ---

4 A: I do.

5 Q: --- ju- -- this is -- was it ---

6 **MR. STREISEL:** What did -- label is that?

7 **THE COURT:** It's Respondent's ---

8 **MS. WOOTEN:** Respondent's Exhibit 4.

9 Q: Okay. Respondent's Exhibit 4. Did you rely on
10 this document for your opinions?

11 A: This particular one? I wouldn't be able to
12 answer that because there are, there are
13 hundreds of these. Some of which we relied on
14 and some of which we didn't, so I don't know.

15 Q: And can you -- you produced a number of Excel
16 files as well, correct?

17 A: Yes.

18 Q: Do you -- can you approximate how many?

19 A: Dozens. I mean, there were, there were a good
20 number of them. I would say, over 15.

21 Q: This document on the screen, would you be able
22 to number -- or -- I assume you cannot right
23 now, but would you be to ---

24 **OBJECTION:**

25 **MS. WOOTEN:** Objection. Ass- ---



1 **MR. STREISEL:** All right.

2 **MS. WOOTEN:** He's asking him to assume something.

3 **Q:** This document on this screen, are you able to
4 connect this to a corresponding Excel file that
5 would contain this data, but in an Excel file
6 in a different format?

7 **A:** Yes. I think I understand what you're asking.
8 We could connect this particular file and the
9 instructions that it represents to an Excel
10 file that's equivalently doing the same thing.
11 That's what I think you were asking.

12 **Q:** Yes. Yes. Can you explain what you learned
13 from the SKU data and how that related to the
14 extent of your discussions with Tractor Supply
15 personnel?

16 **A:** Okay. So, what happened was -- in the order of
17 how this evolved, in terms of the work
18 performed, we first received the SKU
19 transaction level data. That led us to
20 understand certain facts about the company's
21 product lines, departments, and how they've
22 categorized everything, and as a result, we
23 suggested that it was appropriate to talk to
24 some individuals who would be able to answer
25 some questions about things like buying,



1 procurement, pricing. So, because of the data
2 that we had access to, we limited our scope of
3 those interviews to only the things that we
4 needed to get verification for. So, that's one
5 reason why they were a shorter duration.

6 Q: And I guess, what, what were the, what were the
7 questions that were not answered by the SKU
8 data that led you to talk to those personnel?

9 A: Some involved, context, to understand how the
10 pricing data was being used by the company to
11 optimize results, or optimize whatever they
12 were trying to improve. And others were about
13 trying to understand the buying function -- so,
14 actually, we -- taking a step back. We looked
15 at the data, we knew that we had the cost from
16 -- that we were -- that they were paying to the
17 vendors and we had the pricing that they were
18 charging out at the retail stores, but we
19 needed more context about those two ends. And
20 so, one person, we talked to was a buyer within
21 procurement that helped to understand the cost
22 that they were paying to vendors and how that
23 data was being used by the company to better
24 manage that process of buying, procuring. And
25 then, the other person we talked to was a



1 pricing expert that would help us understand
2 how they were optimizing their pricing to end
3 customers.

4 Q: And Ms. Wooten asked you a number of questions
5 about other retailers and whether, whether all
6 retailers would perform procurement functions.
7 Do you recall that?

8 A: Yes.

9 Q: That general topic being discussed?

10 A: Yes, I do.

11 Q: Okay. And what would you need to evaluate in
12 order to learn whether other companies'
13 procurement function had the same value as
14 Tractor Supply of Texas' procurement functions?

15 A: There are number of things that I would want to
16 look at, including how the company trains its
17 teams of buyers or procure staff -- or procure
18 teams' members. Things like, are they, are
19 they experienced, or are they younger and
20 inexperienced? Do they have a mentor, or is
21 there a leader in the company that sets the
22 vision for the goals for that buying group or
23 that procurement group? How, how extensive is
24 their influence on the products that are
25 actually on the shelves of the retailer?



1 These are all the questions that I seek to
2 look for answers on in order to understand how
3 procurement and the act of buying and sourcing
4 is functioning at a particular retailer.

5 Q: And what would you need to do to learn all of
6 that information that we just described?

7 A: I would look at their internal data that's
8 represented by the ERP system, as I mentioned
9 yesterday. The enterprise resource planning
10 systems are very helpful in showing all the
11 content that the company is tracking on -- down
12 to a minute-by-minute basis these days. That
13 would give me a good indication of what's
14 important, what they're keeping good watch
15 over, so they can help feed back into the
16 system of improving results, whether it's in
17 the buying, sourcing or vendor qualification
18 side. And in addition to that, I would talk to
19 individuals, but I would use those in
20 conjunction with each other to understand
21 what's going on and what I would need to get
22 answers to.

23 Q: And what else would you do?

24 A: I'm -- I mean, there, there -- there'd be a
25 number of other things I'd probably be



1 interested in, but I can't think about here
2 right now as I sit here today.

3 Q: Would you evaluate their SKU data?

4 A: Well, that's what I was talking about before,
5 is that the enterprise resource planning data,
6 which essentially, represents all stock keeping
7 unit or SKU data, transaction level data. That
8 -- that's -- I already mentioned that in my
9 previous explanations.

10 Q: Okay. And you mentioned a number of other
11 retailers that you've studied in your career.
12 How did their procurement functions compare to
13 Tractor Supply of Texas' procurement functions?

14 A: There was different -- certainly differences
15 and there are some similarities. I'm thinking
16 about one in -- right now, in my mind, that
17 relies extensively on outsourcing for the
18 production of certain products. And in that
19 case, you can say that their procurement
20 operation was more focused on the materials
21 that were used to make those products that
22 would then feed into their retail store
23 network. Whereas, in Tractor Supply, there
24 seems to be more of an emphasis on the sourcing
25 of actual products, not just materials that



1 would go into the making of those products.

2 So, that -- that's one difference that I
3 see that's fairly common between retailers that
4 have extensive networks of contract
5 manufacturers or assemblers that bring the
6 product to the company that's already in an
7 assembled fashion.

8 Q: And so, a question before this -- or two
9 questions ago, we were talking about what you
10 would look at in these other companies to
11 compare them to Tractor Supply's procurement
12 functions. And, can you give some examples of
13 the types of things you would be looking at in
14 other companies' SKU data in order to make a
15 comparison to Tractor Supply of Texas'
16 procurement functions?

17 A: Okay. I would look for how stratified the data
18 is. What I mean by that, is that there may be
19 certain classifications that the company
20 chooses to use as categories of product lines
21 or departments, or a variation of products
22 within product groups. So, the stratification
23 tells you a lot about how closely their
24 tracking important categorization of the
25 activity. And some companies, they tend to



1 just keep but just a few, call it buckets, of
2 these things. And other companies, they keep
3 hundreds of them or even thousands of them.
4 So, it tells me how detailed their system is
5 and how important it is to track all this
6 stuff, so they can help management decide how
7 to improve performance based on this -- the
8 data that's coming through.

9 There's also just the, the level of effort
10 involved in training the team members to use
11 the data to improve their results, which I've
12 seen variations on that, some have no training,
13 some have extensive training. So, these are
14 the things that I would be looking for when
15 comparing with another retailer.

16 Q: And can you, can you give an example of what
17 Tractor Supply's SKU data allowed you to see,
18 with respect to the entirety of this
19 procurement product development function you've
20 been talking about?

21 A: The first thing that comes to mind is that when
22 you look at the cost of acquiring the products
23 from vendors, you get a sense that they're --
24 that Tractor Supply of Texas, the team that
25 involves in buying the product has very strong



1 relations with these vendors and is able to
2 negotiate favorable terms that translate into
3 low costs of purchase for Tractor Supply of
4 Texas. And when you compare that to the value
5 at the end, when they're selling to the retail
6 customers in the stores, I saw a number of
7 different products that were generating high
8 profit margins, high gross profit margins
9 independent of the freight that was used to
10 ship the products from where they were to where
11 they needed to go. There were also cases where
12 products seemed to suggest that they were more
13 frequently purchase than others, but had lower
14 profit margins. But that frequency was
15 essentially responsible for increasing the
16 volume of the customers in the stores, which
17 led to more purchases of the less frequent
18 needed items. So, I saw that in the data. So,
19 there were a number of things -- a number of
20 patterns that I would have not been able to
21 understand without looking at that data that I
22 learned from actually studying the data and
23 running some checks on it and, and setting it
24 up in a way that I could understand it better.

25 Q: Can you give an example of one of these



1 products and what the data showed you?

2 A: The feed products, where the product that I
3 think that they represent as the CUE,
4 consumable, usable, edible -- I'm sorry,
5 consumable, usable, edible product, where it
6 has a higher frequency of purchase just because
7 it runs out, you need more, you go back. And
8 those profit margins were lower. They were
9 still high from the perspective of this type of
10 company, but they were lower than the other
11 profit margins. And then, in another example
12 of a profit -- of a product, it would've been
13 tools. So, there were tools that were
14 generating very high profit margins, much
15 higher than feed. And I saw a relationship
16 where, as feed purchases increase, it appeared
17 that there was a corresponding increase in the
18 dollar volume of profit that was earned by
19 tools. And this not only played out in the
20 relationship between feed and tools, but it
21 also played out in the relationship between
22 feed and garden, feed and pet products, feed
23 and seasonal products. So, it just seemed to
24 be suggesting that -- the data was telling me
25 something that I wasn't able to capture just in



1 understanding the SEC filing or interviews with
2 people.

3 Q: And so, what that data was telling you, how did
4 that help you determine where value was
5 generated here?

6 A: By dividing it up into the products groupings
7 that I, that I listed, the farm, pet, feed,
8 garden tools, and miscellaneous, I was able to
9 see that those different profit margins
10 suggested that I have a way of looking at
11 comparability -- excuse me -- that would be
12 improved by that data. So, that I could line
13 up the comparable companies for each of these
14 product groupings to those product grouping
15 results, so I can get a weighted average
16 calculation of, what I call, the pure gross
17 profit margin. The weighted average
18 calculation being weighted by the percentages
19 of these products in proportion to the total.
20 That helped with comparability. It helped with
21 the calculation of the routine gross profit,
22 which in turn allowed me to calculate the
23 premium gross profit for each of these product
24 groupings.

25 Q: And all that that you were just describing of



1 the product groupings, and determining the
2 routine gross profit, and then calculating the
3 premium gross profit, that all occurred before
4 that Excel document we had up earlier as part
5 of your analysis, correct?

6 **OBJECTION BY MS. WOOTEN:**

7 **MS. WOOTEN:** Objection. Leading.

8 **THE COURT:** Sustained.

9 Q: What you just described, where did that occur,
10 in terms of your profit split method?

11 A: I'm sorry. Can you repeat the question?

12 Q: What you were just describing and breaking it
13 up into the five categories and finding
14 comparables, where does that occur in relation
15 to the full picture of the implementation of
16 your residual profit split method?

17 A: That occurs in step one, which yesterday was
18 reviewed, where I have to determine
19 comparability and the evidence I'm using for
20 comparable companies that would apply to
21 determining comparability, as well as in
22 generating the calculation for the total gross
23 profit per product line. So, between doing
24 those calculations for the gross profit at the
25 starting point, and the gross profit that I



1 would estimate as a routine gross profit, that
2 I would subtract from that starting point to
3 estimate the premium profit. This information
4 was useful during all those steps.

5 Q: Okay. And the Demonstrative that we had that
6 you discussed yesterday, the Excel document,
7 why did you do that part of your analysis?

8 **OBJECTION BY MS. WOOTEN:**

9 **MS. WOOTEN:** Your Honor, I'm just going to object so
10 that we -- the Court -- or the record is clear
11 as what Demonstrative we're referring to in his
12 testimony.

13 **MR. STREISEL:** It's the only Excel one that -- I
14 don't know what exhibit it was.

15 **THE COURT:** Well, refer to it, specifically.

16 **MR. STREISEL:** What, what exhibit is it?

17 **MS. GEER:** It was -- let's see.

18 **MR. STREISEL:** Yeah. I guess, it was Tractor Supply
19 Company's Exhibit 1. If you would, put that on
20 the screen.

21 Q: Why did you perform this -- or ---

22 **MR. STREISEL:** I guess, go to the second tab,
23 please.

24 **MS. GEER:** But which one are we on?

25 **MR. STREISEL:** Yeah. The colors are confusing.



1 MS. GEER: Oh, yeah, the color scheme.

2 MR. STREISEL: Yeah.

3 MS. GEER: Where do you want to be on it?

4 MR. STREISEL: I guess, just at the beginning.

5 (Petitioner's Exhibit Number 1 was referenced at this
6 time.)

7 Q: Why did you perform this part of your analysis
8 that's shown on this entire tab here?

9 A: I performed this part of the analysis to
10 reconcile the gross profit estimates that I was
11 obtaining with operating profit reported by the
12 Company in its trial balances.

13 Q: Okay. So, it's showing the implementation of
14 your method?

15 A: It's showing -- yes. It -- you could say that
16 it's showing the full implementation of the
17 method down to the operating profit level as
18 opposed to just using the gross profit level.

19 Q: And so, was your method used by Tractor Supply
20 in their trial balances?

21 A: My method was not used in, in Tractor Supply as
22 a transfer pricing policy. Is that what you're
23 asking?

24 Q: Yes.

25 A: No. It was not used as a transfer pricing



1 policy for the company.

2 Q: Okay. And what was used as a transfer pricing
3 policy for the company in their trial balances?

4 A: They were applying a markup to the cost of
5 sales -- the inventory cost of sales that was
6 based on what PwC had recommended to them as a
7 markup percentage of 9.7 percent, as shown here
8 in cell B, boy, 10.

9 Q: And so, is that why cell 10 includes that 9.7
10 percent, you're just showing what was actually
11 used by the company in the trial balances?

12 A: Yeah. It was a reminder that the company was
13 using that in their trial balance calculations
14 during the years under audit.

15 Q: Okay. And the last chart on this -- we're now
16 on the first tab of Tractor Supply Exhibit 1.

17 **MR. STREISEL:** Can you scroll down just a little
18 bit?

19 **MS. GEER:** Where you want to be?

20 **MR. STREISEL:** Table C.

21 Q: That, that information is from Tractor Supply's
22 actual trial balances during the tax years of
23 this audit, correct?

24 A: That's right.

25 **OBJECTION BY MS. WOOTEN:**



1 **MS. WOOTEN:** Objection. Leading.

2 **Q:** Okay. Where does that information come from on
3 Table C?

4 **A:** That comes from Tractor Supply's trial balances
5 that they actually booked during the tax years
6 at issue, which are shown here individually and
7 in a weighted average, column B, format.

8 **Q:** Okay. And Table B, what are those values?

9 **A:** Those are, those are ratios that are coming
10 from comparable companies, as comparable, as
11 comparable evidence used to help estimate what
12 the routine portions of these -- I'm sorry. Let
13 me back up.

14 Those are ratios that estimate the ranges
15 that apply to both TSC of Texas and TSC parent
16 over each year, as well as the average over the
17 years. And the -- in row 16 and 17 is the
18 markup on total cost that's applied to Texas,
19 consolidated, not just one activity, but the
20 whole Texas operation. And in lines 20 and 21,
21 that's the operating margin that's applied to
22 the TSC parent.

23 **Q:** And earlier you were asked some questions about
24 the intellectual property of the company. The
25 value that's generated by the intellectual



1 property, how is that allocated by the
2 application of your method?

3 A: Which intellectual property? Can you be more
4 specific? Which entity?

5 Q: I guess, the intellectual property that's owned
6 by Tractor Supply of Texas. Using your method,
7 how is the value that's generated by that
8 intellectual property allocated to the group?

9 A: It would imbedded in that 50 percent allocation
10 of premium profit. Whatever, whatever the
11 activities are that represent high-value
12 functions, non-routine contributions, or
13 ownership of intangible property rights, that
14 all contributes toward that 50 percent
15 allocation of premium property.

16 Q: Okay. So, which -- okay. And the trademarks
17 that are owned by Tractor Supply of Texas,
18 would you attribute any -- or, tell me your
19 opinions about -- or, tell me your thoughts on
20 the value of the trademarks owned by Texas in
21 this case, as it relates to the retail stores
22 use of them?

23 A: The trademarks, in general, are going to have
24 some value because they distinguish the company
25 from other companies, and because product



1 selection and product sourcing and product
2 development are an important part of the
3 operations, in particular, the Texas
4 operations. The trademarks will help the
5 company with infringement activity and also
6 help the market identify that it has a unique
7 assortment of products that it owns rights to.
8 So, I guess, you could say, that in general
9 those trademarks are valuable and they do
10 contribute value. Although, I have not
11 quantified that specifically, it's imbedded in
12 my analysis.

13 Q: Okay. And would it -- and how would it impact
14 the retail stores owned by the parent if they
15 were not allowed to use the trademarks owned by
16 Tractor Supply of Texas?

17 A: It would be detrimental.

18 Q: Can you elaborate on that?

19 A: Well, if they were not allowed to use the
20 trademarks, then if they used them anyway, that
21 can be a violation of agreement, you can say
22 that would be an infringement. But if they
23 weren't allowed to put those trademarks in the
24 stores, and they had to remove them and just go
25 with faceless products with no brand on it,



1 that could have a harm to the business over
2 time, as people are not connecting Tractor
3 Supply stores and their products with specific
4 names of products, brands. That would be
5 detrimental.

6 Q: Okay. And there's, I believe, one more
7 question. Well -- sure -- I believe.

8 Your method was allocating the routine
9 profit to retailers, which retail stores are
10 you referring to in terms of the three entities
11 that own retail stores?

12 A: Well, it -- to me it'd be obvious based on just
13 the name of the entity. If it's TSC of Texas,
14 it'd be the retail stores that are in Texas.
15 If it's TSC of Michigan, it'd be the retail
16 stores that are in Michigan. And if it's TSC
17 parent, it would be all the other retail stores
18 that are not in Michigan and not in Texas.

19 Q: Let me, let me rephrase it then. When you
20 allocate routine profit to retailers in this
21 case, which retail stores are you allocating it
22 to?

23 A: Routine, routine profit is allocated to all
24 stores, whether they be located in Texas,
25 Michigan, or other states that the parent would



1 own.

2 Q: Okay. And then, the residual is split between
3 who?

4 A: The residual is only split between TSC of Texas
5 and TSC parent. Michigan doesn't get any
6 residual because it doesn't make any
7 significant non-routine contributions. It
8 doesn't have any functions that are considered
9 extraordinary. There's only two entities
10 involved in, in that activity, and that's the
11 parent and Texas.

12 Q: And so, if that is split 50/50 between Texas
13 and the parent, can you explain why Texas in
14 Table C is so much more profitable than the
15 parent?

16 A: Yeah. Well, there's, there's a good reason for
17 the line 30, where you see MTC, which stands
18 for markup on total costs, being higher. And
19 that's driven by the fact that the procurement
20 operations are generating value, in that, the
21 company applied a 9.7 percent markup on the
22 inventory costs to help capture some of that
23 value, but in addition to that, the Texas
24 stores themselves are going to have a higher
25 profit ratio because they're not paying the 9.7



1 percent markup. It's within Texas. It stays
2 within Texas. So, these numbers are indicative
3 of Texas having, not only its procurement and
4 product development activities, but also the
5 fact that it has some distribution and retail
6 activities that earn higher margins because
7 they were not charged the 9.7 percent. So,
8 that's a blended number you see on line 30.
9 Does that answer your question?

10 Q: Probably, though my question wasn't the best.
11 *(Laughter.)*

12 **MR. STREISEL:** I think I've got it. That's it.

13 **THE COURT:** Re-cross on new matter?

14 **MS. WOOTEN:** No, Your Honor. Thank you.

15 **THE COURT:** You may step down.

16 A: Thank you, Your Honor.

17 **MS. WOOTEN:** Oh, thank you.

18 **THE COURT:** Where do y'all stand?

19 **MS. GEER:** It's the Department's ---

20 **MS. WOOTEN:** Well ---

21 **THE COURT:** (To Ms. Geer) Are y'all through?

22 **MS. WOOTEN:** Yeah ---

23 **MS. GEER:** Oh ...

24 **THE COURT:** The magic word ---

25 **MS. GEER:** Yes, sorry.



1 **THE COURT:** --- do you rest?

2 **MS. GEER:** Sorry. Sorry. We rest.

3 **THE COURT:** Okay.

4 **MS. GEER:** Thank you.

5 **RESPONDENT'S REBUTTAL:**

6 **MS. WOOTEN:** Thank you, Your Honor. On rebuttal, we
7 would call Akash Sehgal.

8 **THE COURT:** You are still under oath.

9 **MR. SEHGAL:** I understand.

10 **MR. SEHGAL - DIRECT EXAMINATION BY MS. WOOTEN:**

11 Q: Good morning.

12 A: Good morning.

13 Q: Were in the courtroom ye- -- most of the day
14 yesterday?

15 A: Yes.

16 Q: Okay. And do you recall testimony presented
17 from an accounting expert?

18 A: Yes.

19 Q: Okay. And as part of that testimony, do you
20 recall testimony suggesting that the
21 Department's method is taxing nine percent of
22 TSC's income, even though it is applying -- the
23 Department is applying a sales factor of
24 approximately two percent?

25 A: Yes.



1 Q: Okay. Based on the facts of this case, is that
2 accurate from an accounting perspective?

3 A: It's not accurate from an accounting
4 perspective because what the Department is
5 doing is they're computing income on a combined
6 reporting basis, and then applying a combined
7 sales factor -- combined unitary sales factor
8 to that number. So, the -- in effect, what the
9 Department is doing, is they're using a base
10 that is abased on the combined reporting method
11 and a -- and a corresponding sales factor
12 that's also based on a combined reporting
13 method.

14 Q: Okay. And in your experience, from an
15 accounting perspective, how would the sales
16 factor be applied under combined unitary
17 reporting?

18 A: So, the sales factor would also be computed on
19 a combined reporting basis and then applied to
20 combined reporting -- combined income that's
21 computed on a combined basis.

22 Q: And again, in your experience, have you
23 prepared state income tax returns for
24 multistate businesses?

25 A: Yes.



1 Q: Okay. And in separate entity states?

2 A: Yes.

3 Q: What about unitary states?

4 A: Yes.

5 Q: And in that experience, have you ever advised
6 a client to file a unitary return in a unitary
7 state even though the client did not consider
8 themselves a unitary business?

9 A: Yes. I -- I've done that. And the reason for
10 that is because, when I'm trying to make a
11 determination from an accounting perspective as
12 to whether a client or their group is a unitary
13 combined group, it's important for me to look
14 at the various rules in the states and then
15 apply those to the client's facts. So,
16 although, the client may not think they're a
17 unitary business, ultimately from a reporting
18 standpoint, I'm looking at a specific combined
19 unitary rules in states and making a
20 determination based on that.

21 Q: And during your -- the testimony yesterday, do
22 you recall a discussion about adjusting the tax
23 returns if a transfer price is determined to be
24 incorrect or unreliable?

25 A: Yes.



1 Q: Okay. And do you recall the specific testimony
2 that if a 9.7 percent inventory markup were
3 determined to be non-arm's length, a witness
4 would simply adjust the transfer price to the
5 arm's length price, and I believe an example is
6 seven percent ---

7 A: Yes.

8 Q: --- rather than resorting to combined unitary
9 reporting?

10 A: Yes, I remember that testimony.

11 Q: Okay. First, if the transfer price is not
12 arm's length, will a taxpayer's income fairly
13 reflect its activities in the state from an
14 accounting perspective?

15 A: No, it would not.

16 Q: Okay. And staying with this same hypothetical,
17 but the transfer price is non-arm's length,
18 does your opinion depend on whether you apply
19 a sales factor or a different apportionment
20 factor to the income of that separate entity?

21 A: No. It would not matter, because regardless of
22 what type of factor you apply to the income, if
23 the arm's length is -- if the transfer pricing
24 is not at arm's length, it doesn't matter what
25 sales fa- -- what type of factor you apply to



1 the income.

2 Q: And did you review Tractor Supply's South
3 Carolina and federal tax returns?

4 A: Yes, I did.

5 Q: Okay. Did you find Tractor Supply Company's
6 inventory purchases on these returns?

7 A: I found them -- they were reported on the
8 federal return, but not on the South Carolina
9 return.

10 Q: Okay. So, again, staying with this example of
11 the -- you know, where we've -- the Court has
12 determined that the transfer pricing of 9.7 is
13 incorrect and that seven percent would be a
14 more appropriate markup, if you wanted to
15 calculate the taxpayer's taxable income using
16 that adjusted markup and keeping separate
17 income reporting, could you do that based on
18 the information in the federal tax return?

19 A: I could not do that based solely on the
20 information in the federal tax return. I may
21 use the federal tax return to do a very, very
22 high-level computation just get a basic
23 understanding of where the numbers may end up.
24 But, in order for me to properly report this on
25 an income tax return, I would advise the client



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1 to go back and to adjust their books and
2 records in, specifically, the various
3 transaction journal entries that are made with
4 respect to these transactions. And then, once
5 those journal entries are made and the trial
6 balances are updated, I would take that da- --
7 those data points and compute federal taxable
8 income and then, South Carolina income tax.
9 That would give me a better, clear reflection
10 of what the actual changes are.

11 Q: Okay. And what about based on the information
12 in PwC's July 2015 transfer pricing Memo?

13 A: Yeah. So, the transfer pricing Memo would
14 provide me with the various ranges that were
15 used, but would not give me accurate
16 information in order to compute income tax for
17 purposes of filing an income tax return.

18 Q: Okay. So, let's look at -- did Tractor
19 Supply's tax returns provide information on
20 Texas's cost of providing the procurement
21 services?

22 A: No, it did not.

23 Q: Okay. And is that figure found in the trial
24 balances?

25 A: No, it's not.



1 Q: Okay. I believe there was also testimony
2 yesterday that, in the event that transfer
3 pricing were determined to be non-arm's length,
4 one could simply "meet in the middle" by
5 adjusting the inventory markup and retaining
6 separate entity reporting. Do you recall that
7 dialogue?

8 A: Yes.

9 Q: Okay. As an accountant, do you agree with that
10 statement?

11 A: I don't agree with that statement for a couple
12 reasons. Number one, as I mentioned, first, I
13 would -- it would be very important that the
14 company itself go back and make the appropriate
15 changes to their financial statements and to
16 their trial balance to reflect the appropriate
17 arm's length transfer price. I think Mr.
18 Small, yesterday in his testimony, also
19 mentioned that, you know, it could be as simple
20 as computing a new arm's length based on
21 looking at the tax returns itself. My concern
22 there is, what happens in a situation where the
23 actual transfer price is way off from the
24 original transfer pricing that was used. In
25 that case, it would be very difficult to just



1 meet in the middle or find a middle number to
2 use. And so, as an example of that, in Dr.
3 DeRamus' testimony, he mentioned that it may be
4 more appropriate to use the cost of providing
5 the procurement services as the base. And so,
6 if I was to use that example against what was
7 used on the returns as opposed to applying the
8 arm's length transfer pricing against billions
9 of dollars of inventory, for example, you
10 really can't meet in the middle in that
11 situation. So, as an accountant, I would move
12 towards combined reporting as a way to address
13 that and to provide a more reliable starting
14 point.

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

16 **THE COURT:** Any questions?

17 **MS. GEER:** Yes, Your Honor. One moment.

18 **MR. SEHGAL - CROSS-EXAMINATION BY MR. STREISEL:**

19 Q: Good morning.

20 A: Good morning.

21 Q: So, the markup on the inventory with 9.7
22 percent were during the audit years, right?

23 A: Correct.

24 Q: And are you saying that if it should have been
25 seven percent, that you wouldn't be able to



1 calculate the tax due to South Carolina using
2 a separate return and the standard
3 apportionment method?

4 A: So, as I mentioned, I could probably do a very
5 high level calculation just for my own
6 understanding of, directionally, what the tax
7 impact may be, but in terms of actually
8 preparing the tax return, I would -- I'm not
9 sure that I have accurate enough information to
10 do it simply based off the tax returns
11 themselves. In addition to that, I would have
12 some concern from a documentation standpoint
13 that, if I'm basing it solely off of the
14 federal tax return, for example, that I
15 wouldn't have sufficient documentation in case
16 there is a potential state audit down the road.

17 Q: I'm not sure you answered my question. So, are
18 you saying you would not be able to determine
19 the tax due to South Carolina using a separate
20 return and the standard apportionment method if
21 you were asked to change a 9.7 percent markup
22 to seven percent?

23 **OBJECTION BY MS. WOOTEN:**

24 **MS. WOOTEN:** Objection, Your Honor. Asked and
25 answered.



1 **MR. STREISEL:** What's he ---

2 **THE COURT:** That's interesting, but I don't know if
3 he answered it.

4 **MS. WOOTEN:** Thank you, Your Honor. Just preserving
5 the record. Thank you.

6 A: So, if I can ask a clarifying question? So are
7 you asking me whether I can compute the actual
8 tax due, or are you asking me whether I can
9 prepare a South Carolina return and have the
10 pro- -- proper documentation to do that?

11 Q: I guess, what -- I don't know what proper
12 document- -- I -- I'm not -- all right, let me
13 rephrase this. So, you have the trial
14 balances, correct?

15 A: Correct.

16 **THE COURT:** Here. I'll go with your first request,
17 because I would like to know.

18 **MR. STREISEL:** Yeah.

19 **THE COURT:** Or your first scenario, because I'd like
20 to know that from my standpoint.

21 A: So, as I mentioned, from a very high level, I
22 could probably compute the change in the markup
23 and what the impact would be from a South
24 Carolina tax perspective, but I wouldn't
25 necessarily have confidence that my number is



1 the actual number that would be reported on the
2 return. And the reason for that is, because
3 when you're looking at a trial balance of a
4 company, it's important to understand the
5 various components of a specific account. So
6 I'm not 100 percent sure just by looking at a
7 trial balance exactly what is included in cost
8 of sales, for example, there's various
9 components to it. So, in order for me to have
10 the proper documentation and to feel
11 comfortable with what I'm reporting on a South
12 Carolina return, I would want the client to go
13 back and adjust their financial statements to
14 ensure that whatever change in the arm's length
15 transfer pricing has -- whatever proper
16 percentage should be used, is accurately
17 reflected in their books and records, so that
18 I have confidence that when I'm preparing an
19 income tax return, I am using the correct
20 information.

21 Q: So, I'm asking you, are you unable to make the
22 adjustment in their financial records, changing
23 that 9.7 percent markup to seven percent
24 markup, and then calculating the tax due to
25 South Carolina based on that adjustment, using



1 a separate tax return and the standard
2 apportionment method?

3 **OBJECTION BY MS. WOOTEN:**

4 **MS. WOOTEN:** Your Honor, I'm going to object again
5 for asked and answered. I think he's explained
6 his answer.

7 **MR. STREISEL:** It's a yes or no question.

8 **THE COURT:** I still -- I'm going to allow him to ask
9 it ---

10 **MS. WOOTEN:** Okay.

11 **THE COURT:** --- one more time.

12 **MS. WOOTEN:** Thank you.

13 **THE COURT:** You don't have to thank me for ruling
14 against you.

15 *(Laughter.)*

16 Q: Are you saying that you would be unable to make
17 the adjustment in the company's financial
18 records, changing ---

19 **THE COURT:** Well, now he's asking a different
20 question.

21 **MR. STREISEL:** (To court reporter) Can you repeat my
22 last question?

23 **THE COURT:** Just ask it -- ask one more time and
24 let's see if we can get through. If anything,
25 I'll ask it.



1 Q: Yeah. I -- so, are you saying that you are
2 unable -- let me rephrase this.

3 If we asked you to assume that the 9.7
4 percent markup that was used should be a seven
5 percent markup, and we asked you to make the
6 adjustments in the company's financial records
7 to reflect that different price, are you saying
8 that you are unable to do that and calculate
9 the tax that would be owed to South Carolina
10 using a separate return in the standard
11 apportionment method?

12 A: So, I'm not able to do that because, again, I
13 -- I'm not familiar with the company's books
14 and records, and I don't know everything that
15 goes into the various accounts included in the
16 trial balance.

17 Q: But what if you have access to their books and
18 records and their trial balance, which I know
19 you have access to the trial balance, so.
20 Let's assume you have those materials, then,
21 would you be able to calculate the tax due to
22 South Carolina?

23 A: You know, if I had all of the information I
24 needed, I could -- I could make that adjustment
25 within their trial balance.



1 Q: Okay. What other information do you need?

2 A: Well, like I said, when you're looking at a
3 specific trial balance account, there's a lot
4 of information that goes in there. It's not
5 just taking whatever ending balance or
6 beginning balances within that account and
7 adjusting the transfer price on that entire
8 amount. There may be various components of
9 what makes up a specific account outside of
10 just sales -- cost of sales, for example. So,
11 again, I wouldn't be comfortable just taking
12 the number on the trial balance and making an
13 adjustment, I would really like to understand
14 what's included within those various accounts
15 because there may be several hundred
16 transactions that are recorded within a
17 specific trial balance account, and just taking
18 one number and making that adjustment, I would
19 not be able to do that and feel comfortable
20 with that computation.

21 Q: Okay. Do you think others could be comfortable
22 making that computation?

23 **OBJECTION BY MS. WOOTEN:**

24 **MS. WOOTEN:** Objection, Your Honor. Speculation.

25 **THE COURT:** Yeah, I sustain that.



1 **MR. STREISEL:** All right.

2 **Q:** If Tractor Supply Company -- let me back this
3 up. I think you said -- or, did you say
4 earlier that the -- that if the transfer
5 pricing price was too high, the tax return from
6 South Carolina does not fairly reflect the
7 business activity because the income reported
8 is too low?

9 **A:** I'm not sure I said that exactly, but ---

10 **Q:** Well, can you, can you tell me why the South
11 Carolina tax return does not fairly reflect
12 business activity, and the transfer price is
13 too high?

14 **OBJECTION BY MS. WOOTEN:**

15 **MS. WOOTEN:** Your Honor, I -- I don't believe I
16 asked him that on -- on direct, and thus
17 exceeding the scope of ---

18 **MR. STREISEL:** Okay. That's fine. Can you put up
19 that exhibit right there?

20 *(Whispering.)*

21 **Q:** If Tractor Supply Company had made a mistake in
22 taking a deduction for too much depreciation,
23 would its tax return fairly reflect it's
24 business activity in the state from an
25 accounting perspective?



1 **OBJECTION BY MS. WOOTEN:**

2 **MS. WOOTEN:** Your Honor, I would object to this line
3 of questioning, too. He's a rebuttal witness
4 and I did not ask any of those questions on
5 direct.

6 **THE COURT:** Well, the question is did you -- didn't
7 you -- where, where are we at re-cross?

8 **MS. BUCKNER:** We're on cross of rebuttal witness.

9 **THE COURT:** Yeah. Okay. All right. Any response?

10 **MR. STREISEL:** Yeah. I guess, my response is that,
11 at the very beginning of this, I don't have the
12 question in front of me, was something to the
13 effect of, if the 9.7 percent payment was too
14 much -- too high, that from an accounting
15 perspective, the South Carolina tax return
16 would not fairly reflect the taxpayer's income,
17 or something to that effect.

18 **THE COURT:** That's ---

19 **MR. STREISEL:** And I'm trying to understand the
20 logic behind that statement. So I'm trying to
21 ask, what if Tractor Supply Company rather than
22 paying the 9.7 percent, what if instead, it too
23 much depreciation, more than it was allowed,
24 would you still ---

25 **THE COURT:** Well, now ---



1 **MR. STREISEL:** --- be saying the tax return does not
2 fairly reflect business activity from an
3 accounting standpoint in that hypothetical?

4 **THE COURT:** Any response?

5 **MR. STREISEL:** There was one business deduction
6 we're talking about, so depreciation is another
7 wrong deduction, we'll call it.

8 **MS. WOOTEN:** Your Honor, again, I did not go into
9 depreciation. I did not go into in the
10 deduction.

11 **THE COURT:** I -- I recognize -- that we're on ---

12 **MS. WOOTEN:** We're on rebuttal.

13 **THE COURT:** We're on rebuttal, but it's a cross-exam
14 -- cross-examination of a witness, even though
15 it is rebuttal. So, I'm going to let him go
16 into it.

17 **MS. WOOTEN:** Understood. Is that a prop- -- better
18 response for you?

19 **THE COURT:** Yes.

20 Q: So, let's just say ---

21 **THE COURT:** You understand my ruling, you may not
22 agree with it, but.

23 **MS. WOOTEN:** Understood.

24 *(Laughter.)*

25 Q: Let's just say, Tractor Supply incorrectly took



1 a 10 million dollar depreciation deduction in
2 2014 that it was not allowed to take, but it
3 did, what would you say about its South
4 Carolina tax return, and whether that fairly
5 represents its business activity from an
6 accounting perspective?

7 A: So, if -- in that specific case, I think I
8 would say that it does not fairly represent its
9 business activity in the State.

10 Q: Okay.

11 A: Again, from an accounting perspective, and from
12 an income tax perspective.

13 Q: And that's just because the income ultimately
14 reported is lower than it would have been, but
15 for that one error?

16 A: Correct.

17 Q: Okay. And is that the same logic you are
18 applying when you are saying that, if the 9.7
19 percent markup is too high and it instead
20 should be seven percent. Are you applying the
21 same logic when you said that, from an
22 accounting perspective, the South Carolina tax
23 return does not fairly reflect the business
24 activity from an accounting perspective?

25 A: I would say yes to that.



1 Q: Okay.

2 **MR. STREISEL:** One moment, please.

3 Q: So, two questions ago, a depreciation, if they
4 corrected that error, would a separate tax
5 return using the standard method of
6 apportionment, then, fairly represent their
7 business activity in South Carolina from an
8 accounting perspective?

9 A: So, if I'm just looking at that specific issue
10 in a vacuum without factoring anything else
11 that's gone into the South Carolina return, and
12 assuming that everything else within the South
13 Carolina return was correct and does fairly
14 represent the taxpayer's business activity in
15 the State, then I would say, yeah, making that
16 adjustment could fairly reflect the business
17 activity in the State. But, again, I'm only
18 looking at that in a vacuum, I'm not factoring
19 in anything else that's included in the return.

20 Q: Okay. And so, the transfer pricing issue we
21 are talking about, if you're looking at that in
22 a vacuum and saying the 9.7 percent should have
23 been seven percent, do you believe that
24 correcting that 9.7 percent to seven percent
25 would ultimately lead to the South Carolina tax



1 return, as filed, being a fair representation
2 of the taxpayer's business activity in the
3 State from an accounting perspective?

4 A: I would answer that as, actually, no. And the
5 reason for that, is because when you're dealing
6 with transfer price and you're dealing with
7 intercompany transactions and you're dealing
8 with a lot of other things that go into a
9 specific transfer pricing analysis, and things
10 of that nature, there's more that would go into
11 it to determine whether or not the taxpayer's
12 business activity fairly repre- -- is fairly
13 represented in the state. Depreciation is a
14 different thing, because that's unique to that
15 taxpayer. It doesn't apply across various
16 entities. There's no intercompany
17 transactions. There's, there's other things
18 that go into determining a transfer price. So,
19 I would answer that as no.

20 Q: Isn't it just one adjustment in the trial
21 balance?

22 A: Not necessarily because, again, there's more
23 that goes into transfer pricing than just
24 making one adjustment.

25 Q: All right.



1 *(Whispering.)*

2 **MR. STREISEL:** I'm finished. No, no further
3 questions.

4 **THE COURT:** Re-direct?

5 **MS. WOOTEN:** Nothing on re-direct, Your Honor.

6 **THE COURT:** You may step down. Well, are we going
7 to take a break or we ready?

8 **MS. WOOTEN:** Actually, Your Honor, we were going to
9 ask if we could take -- since we started early,
10 if we take a lunch break before our next
11 witness?

12 **THE COURT:** Any objection?

13 **MS. GEER:** Can we just do 30 minutes?

14 **MS. WOOTEN:** For a lunch break?

15 **MS. GEER:** No. I mean, can we just like get in 30
16 minutes. We ordered our lunch to be brought
17 here, so we -- it wouldn't get here in time if
18 we break this early.

19 **MS. WOOTEN:** Okay.

20 **MS. GEER:** Does that cause you ...

21 **THE COURT:** Well, if we take a ---

22 **MS. GEER:** Can we just do qualifications, if it's a
23 -- oh, I don't know who it is. Sorry. I, I
24 was thinking it might be Bruce, but.

25 **MS. WOOTEN:** Right. Your -- can -- may we take a



1 five-minute break to discuss how we're going to
2 do ---

3 **THE COURT:** We can take a five-minute break. If we
4 break for an hour and a half it will include
5 your ---

6 **MS. WOOTEN:** Yes.

7 **THE COURT:** --- your getting your lunch.

8 **MS. WOOTEN:** Yes, it would.

9 **THE COURT:** Let's just take a five-minute break
10 right now.

11 **MS. WOOTEN:** Okay.

12 (Off the record from 11:33 a.m. until 11:40 a.m.)

13 **MR. LUTHER:** Your Honor, Your Honor, at this time,
14 the Department would call Bruce Fort.

15 **THE COURT:** What do you know.

16 **COURT REPORTER:** If you'll raise your right hand for
17 me?

18 **MR. FORT:** (Witness complies.)

19 **COURT REPORTER:** Do you swear to tell the truth, the
20 whole truth and nothing but the truth, so help
21 you God?

22 **MR. FORT:** I do.

23 **COURT REPORTER:** Thank you.

24 **BRUCE FORT,** having been duly sworn, testifies as
25 follows:

