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THE STATE OF SOUTH CAROLINA
In the Supreme Court

APPEAL FROM THE ADMINISTRATIVE LAW COURT

Carolyn C. Matthews, Administrative Law Judge

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

CarMax Auto Superstores West Coast, Inc., ...Respondent/Petitioner,

v.

South Carolina Department of Revenue, ...Petitioner/Respondent.

AMICUS CURIAE BRIEF OF COUNCIL ON STATE TAXATION

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes

Other Authorities

INTEREST OF THE AMICUS

The Council On State Taxation ("COST") is a nonprofit trade association based in Washington, D.C. COST formed in 1969 as an advisory committee to the Council on State Chambers of Commerce. Today COST has grown to an independent membership of over 600 major corporations engaged in interstate and international business. COST's objective is to preserve and promote the equitable and nondiscriminatory state and local taxation of multi-jurisdictional business entities. COST members employ a substantial number of South Carolinians, own and lease property in South Carolina, and conduct substantial business in South Carolina.

Similar to most other states, South Carolina apportions the income of multistate businesses by using a set of rules partially based on the Uniform Division of Income for Tax Purposes Act ("UDITPA").[1] UDITPA has been adopted in whole or in part by a majority of other states, and the states that have adopted UDITPA often look to court decisions in their sister states when called on to interpret this uniform law. How UDITPA is administered and applied in South Carolina is, therefore, of vital interest and importance to COST and its multistate corporate membership. COST is concerned that the holding of the lower courts in this case will not only negatively impact how South Carolina administers its corporate income tax; it could also negatively impact how other states administer their tax laws. Thus, if allowed to stand, the decision will not only lead to multiple taxation but it will inevitably lead to the very lack of

[1] UDITPA was drafted by the National Conference of Commissioners on Uniform State Laws (now the Uniform Law Commission) at their 1957 annual conference in order to provide "a uniform method of division of income for tax purposes among the several taxing jurisdictions." UDITPA, Prefatory Note, 7 U.L.A. 142 (2002).

uniformity and uncertainty that UDITPA was designed to prevent.

COST submits this *amicus curiae* brief to aid this Court in understanding how the decision of the Administrative Law Court ("ALC")—allowing the South Carolina Department of Revenue ("Department") to deviate from statutory rules in a very common situation—undermines the certainty of uniform multistate apportionment. If left to stand, the ALC's decision will result in unstable and indiscriminate taxation by the State of South Carolina.

For use in unusual circumstances, UDITPA provides a safety valve for the taxpayer or a revenue agency to seek alternative apportionment from the standard formula. *See UDITPA*, § 18. The South Carolina legislature adopted this UDITPA section in 1995. *See* S.C. CODE ANN. § 12-6-2320. When invoked by a revenue agency, alternative apportionment should be based on promulgated regulations that clearly provide the rules in those instances where a group of taxpayers or an entire industry has unique facts that warrant alternative apportionment. It is only in the rarest and most unusual circumstances the Department can justifiably vary from the standard apportionment methodology provided for in South Carolina's statutes and rules. S.C. CODE ANN. § 12-6-2320.[2] The ALC's decision threatens to disrupt this long-standing approach. In essence, that decision arms the Department with the power to deviate from the normal statutory scheme not just in rare and unusual circumstances, but even in situations where the facts are commonplace, and to do so in an arbitrary way. In short, the ALC's decision allows the Department to make up the apportionment rules as it goes along.

[2] The South Carolina Department of Revenue has the authority to promulgate regulations setting forth the criteria it will use to require a taxpayer to vary from the standard apportionment method. The Department has failed to issue such regulations.

Additionally, COST and its members have an interest in promoting efficiencies and controlling costs in litigation such that taxpayers can avoid an extended, time-consuming and expensive process that results in substantial financial burdens and delayed resolutions for taxpayers. In this case, the Department failed to provide sufficient support for its use of alternative apportionment, and therefore the assessment against the taxpayer should be dismissed.

ARGUMENT

Affirmance of the Court of Appeals decision, modified to direct the Court of Appeals to dismiss the case is warranted because of the potentiall y widespread impact the decision could have on the consistency and reliability of South Carolina's corporate income tax laws. The importance of this case goes far beyond the application of a rarely imposed statutory exception to a multi-jurisdictional business. This Court needs to affirmatively reject the latitude the ALC granted the Department to deviate from the standard statutory apportionment formula, because it will have a significant impact on South Carolina taxpayers. Of equal, if not greater, importance is the fact that this action of the Department threatens the consistency and uniformity the South Carolina legislature has sought to achieve in the realm of state taxation of businesses engaged in interstate commerce.

I. THE DEPARTMENT FAILED TO JUSTIFY ITS USE OF SEPARATE ACCOUNTING, A FORM OF ALTERNATIVE APPORTIONMENT, IN THIS CASE.

As the Court of Appeals held, it is well settled that the Department bears the burden of proof to assert equitable apportionment. In Hellerstein & Hellerstein, State Taxation ¶ 9.20 [7] states:

> [7] **Burden of Proof Under Equitable Apportionment Provisions and Regulations Promulgated Thereunder**
>
> Courts construing equitable apportionment provisions have generally held that the burden of proof rests on the party seeking to invoke the provision. In other words, the party seeking a deviation from the standard apportionment provisions must demonstrate that they 'do not fairly represent the extent of the taxpayer's business activity in the state' and that the proposed alternative method 'effectuate(s) an equitable allocation and apportionment of the taxpayer's income.'

Recent cases to this effect include: *Microsoft Corp. v. Franchise Tax Bd.*, 39 Cal. 4th 750, 139 P3d 1169, 47 Cal. Rptr. 3d 216, 227 (2006) ("As the party invoking [UDITPA § 18], the Board has the burden of proving by clear and convincing evidence that (1) approximation provided by the standard formula is not a fair representation, and (2) the proposed alternative is reasonable"); *Appeal of Crisa Corporation*, No. 34424, 2002 WL 1400003 at *8 (Cal. State Bd. of Equaliz., June 20, 2002 ("It is well settled that the party invoking [UDITPA § 18]...bears the burden of proof."); *Union Pac. Corp. v. Idaho State Tax Comm'n*, 139 Idaho 572, 83 P3d 116, 120 (2004) ("The party asserting the alternative apportionment...bears the burden of showing that alternative apportionment is appropriate."); *Bellsouth Adver. & Publ'g Corp. v. Chumley*, 308 SW3d 350, 362 (Tenn. App. 2009) ("[t]he burden is on the party seeking a variance to establish that the formula does not fairly represent [the taxpayers'] business activities in the taxing state") (quoting *American Tel. & Tel. Co. v. Huddleston*, 880 SW2d 682, 691-692 (Tenn.

App. 1994)).

In addition, the statutory authority of the Department to require an alternative method is triggered *only* if the standard apportionment formulas contained in Title 12, Chapter 6 fail to fairly represent the extent of the taxpayer's business activity in South Carolina. This standard was evoked by Prof. William Pierce, UDITPA's principal draftsman, who stated that the equitable apportionment provision should be limited to the "unusual case:"

> Of course, departures from the basic formula should be avoided except where reasonableness requires. Nevertheless, some alternative method must be available to handle the constitutional problem *as well as the unusual cases*, because no statutory pattern could ever resolve satisfactorily the problems for the multitude of taxpayers with individual business characteristics. (Emphasis added.)

W. Pierce, 'The Uniform Division of Income for State Tax Purposes," 35 Taxes 747, 781 (1957). The Multistate Tax Commission Regulations took a similar position in the years at issue in this case. Prior to 2011, MTC Reg. IV.18.(a) provided:

> [UDITPA §] 18 permits a departure from the allocation and apportionment provisions of [UDITPA] *only in limited* and specific cases. [UDITPA § 18] may be invoked only in specific cases where *unusual fact situations* (which ordinarily will be *unique and nonrecurring*) produce incongruous results under the apportionment and allocation provisions contained in [UDITPA]. (Emphasis added.)

(The MTC amended the Regulation in 2010.) The drafters of the UDITPA made it clear that the alternative apportionment provisions were "designed to permit the use of methods different than those prescribed in the Act only in *unusual* cases where the application of the specifically prescribed methods might be held unconstitutional." *Keesling and Warren, California's Uniform Division of Income for Tax Purposes Act,* 15 UCLA L. Rev. 156, 171 (1967).. The intent of the UDITPA

drafters is clear – the provision should be used sparingly.

Hellerstein, State Taxation (3d ed.) similarly states in ¶ 9.20[3][c]:

> A number of courts—often invoking the remarks of Professor William Pierce, UDITPA's principal drafter, that the equitable apportionment provision should be limited to the 'unusual case' and to the Multistate Tax Commission (MTC) regulations (prior to their revision in 2010) taking a similar position – have insisted that the central question under UDITPA's relief provision 'is not whether some quantitative comparison has produced a large-enough 'distortive' figure,' but rather '*whether there is an unusual fact situation* that leads to an unfair reflection of business activity under the standard apportionment formula.'

The present situation does not compel the utilization of alternative apportionment. The taxpayer in this case sells used cars and employs commonplace, arm's-length intercompany agreements in the management of its internal affairs. CarMax Auto Superstores West Coast, Inc. ("CarMax West") does not develop novel technology heretofore unknown in the law, nor does the Department allege CarMax West uses arcane, financial chicanery to grossly distort its income. CarMax West's business is operational and not undergoing bankruptcy, receivership, or other corporate turmoil. The Department made absolutely no showing at trial that CarMax West's business constituted an "unusual fact situation" warranting alternative apportionment. In the absence of such a showing, alternative apportionment is not proper. The Department's discontent with the tax result of the taxpayer's perfectly ordinary business is not enough to support the application of alternative apportionment.

Note also that the statutory apportionment formula is presumptively correct and constitutional. *See, e.g., Sherwin-Williams Co. v. Johnson*, 989 S.W.2d 710, 716 (Tenn. App. Ct. 1998). Recognizing that exact apportionment is practically impossible, South Carolina has held that a "rough approximation" is sufficient. *Covington Fabrics Corp. v.*

S.C. Tax Comm'n, 264 S.C. 59, 67, 212 S.E.2d 574, 577-78 (1975) (*citing Illinois Central Ry. Co. v. Minnesota*, 309 U.S. 157, 161, 60 S. Ct. 419, 422 (1940)). The party challenging the statutory apportionment formula has the burden of showing that is does not fairly represent the taxpayer's income from South Carolina. *See NCR Corp. v. S.C. Tax Comm'n*, 304 S.C. 1, 11, 402 S.E.2d 666, 672 (1991) ("NCR I") (holding that the taxpayer challenging application of the statute has the burden of proving "gross distortion"); *Covington Fabrics*, 264 S.C. at 66, 212 S.E.2d at 577 ("One who attacks a formula of apportionment carries a distinct burden of showing by 'clear and cogent' evidence that it results in extraterritorial values being taxed.") (citations omitted); *Container Corp. v. Franchise Tax Ed.*, 463 U.S. 159, 180, 103 S. Ct. 2933, 2948 (1983).

There are no clear criteria for what constitutes distortion of apportionment factors. Courts analyze whether the amount of income upon which the corporation is taxed fairly and accurately reflects the business the taxpayer carries on in the state. An apportionment method is "distortive" if it unfairly or inaccurately apportions income to a state relative to the business the taxpayer does there.

In *Eastman Kodak Co. v. S.C. Tax Comm'n*, 308 S.C. 415, 418 S.E.2d 542 (1992), the South Carolina Supreme Court addressed this issue. The Tax Commission disallowed certain deductions related to safe harbor leases from Kodak's net income. The Tax Commission argued that these deductions distorted Kodak's net income because only a small percentage of its total income from these leases was attributable to South Carolina. The court stated:

> This Court has held that the apportionment formula is a reasonable basis for establishing the income tax of corporations which, like Kodak, do business on a multistate level. Since the safe harbor lease transactions

> were a part of Kodak's general business, they were properly included in the denominator of the apportionment formula in computing Kodak's national net income from payroll, property, and sales. The fact that a very small percentage of the leased assets are located in South Carolina is accounted for in the numerator of the apportionment formula in which Kodak's payroll, property, and sales in this state are computed. Therefore, the apportionment formula reflects a 'reasonable representation' of Kodak's business in this state.

Id. at 419, 418 S.E.2d at 544 (internal citations omitted).

South Carolina considered what constitutes distortion in *NCR Corp. v. S. C. Tax Comm'n*, 312 S.C. 52, 402 S.E.2d 254, 256 (1993) ("NCR II"). In *NCR II*, the taxpayer claimed that South Carolina's application of the statutory apportionment formula "violate[d] the due process [clause] because it result[ed] in an unfair apportionment of income to South Carolina." *Id.* at 56, 402 S.E.2d at 256. In order to show a due process violation, the taxpayer had the burden of proving that the statutory apportionment formula *grossly* distorted the taxpayer's South Carolina income. *See NCR I*, 304 S.C. at 11, 402 S.E.2d at 672.

In addition, the Court of Appeals correctly held "the Department, as the proponent of an alternative apportionment method, must establish that its alternative method is not only appropriate, but more appropriate than any competing methods."[3] By requiring the Department to prove the alternative apportionment method is "more appropriate than any other competing methods," the Court of Appeals placed a burden on the Department to show the alternative apportionment method is not only likely to be more appropriate than the standard apportionment formula, but more appropriate than *any* other method. *See Media General Communications, Inc. v. South Carolina Department of Revenue*, 388

[3] *CarMax Auto Superstores West Coast, Inc. v. South Carolina Dep't of Revenue*, 397 S.C. 604, 611, 725 S.E.2d 711, 714 (2012).

S.C. 138, 694 S.E.2d 525 (2010), where the Court stated that since "the Department has not established that another method would be more appropriate", the assessment should be dismissed. *Id.*

Interestingly, until this case, the courts and laws of South Carolina have been mute on what burden of proof is required when the Department seeks to override the standard statutory apportionment method. Some states have addressed the issue, and in a recent multistate survey, twice as many of those states responding require clear and convincing evidence than preponderance of the evidence.[4] For example, FLA. ADMIN. CODE ANN. R. 12C-100152 states a party "seeking to utilize an alternative apportionment method must show by clear and cogent evidence that the regularly applicable formula would result in taxation of extraterritorial values." This high standard makes sense because alternative apportionment seeks to satisfy a federal, constitutional standard.

The Department has issued no regulations or Policy Documents (e.g. Revenue Rulings) to put South Carolina's taxpayers on notice of when the Department will require an alternative method of apportionment. Without written guidance and interpretations for taxpayers, the Department should be estopped from applying alternative apportionment to situations and businesses the Department acknowledges are commonplace.

Not only did the Department use a different method of apportionment, it also "cherry-picked" which income to include in South Carolina, and how that income is apportioned to the State. The Department used separate accounting to strip out the royalty management fee and the financing receipts income to its advantage, while

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[4] *See* Bloomberg BNA, *2013 Survey of State Tax Departments*, 20 TAX MGM'T MULTISTATE TAX REP. S-1; S-18 (2013), *available at* http://taxandaccounting.bna.com/btac/core_adp/get_object/tmssurvey_currentyear.pdf.

ignoring CarMax West's other income, such as its retail motor vehicle sales. *Court of Appeals Op.*, 397 S.C. at 607-08, 725 S.E.2d at 712-13. "The linchpin of apportionability in the field of state income taxation is the unitary-business principle." *Mobil Oil Corp. V. Comm'r of Taxes of Vermont*, 445 U.S. 425, 439 (1980). To establish the retail sales are not subject to apportionment in South Carolina, the Department must show the retail income "was earned in the course of activities unrelated to" the royalty management fees and the financing receipts. *Id.* Without the retail motor vehicle sales, there would be no need for the financing receipts or the management royalty fees, and the Department cannot equitably separate them in order to require a taxpayer to pay more corporate income tax to South Carolina. The income from CarMax West's ordinary operations should be apportioned just like the ordinary income of every other business in South Carolina is apportioned.

The typical state administrative procedure act contains two separate sets of procedures—one for rulemaking and one for adjudication. While agencies with delegated authority to issue rules and to decide individual cases normally have some limited discretion as to the means by which they may enforce a particular law, those agencies are still bound by their state laws. To date, the Department still has not filed any regulations relating to alternative apportionment in accordance with the South Carolina's administrative procedures act. S.C. CODE ANN. § 1-23-10 *et seq.* and S.C. CODE ANN. § 12-4-320(1). Also, the Department announces general statements of position for guidance through advisory opinions which are not regulations and do not have the force of law. *See* S.C. CODE ANN. §§ 1-23-10(4) and 12-4-320. The legislature obviously recognized that the Department would need to exercise some limited discretion

in furtherance of its duty to enforce the tax laws of the State, and that in exercising its discretion taxpayers need to be advised of all rules utilized by the Department to enforce the tax laws of the State. With the Department having no regulation or guidance in place to notify taxpayers when the Department will invoke alternative apportionment, the Department must clearly show a compelling reason for using alternative apportionment and support why the method used is better than any other alternatives.

In our view, the Court has established a procedural environment wherein the Department has virtually unbridled discretion to ignore its own longstanding, unambiguous tax rules and regulations to assess taxpayers under whatever apportionment method the Department concocts to produce the highest tax liability for the taxpayer. It is not equitable to put a taxpayer in a position when dealing with the Department on an alternative issue to have the Department say "heads I win (when seeking the use of alternative apportionment) and tails you lose (when taxpayer is seeking its use)."

To conclude, as the Department does, that it need not go through the rulemaking process (or offer any other guidance) ignores the affirmative statutory duties placed on the Department by the legislature. Rulings from other states are instructive. In *CBS, Inc. v. Comptroller*, 319 Md. 687 575 A.2d 324 (Md. Ct. App. 1990), the Maryland Court of Appeals (Maryland's highest court), addressed a situation similar to one here, and held that the tax administrator may enact certain tax policies only prospectively, and then only by formal rulemaking. *Id.* at 688-89, 330. *CBS* dealt with the manner in which a taxpayer apportioned advertising receipts of national broadcasting companies. *Id.* at 690, 325. Despite a prior history of acquiescence in the taxpayer's method of apportionment, "when the 1980 and 1981 returns were audited, the Appellant for the first time insisted on

the application" of a new apportionment method. The Maryland Court of Appeals' explicitly rejected the tax administrator's assertion that the alternative apportionment authority granted to the tax administrator, which is identical to the South Carolina provision at issue here, gave the administrator the authority to enact this new policy without formal rulemaking. Referring to *Metromedia, Inc. v. Dir., Div. of Taxation*, 97 N.J. 313, 478 A.2d 742 (1984), the Maryland Court noted: "it does not follow that, because [an agency] has statutory discretion, the manner in which this discretion is exercised is not governed by the standards that determine whether rulemaking or adjudication must be followed in a given case." *CBS*, 319 Md. 698, 575 A.2d 329. The Court held that the tax administrator's new policy could not be effectuated through *ad hoc* adjudication, but only prospectively pursuant to the formal rulemaking procedures of the Maryland Administrative Procedure Act. *Id.* at 698, 330. As a result, the Appellant's position could not be applied retroactively. *Id.*

The Maryland Court of Appeals' reasoning in *CBS* is directly applicable to an analysis of the South Carolina Administrative Procedure Act, which also requires that a change or implementation of policy by a state agency be accomplished by promulgating a regulation. *See* S.C. CODE ANN. §§ 1-23-10 through 1-23-680. It is inequitable for the Department to invoke such a unique apportionment regime on a common scenario through the adjudicatory process. Rather, it should have promulgated rules so that all similarly situated taxpayers have notice of the Department's intentions to carve up income and alter apportionment factors. Such notice treats all similarly situated taxpayers equally and gives these taxpayers a meaningful opportunity to prospectively comply with the law when filing their tax returns.

In the absence of such guidance, if the Department disagrees on an *ad hoc* basis with a taxpayer's application of the plain, statutory apportionment scheme, as is the case here, then the Department must produce clear evidence that the standard methodology to report and apportion a taxpayer's income does not fairly represent the extent of that taxpayer's business activities in this State and the Department's alternative is more reasonable than that method or any other method. *See* S.C. CODE ANN. § 12-6-2320(A). CarMax West had a clear right and, in fact, duty under the statute, to use the standard method in South Carolina to calculate its taxable income and apportion that income to the State. The South Carolina Statute for apportionment for service businesses like CarMax West has been in existence since the 1950s. It was drafted by the General Assembly—not the Department. The Department drafted the corporate income tax returns which CarMax West duly and accurately filled out and filed. Tens if not hundreds of thousands of businesses have filed these same forms in the same manner with the Department during the audit period.

If the Department wanted to refute that method, it needed to present clear evidence to justify a deviation from the standard method provided for in South Carolina's law. It did not present such evidence.

The importance of clear regulatory guidance that is available to all taxpayers prior to the time they file a return cannot be overstated because, at a minimum, such guidance aids in tax compliance. The ability to make reasonably accurate forecasts of state tax liability is an essential element of informing investors. Forecasts of a taxpayer's total state tax liability cannot be made without reasonably fixed standards. The standard South Carolina rules for apportionment are designed to provide certainty through fixed

standards. When a tax is imposed without regard to the recognized standards–as was the assessment here–sound business decisions based on expected tax liabilities become impossible. This uncertainty produces a significant financial reporting issue for businesses. ASC 740 (formerly FAS 109) requires taxpayers to accrue tax for uncertain tax positions that remain open for examination if the liability is probable and can be determined with reasonable accuracy. The negative financial reporting from the uncertainty created by allowing the Department to force taxpayers to apportion income based on an uncertain alternative apportionment method could have a significant negative impact on the business's value and corresponding stock price.

In sum, the Department had every opportunity to present evidence that alternative apportionment was properly invoked. In deciding solely to rest on its arguments regarding the burden of proof the Department waived its opportunity, so a remand to present evidence is unnecessary. Accordingly, this Court should simply enter judgment in favor of the taxpayer. A remand on this issue only burdens the taxpayer and the State of South Carolina with unnecessary expenses and delay in obtaining a final resolution in this matter.

II. THE SOURCING OF RECEIPTS TO SOUTH CAROLINA SHOULD BE INDEPENDENT OF THE TAX TREATMENT IN OTHER STATES.

CarMax West correctly asserts the Department should not have sourced CarMax West's income from financing receipts to South Carolina because the activities related to earning that income took place out of state. In support of its position, the Department attempts to justify the sourcing of financing receipts to South Carolina simply because those receipts would not be subject to tax if they were sourced to Georgia, pursuant to

Georgia law. Thus, the Department maintains the receipts would become "nowhere income" that would go untaxed unless sourced to South Carolina. Pet'r/Resp't Resp. Br. 8-9. The Department should not look to the tax treatment of a taxpayer's receipts in other states to determine the sourcing or taxability of those receipts in South Carolina.

South Carolina law provides that if the income-producing activity of a multi-state taxpayer is performed partly within and without the State, gross receipts are attributable to the State to the extent the income-producing activity is performed within the State. S.C. CODE ANN. § 12-6-2295(A)(5) (2012). In other words, South Carolina sources receipts from services based on cost of performance.[5] Under this test, the CarMax Business Services ("CMBS") financing receipts should be sourced outside of South Carolina. All of the activity or work performed by CarMax West employees in producing these receipts—servicing and securitizing loans after the initial sale in South Carolina—took place in Georgia.

To adjust South Carolina's statutory rules for sourcing receipts based on the impact of a rule employed in another state runs directly counter to South Carolina legislative intent. While South Carolina previously had a provision (throwback rule) to apportion sales of tangible personal property to the origin state, rather than the destination state, if the destination state could not impose a tax, the South Carolina legislature expressly (and wisely) repealed its throwback rule in 1995, overtly rejecting the apportionment of sales to South Carolina based on a taxpayer's taxable status in another state. S.C. CODE ANN. §12-7-1170 (repealed in 1995), . *See* L. 1995, Act 76, § 24.

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[5] *See* S.C. CODE ANN. §12-6-2295, ("If the income-producing activity is performed partly within the and partly without this State, sales are attributable to this State to the extent the income-producing activity is performed within this State.")

Changing one state's statutory rules based on rules in other states also runs afoul of fair apportionment principles. *See Whirlpool Properties v. Director, Division of Taxation*, 208 N.J. 141, 26 A.3d 446 (2011). In *Whirlpool*, the taxpayer challenged the constitutionality of the State's former apportionment "throw-out" rule after the New Jersey Division of Taxation applied it to increase Whirlpool's income apportioned to that State. The throw-out rule worked to throw out nowhere sales from the sales factor, causing more income to be assigned to the jurisdiction applying the throw-out rule. 208 N.J. at 173, 26 A.3d 465.

While the *Whirlpool* court held the throw-out rule was not facially unconstitutional, *id.*, 208 N.J. at 151, 26 A.3d at 452, the court did find the throw-out rule could not be applied to receipts sourced to a state that had simply chosen not to impose an income tax, because such a result would not be externally consistent. *Id,* 208 N.J. at 173, 26 A.3d at 465. External consistency is satisfied only if "the factor or factors used in the apportionment formula actually reflect a reasonable sense of how income is generated . . . the question is whether the state's tax law reasonably reflects the activity within its jurisdiction." *Id.* at 165, 461.

Taxing CarMax West's financing receipts in South Carolina would not reasonably reflect its activity within South Carolina. CarMax West earns income from its ownership interest in CMBS that is derived from out-of-state activities of CMBS's vehicle financing division ("CAF"). CAF engages in activity outside the state of South Carolina related to the financing of vehicles after the initial sale occurs, including servicing and securitizing these retail installment contracts. CMBS associates in Georgia service the contracts assigned to CMBS by receiving interest payments from customers and answering

customer questions. These out-of-state activities produce the revenue the Department seeks to tax through its assessment.

The *Whirlpool* decision highlighted the disconnect between a state's tax policy decisions and the tax consequences in other states:

> [A]lthough a lack of jurisdiction is rationally related to how much business a taxpayer does in a state, a state's legislative tax system is not. Whether another state chooses to tax a receipt has no bearing on how much income is attributable to New Jersey. A state's choice not to impose a tax is equivalent to taxing at a rate of 0%. New Jersey's share should not increase because another state sets its tax rate at 0% any more than if that state's rate was .01% or 10%. Such an increase would interfere with the taxing authority of the other state over the receipts generated in that state. 208 NJ 141, 169, 26 A3d 446, 463.

"Some activities contribute more value to a transaction than others," and the sales factor does not only measure where sales take place, but serves "as a proxy for how much a state contributed to the income generated by the sales." *Id.* at 171, 464. Apportionment recognizes that more than one state may contribute to a transaction even if a taxpayer would attribute the transaction to only one state. *Id.* The facts of this case demonstrate South Carolina did not contribute to the financing receipts as much as Georgia, where the activity generating those receipts took place. In addition, contrary to the Department's argument, the sourcing decisions enshrined in Georgia's—or any other state's—law should not, and do not, impact the South Carolina legislature's policy decisions regarding the sourcing of receipts to South Carolina.

Other state courts have also recognized that another state's tax treatment of a taxpayer has no bearing upon the taxability of its income. In *Oracle Corp. v. Dep't of Revenue*, 2010 WL 496945 (Or. T.C. 2010), the Oregon Tax Court considered whether certain gains from the sale of stock and other corporate assets constituted business

(apportionable) or nonbusiness (allocable) income. *Id.* at *1. The taxpayer asserted that because of differences in state law, their "method of reporting the sale of stock under California law does not inform, much less control, the question of how they should be treated under Oregon law. *Id.* at *2. The Oregon Tax Court agreed, stating "[t]he right of each state to have its own tax laws and interpret them in its own fashion is fundamental to our federal system of government," and to hold otherwise would result in a ruling mandating that the characterization of income in another state controls how that income is reported. *Id.* at *3.

If the financing receipts are considered taxable in South Carolina merely because those receipts would otherwise go untaxed in Georgia, such a decision would result in confusion as to how the tax treatment of the income in another state controls or influences how income is taxed in South Carolina. In fact, taxpayers would be unaware at the time of filing whether another state might in turn assert its alternative apportionment authority, demonstrating the absurdity of one state seeking to coordinate its tax policy—administratively, retroactively, and on an *ad hoc* basis—with the tax policy adopted by other states. Accordingly, this Court should rule that the sourcing of receipts to South Carolina should be independent of the tax treatment in other states.

CONCLUSION

Alternative apportionment should not be invoked in cases where the state taxing authority does not show why the ordinary application of the law as written is wrong. COST respectfully urges this Court to affirm the Court of Appeals' decision, with modified instructions to dismiss the case because the Department failed to provide sufficient evidence: 1) to support its use of alternative apportionment and 2) showing that

its method was more appropriate than any other method. COST also respectfully urges this Court to reiterate the importance of South Carolina applying its state law regarding the taxability of a transaction in this state, not upon the laws of another state.

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January _____, 2014

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THE STATE OF SOUTH CAROLINA
In The Supreme Court

APPEAL FROM THE ADMINISTRATIVE LAW COURT

Carolyn C. Matthews, Administrative Law Judge

Case No. 09-ALJ-17-0160-CC

CarMax Auto Superstores West Coast, Inc.....Respondent/Petitioner

v.

South Carolina Department of Revenue.....Petitioner/Respondent

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CERTIFICATE OF COUNSEL

The undersigned certifies that this Brief of Amicus Curiae by the Council on State Taxation ("COST") complies with Rule 211(b), SCACR.

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PROOF OF SERVICE

I certify that I served the **Amicus Curiae Brief of Council on State Taxation ("COST")** on the Petitioner and Respondent by depositing copies of it in the United States Mail, postage prepaid, on January 14, 2014 addressed to their attorneys of record as follows:

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