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S.C. Supreme Court

THE STATE OF SOUTH CAROLINA
In The Supreme Court

APPEAL FROM THE ADMINISTRATIVE LAW COURT

Ralph K. Anderson III, Administrative Law Judge

Opinion No. 5274 (S.C. Ct. App. filed October 8, 2014)

Duke Energy Corporation..... Petitioner,

v.

South Carolina Department of Revenue..... Respondent.

PETITION FOR A WRIT OF CERTIORARI

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CERTIFICATE OF COUNSEL

Counsel for Petitioner hereby certifies that a Petition for Rehearing was timely filed on October 21, 2014, and finally ruled on by the Court of Appeals on November 21, 2014. (App. pp. 8457-8458.)

QUESTIONS PRESENTED FOR REVIEW

- I. Did the Court of Appeals err in holding that a company is a “manufacturer” for South Carolina corporate income tax purposes even though its primary business was the sale of services?
 1. Did the Court of Appeals err in disregarding decades of longstanding precedent when construing the term “manufacturer” and raise a novel issue of whether a service provider can also be a manufacturer for South Carolina corporate income tax purposes?
 2. Did the Court of Appeals err in considering whether apportioning Duke Energy’s income based on the single-factor apportionment formula reasonably represents its business activities in South Carolina even though the Department has not alleged or offered evidence that the single factor apportionment method did not reasonably represent Duke Energy’s business in South Carolina?
- II. Did the Court of Appeals err in narrowing the definition of “receipts” for South Carolina corporate income tax purposes and in holding that securities sold in Duke Energy’s ordinary course of its business are not “receipts” for South Carolina corporate income tax purposes even though South Carolina statutes require that taxpayers include their “total gross receipts” or “total sales” in apportioning their income to South Carolina?
 1. Did the Court of Appeals err in rendering the South Carolina Legislature’s 2007 legislative changes regarding the meaning of “sales” and “gross receipts” meaningless?
 2. Did the Court of Appeals err in failing to consider the plain meaning of the terms “total gross receipts” and “total sales” and in failing to apply the long-settled principle that tax statutes must be construed in favor of the taxpayer when construing the definition of “total gross receipts” and “total sales”?
 3. Did the Court of Appeals err in considering whether including all receipts from Duke Energy’s sales of securities in its apportionment formula reasonably represents its business activities in South Carolina even though the Department has not alleged or offered evidence to

support that conclusion, and err in concluding that sales of securities cannot be “total gross receipts” or “total sales” for South Carolina corporate income tax purposes?

STATEMENT OF THE CASE

This petition for a writ of certiorari presents several important questions the determination of which will significantly affect South Carolina corporate taxpayers. These questions include whether the Court of Appeals erred by determining that Duke Energy Corporation (“Duke Energy”) is a “manufacturer” even though the Court of Appeals held Duke Energy was a service provider. If the Court of Appeals’ decision is left undisturbed then the scope of “manufacturer” is broadened to include many service providers and casts in doubt the accuracy of many South Carolina tax returns.¹ Further, the Court of Appeals rejected Duke Energy’s claim that it is entitled to apply a single-factor apportionment method because it summarily determined that this method produces a result that does not reasonably represent its South Carolina business activities. However, the South Carolina legislature subsequently has determined that all South Carolina corporate taxpayers are entitled to apply the single-factor method rejected by the Court of Appeals. S.C. Code Ann. § 12-6-2252. The Court of Appeals’ decision, if left undisturbed, provides an invitation to all taxpayers to claim that the single-factor method does not reasonably represent South Carolina business activities. These and other important questions significantly alter South Carolina corporate taxation and warrant this Court’s review.

¹ S.C. Code Ann. §§ 12-36-910(B)(4) (application of sales tax); 12-36-110(2) (exemption for sales of tangible personal property manufactured in South Carolina, transported out of state, and installed at the out-of-state job site); 12-36-120(2) (exemption for sales of property to a manufacturer as a component part of the ultimate product); 12-36-2120(9) and (19) (sales tax exemptions for sales of fuel and electricity); 12-37-220(A)(6) (application of property tax exemptions for inventories); 12-37-930 (special valuation rules for depreciation of property).

1. The Department's Audit of Duke Energy and its Denial of Duke Energy's Refund Claims

This case arises from the South Carolina Department of Revenue's (the "Department") denial of Duke Energy Corporation's ("Duke Energy") claims for refund of South Carolina corporate income taxes (collectively "refund claims") for the tax years 1978 through 2001 ("Tax Periods at Issue") in the amount of \$126,240,645 plus interest. (App. pp. 4183-5531; App. p. 49; App. p. 2438, lines 14-21.)

Duke Energy's refund claims related to two issues. First, Duke Energy was a service provider and thus was required to apportion its income using the single-factor apportionment method instead of the multi-factor method required for companies that manufacture tangible personal property. (App. p. 2424, line 22-p.2426, line 1; App. p. 2496, line 18-p. 2497, line 5; App. p. 2514, lines 8-18; App. p. 2520, line 25-p. 2521, line 10; App. p. 5808; App. p. 5922; App. pp. 7707-7708; App. pp. 7272-7273.)

Second, Duke Energy was required to include receipts from securities sold in the ordinary course of its business in the denominator of its gross-receipts factor.² (App. pp. 8195-8197 § 5.A; App. p. 51.)

The Department denied Duke Energy's refund claims and its subsequent appeal. (App. pp. 5532-5542; App. p. 123; App. p. 2439, lines 17-23; App. p. 2442, line 14-p. 2443, line 11; App. pp. 5546-5556; App. p. 123; App. p. 2449, lines 13-18). Duke Energy

² During the Tax Periods at Issue, South Carolina law provided that a taxpayer required to apply the single-factor gross-receipts apportionment formula must do so "using a fraction in which the numerator is gross receipts from within this State during the taxable year and the denominator is total gross receipts from everywhere during the taxable year." *See, e.g.*, S.C. Code Ann. § 12-6-2290 (applicable for tax years beginning after 1995) (emphasis added); former S.C. Code Ann. § 12-7-1190 (applicable for tax years prior to 1996) (emphasis added). For a taxpayer required to apportion its income based on the three-factor apportionment formula, the sales factor consists of a fraction in which the numerator is the "total sales" of the taxpayer in South Carolina during the taxable year and the denominator is the "total sales" of the taxpayer everywhere during the taxable year. S.C. Code Ann. § 12-6-2280 (for tax years after 1995 and before 2011); former S.C. Code Ann. § 12-7-1170 (for tax years prior to 1996).

then timely requested a contested case hearing before the Administrative Law Court (“ALC”). (App. pp. 5558-5581; App. p. 123; App. p. 2453, lines 10-11.)

2. The ALC’s Decision

Following Duke Energy’s appeal to the ALC, the Department filed a Motion for Summary Judgment (“Department’s MSJ”) asking the ALC to rule that: (1) Duke Energy’s refund claims for the tax years 1978-1993 were untimely (the “Waiver Issue”); (2) Duke Energy is a manufacturer of electricity not entitled to use the single-factor gross-receipts apportionment formula (the “Manufacturing Issue”); and (3) Duke Energy should not include the gross proceeds from sales of securities in the calculation of the denominator of its South Carolina corporate income tax apportionment formula (the “Gross Receipts Issue”). (App. pp. 166-370; App. pp. 49-50.)

Duke Energy filed a Cross-Motion for Summary Judgment (“Duke Energy’s Cross-Motion”) asking the ALC to find that, as a matter of law, Duke Energy was required to include the entire proceeds from sales of securities in its apportionment formula. (App. pp. 371-824; App. p. 50.)

The ALC conducted a hearing on the parties’ motions on June 26, 2012. (App. p. 50.) On June 29, 2012, the ALC informed the parties of its decision (1) to grant the Department’s MSJ on the Waiver Issue; (2) to grant Duke Energy’s Cross-Motion on the Gross Receipts Issue; and (3) to order an evidentiary hearing with regard to the Manufacturing Issue.³

On August 9, 2012, without any additional input from the parties, the ALC inexplicitly reversed its position and issued an Order finding for the Department on the

³ As a result, the ALC asked the Department to draft a proposed order regarding the Waiver Issue and Duke Energy to draft a proposed order regarding the Gross Receipts and Manufacturing Issues.

Gross Receipts Issue, in addition to finding for the Department on the Waiver Issue. The ALC also ordered an evidentiary hearing on the Manufacturing Issue. (App. pp. 11-46.)

The ALC held that with respect to the Gross Receipts Issue, only the *net* receipts should be included in Duke Energy's apportionment formula. The ALC also held that including all of the receipts from Duke Energy's sales of securities was distortive⁴ even though the Department never argued distortion and neither party presented any evidence regarding potential distortion.

The ALC conducted a hearing on the Manufacturing Issue, and on November 2, 2012, issued a Final Order and Decision once again finding for the Department. (App. pp. 93-119.) Duke Energy filed a Motion for Reconsideration which the ALC denied on December 4, 2012. (App. pp. 1034-1152; App. pp. 147-165; App. pp. 120-146.) On January 3, 2013, Duke Energy timely filed a Notice of Appeal with the Court of Appeals from all orders issued in this matter.

3. Proceedings in the Court of Appeals

In its arguments to the Court of Appeals, the Department did not defend the ALC's conclusion that Duke Energy's apportionment positions did not reasonably represent Duke Energy's business in the State. It also did not contest the fact that Duke Energy's sales of securities were a part of Duke Energy's regular trade or business.

On October 8, 2014, the Court of Appeals issued Opinion No. 5274 (the "Opinion," App. pp. 8435-8447) substantially affirming the results of the ALC Order. Although the Court of Appeals reversed the ALJ and concluded that the provision of electricity is a service, the court upheld the ALC's determination that Duke Energy was a

⁴ The term "distortive" or "distortion" refers to a determination that the statutorily required apportionment method does not fairly represent a taxpayer's in-state business activities.

manufacturer for South Carolina income tax purposes. (App. p. 8443; Op. at 9.) The Court of Appeals also held that apportioning Duke Energy's income to South Carolina based on the single-factor apportionment formula required for service providers did not reasonably represent Duke Energy's business activities in the State. (*Id.*)

The Court of Appeals also held that Duke Energy's receipts from sales of securities were not part of Duke Energy's "total sales" or "total gross receipts" at all for corporate income tax purposes. The Court of Appeals stated that the proceeds from Duke Energy's sales of securities could not be "receipts" or "sales" for corporate income tax purposes because if they were, they would "artificially inflat[e]" the base which reasonably represents the proportion of trade or business carried on within this State." (App. p. 8446; Op. at 12.)

On October 21, 2014, Duke Energy filed a petition for rehearing, which was denied by an order of the Court of Appeals filed November 21, 2014.

SUMMARY OF FACTS

Duke Energy's primary business in South Carolina is the provision of electric service to its customers. (App. p. 2424, line 22-p.2426, line 1; App. p. 2496, line 18-p. 2497, line 5; App. p. 2514, lines 8-18; App. p. 2520, line 25-p. 2521, line 10; App. p. 5808; App. p. 5922; App. pp. 7707-7708; App. pp. 7272-7273.) During the tax periods 1978 through 2001, Duke Energy's South Carolina corporate income tax returns applied the multi-factor apportionment method and excluded the receipts from its sales of securities from the sales factor. (App. pp. 8195-8196 § 5.A.) In 2002, following a review of its South Carolina corporate income tax filings, Duke Energy amended its South Carolina corporate income tax returns to reflect the single-factor apportionment method required for service providers and to include all of its receipts, including receipts

from sales of securities, in its sales factor. (App. p. 51; App. p. 122; App. p. 2437, lines 12-18.)

The Department denied Duke Energy's refund claims even though it initially agreed that Duke Energy's primary business was the sale of electric service and that Duke Energy's treasury department purchased and sold securities in the ordinary course of its business. (App. p. 2425, line 10-p. 2426, line 1; App. p. 123.)

During the evidentiary hearing before the ALC, the parties' expert and fact witnesses agreed that Duke Energy provides a service. (App. p. 2640, lines 14-18; App. p. 2764, line 5-p. 2765, line 13.) The Court of Appeals also concluded that Duke Energy provides an electric service. (App. p. 8443; Op. at 9.)

SUMMARY OF ARGUMENTS

Rule 242 of the Appellate Court Rules lists circumstances that weigh in favor of this Court issuing a writ of certiorari. Among those reasons listed in the Rule are: "(1) Where there are novel questions of law; . . . (3) Where the decision of the Court of Appeals is in conflict with a prior decision of the Supreme Court; (4) Where substantial constitutional issues are directly involved." Rule 242(b)(1), (3) and (4), SCACR. This Court should issue a writ of certiorari to review the Court of Appeals' Opinion because all of the above-listed reasons are present in this matter.

This case involves four novel issues of law: (1) whether the terms "total gross receipts" or "total sales" as used for South Carolina income tax purposes include all of a taxpayer's receipts or sales, including sales of securities; (2) whether, to determine which receipts are included for South Carolina apportionment purposes, one should look to the impact of including such receipts on the taxpayer's South Carolina apportionment; (3) whether a taxpayer whose primary business is the provision of services can be a

manufacturer for South Carolina income apportionment purposes; and (4) whether the Department can disregard the plain meaning of a tax statute by alleging that the statute produces an unreasonable result without actually offering evidence showing such an unreasonable result.

The Court of Appeals' decision also conflicts with prior decisions of this Court. This Court has affirmed rulings providing that service providers must apportion their income based on the single-factor apportionment formula and taxpayers dealing in tangible property, such as manufacturers, must apportion their income based on the multi-factor apportionment method. *Media Gen. Commc'ns, Inc. v. S.C. Dep't of Rev.*, 2009 S.C. Tax LEXIS 56, at *48, *58 (S.C. Admin. L. Ct. May 4, 2009) (emphasis added), *upheld on appeal*, 388 S.C. 138, 694 S.E.2d 525 (2010). In this case, the Court of Appeals held Duke Energy is a manufacturer even though the court found Duke Energy provides a service. Additionally, this Court has held that a party proposing to apply an alternative apportionment method to achieve an equitable apportionment of the taxpayer's income can do so only after introducing evidence showing that the statutorily required apportionment formula does not reasonably represent the taxpayer's business activities in the State. In this case, no evidence was proffered to substantiate such a determination.

This Court has previously held the language of tax statutes must be given its plain meaning and in this case, the Court of Appeals disregarded the plain meaning of the terms "total gross receipts" and "total sales." The Court of Appeals did not apply the longstanding rules established by this Court that in the case of doubt, ambiguities must be construed in favor of the taxpayer and against the Department. And, the Court of

Appeals failed to apply the long-standing rule that agency administrative guidance is entitled to deference.

This case also presents important constitutional issues because the Court of Appeals' Opinion violates the Separation of Powers Clause of the South Carolina Constitution because it renders meaningless the actions of the South Carolina legislature which changed the law to narrow the definition of receipts for periods after those at issue in this case. S.C. Const. art I, § 8.

In view of the foregoing, and as discussed below, important reasons exist for this Court to issue a writ of certiorari and review the Court of Appeals' decision in this matter.

ARGUMENTS

I. This Court should grant certiorari because the Court of Appeals erroneously held that a company whose primary business is selling services is a “manufacturer” for South Carolina corporate income tax purposes.

1. This Court should grant certiorari because the Court of Appeals' holding overturns decades of longstanding precedent and raises the novel issue of whether a service provider can also be a manufacturer for South Carolina corporate income tax purposes.

This Court should grant a writ of certiorari because the Court of Appeals held that Duke Energy is a “manufacturer” for South Carolina corporate income tax purposes, even though South Carolina courts and the Department have consistently held for decades that taxpayers must apportion their income based on their primary business. By overturning this longstanding precedent, the Court of Appeals dramatically altered the landscape of corporate taxation in South Carolina.

“Manufacturer” and “manufacturing” are not defined for South Carolina income apportionment purposes. Nevertheless, South Carolina courts and the Department have

consistently distinguished between manufacturers and service providers as two separate categories of taxpayers for income tax purposes. South Carolina courts have explained that the multi-factor apportionment method “is used for taxpayers whose principal business in South Carolina is dealing in tangible personal property (typically used by businesses that manufacture, sell, or rent tangible personal property),” whereas the single-factor apportionment method is “normally used by taxpayers who do not deal with tangible personal property, such as financial businesses and service businesses . . .” See, e.g., *Media Gen. Commc’ns, Inc.*, 2009 S.C. Tax LEXIS 56, at *48, *58 (emphasis added), *upheld on appeal*, 388 S.C. 138, 694 S.E.2d 525 (2010). Similarly, for decades, the Department has required taxpayers who manufacture tangible personal property to use the multi-factor apportionment formula and service providers to use the single-factor apportionment formula. See, e.g., S.C. Rev. Proc. No. 09-1, 2009 S.C. Tax LEXIS 84, at *2-3 (S.C. Dep’t of Rev. 2009) (“South Carolina generally requires the use of one of the following apportionment methods: 1. (a) A ‘three factor’ apportionment method (based on property, payroll, and double-weighted sales) . . . for taxpayers whose principal business in South Carolina is dealing in tangible personal property. This method is typically used by businesses that manufacture, sell, distribute, or rent tangible personal property. 2. A ‘gross receipts’ apportionment method for taxpayers not dealing in tangible personal property. This method is typically used by financial businesses and service businesses . . .”) (Emphasis added).⁵

⁵ Private Letter Ruling No. PLR-03-1, 2003 S.C. Tax LEXIS 263 (S.C. Dep’t of Rev. March 10, 2003) (same); Private Letter Ruling No. PLR-95-9, 1995 S.C. Tax LEXIS 325 (S.C. Dep’t of Rev. Aug. 14, 1995) (same); Technical Advice Memorandum No. TAM-94-2, 1994 S.C. Tax LEXIS 162, at *4 (S.C. Dep’t of Rev. Sept. 20, 1994) (same); *In Re: A Finding Concerning The Income Tax Liability Of XXX, Inc.*, 1993 S.C. Tax LEXIS 113, at *11-12 (S.C. Tax Comm’n May 6, 1993) (“We note here that ZZ is in the business of providing services. We have no indication that it is dealing in tangible personal property. Accordingly, ZZ must report on the gross receipts method of Section 12-7-1190.”) (emphasis added); Information Letter

In this case, the Court of Appeals has adopted the unprecedented position that service businesses can also be manufacturers. This unprecedented ruling directly conflicts with prior South Carolina precedent that the test for whether a business was a manufacturer or a service provider was based on the primary business of the taxpayer. A company could either be a service business or a manufacturer for South Carolina apportionment purposes but not both. This dramatic change in the tax law opens the door for thousands of service providers to claim they should be treated as manufacturers too.⁶

This Court has previously held that “a strong presumption arises that administrative construction has the approval of the legislature” and that the Court “would not be justified in overturning the commission’s long continued application of the statute to which the legislature has given at least implied assent.” *Ryder Truck Lines, Inc. v. S.C. Tax Comm’n*, 248 S.C. 148, 153, 149 S.E.2d 435, 437 (1966). The Court of Appeals failed to give deference to the Department’s longstanding interpretation of South Carolina law regarding the distinct treatment of manufacturers and service providers for South Carolina income apportionment purposes.

At a minimum, the Court of Appeals’ construction of “manufacturer” and “manufacturing” creates substantial ambiguity arising from the conflict it creates with the Department’s longstanding guidance, other provision of the Income Tax Act, and South

No. IL-11-13, 2011 S.C. Tax LEXIS 20, at *20 (S.C. Dep’t of Rev. Aug. 19, 2011) (“Effective for tax years beginning after 2006, Act No. 384 of 2006 amended Code Section 12-6-2250 to enact a single factor apportionment factor for businesses dealing in tangible personal property using the 3 factor (with double weighted sales) apportionment method. The single factor apportionment factor is being phased in and will replace the 3 factor (with double weighted sales) apportionment method for tax years beginning in 2011.”) (Emphasis added); Information Letter No. IL-10-9, 2010 S.C. Tax LEXIS 42, at *33 (S.C. Dep’t of Rev. Sept. 14, 2010) (same).

⁶ For example, out-of-state service providers such as providers of communications services or financial services can now claim they are manufacturers and should be able to apportion their income to the State based on the multi-factor formula, thereby potentially decreasing their South Carolina corporate income tax liability.

Carolina judicial precedent.⁷ And the Court of Appeals failed to apply the longstanding principle that any ambiguities in construing the meaning of “manufacturer” or “manufacturing,” or in determining whether Duke Energy is a manufacturer, must be resolved in favor of Duke Energy. This Court only recently opined: “Generally, a court must apply the rules of statutory construction to resolve the ambiguity and discover the intent of the legislature. However, in the enforcement of tax statutes, the taxpayer should receive the benefit in cases of doubt.” *Alltel Commc’ns, Inc. v. S.C. Dep’t of Revenue*, 399 S.C. 313, 321, 731 S.E.2d 869, 873 (2012) (internal citations omitted) (emphasis added). However, the Court of Appeals failed to apply that principle.

Furthermore, the Court of Appeals erred by ignoring another longstanding agency precedent. Specifically, the Department has previously ruled that:

[W]hether a business is a service related industry can be made by comparing the gross receipts of the business derived from providing services to total gross receipts of the business. If over 50 percent of the gross receipts are from providing services, then the business would be service related.

Rev. Rul. No. RR-87-5, 1987 S.C. Tax LEXIS 15, at *3 (S.C. Tax Comm’n Sept. 16, 1987). Both parties agree that Duke Energy’s primary business operations are the provision of electricity to its customers. Because the Court of Appeals correctly found

⁷ The separation of service providers and manufacturers for South Carolina income tax purposes is further supported by definitions of the terms “manufacturer” and “manufacturing” in other sections of the Income Tax Act. See *Sonoco Products Co. v. S.C. Dep’t of Rev.*, 378 S.C. 385, 392, 662 S.E.2d 599, 602 (2008) (determining the meaning of a statutory term by referencing other statutes and stating that “when the Legislature promulgated [the statute] it was aware of the use of the term [] in other statutory schemes”) (emphasis added). For example, “manufacturing” is defined for the South Carolina Renewable Energy Income Tax Credit purposes as “fabricating, producing, or manufacturing raw and unprepared materials into usable products, imparting new forms, qualities, properties and combinations. Manufacturing does not include generating electricity for off-site consumption.” See S.C. Code Ann. § 12-6-3588(B)(2). For purposes of the South Carolina Job Income Tax Credit, a “manufacturing facility” is defined as “an establishment where tangible personal property is produced or assembled.” See S.C. Code Ann. § 12-6-2260(M)(5). Inexplicably, the Court of Appeals did not to consider this instructive guidance.

that Duke Energy provides a service, the vast majority of its receipts are derived from the provision of electricity services.

The Court of Appeals' reliance on *Columbia Railway* and *Duke Power* is misplaced because those cases were decided under different taxes. Given South Carolina's judicial precedent and longstanding administrative guidance issued after *Columbia Railway* and *Duke Power*, that a service provider cannot be a manufacturer for purposes of the very same tax and very same issue in this case, the Court of Appeals committed error by relying on non-corporate income tax cases.

Moreover, the Court of Appeals' Opinion undermines public confidence in the credibility and certainty of any Department's longstanding guidance and calls into question the ability of taxpayers to rely on the Department's interpretation of tax principles.

- 2. This Court should grant certiorari because the Court of Appeals erred in considering, whether apportioning Duke Energy's income based on the single-factor apportionment formula reasonably represents its business activities in South Carolina even though the Department did not allege or offer evidence that the single factor apportionment method did not reasonably represent Duke Energy's business in South Carolina.**

The Court of Appeals found that: "In this case, calculating the apportionment based on sales alone would not reasonably represent the taxpayer's business because Duke Energy has significant capital investment and employment in South Carolina." (App. p. 8443; Op. at 9.) At no point in this case did the Department claim or introduce evidence that apportioning Duke Energy's income based on the single-factor apportionment method does not reasonably represent its business activities in South Carolina. As a result, neither party had an opportunity to present evidence regarding whether applying the single-factor method results in a fair representation of Duke

Energy's business activities in the State. Therefore, the Court of Appeals' analysis and holding are not only contrary to South Carolina law but are also not based on any evidence in the record. If left unchanged, the Court of Appeals' Opinion provides the Department with virtually unlimited authority to revise taxpayers' apportionment results anytime the standard apportionment formula results in a lesser tax liability – and worse yet, to deprive the taxpayer with the opportunity to present proof to the contrary.⁸

Because the Court of Appeals concluded that the manufacturing issue was a question of law, its review of the ALC's decision was limited to determining whether, under existing administrative, judicial or other guidance, and after applying the plain meaning analysis and the principle that in case of doubt tax statutes must be construed in favor of the taxpayer, whether Duke Energy is a manufacturer for South Carolina income apportionment purposes. *Alltel*, 399 S.C. at 321, 731 S.E.2d at 873.

Whether apportioning Duke Energy's income to South Carolina based on the single-factor apportionment method “would not reasonably represent the taxpayer's business,” (App. p. 8443; Op. at 9.), is a factual question to be addressed only if raised by the Department and only after the standard apportionment formula results are determined and evaluated. *Media Gen. Commc'ns.*, 388 S.C. 138, 694 S.E.2d 525; *CarMax Auto Superstores West Coast, Inc. v. S.C. Dep't of Rev.*, 397 S.C. 604, 611, 725 S.E.2d 711, 714 (2012), *cert. granted*, 2013 S.C. LEXIS 235 (S.C. Aug. 29, 2013).

Indeed, South Carolina apportionment law provides a “relief mechanism” which authorizes a party to apply an alternative method to “effectuate an equitable apportionment of the taxpayer's income” when the standard apportionment formula does

⁸ Cf. *CarMax Auto Superstores West Coast, Inc. v. S.C. Dep't of Rev.*, 397 S.C. 604, 611, 725 S.E.2d 711, 714 (2012), *cert. granted*, 2013 S.C. LEXIS 235 (S.C. Aug. 29, 2013).

not reasonably represent the taxpayer's business activities in the State. *See, e.g., Media Gen. Commc'ns*, 388 S.C. at 151, S.E.2d 525 at 531; S.C. Code Ann. § 12-6-2230. In this case, the Court of Appeals imputed an *ipso facto* alternative apportionment mechanism.

Moreover, even if the issue of distortion were properly before the Court of Appeals, the court failed to follow the statutory requirements of alternative apportionment. The Court of Appeals must first determine whether under the language of the standard apportionment statutes Duke Energy is a manufacturer or a service provider. Alternative apportionment is a factual issue only used after the standard apportionment results are calculated. *See CarMax*, 397 S.C. at 611, 725 S.E.2d at 714.

Not only is the Court of Appeals' analysis and holding in direct conflict with South Carolina law, but it is not based on the evidence in the record. The Department has not offered evidence that apportioning Duke Energy's income based on the single-factor method will lead to an unreasonable representation of its business activities in the State. *CarMax*, 397 S.C. at 611 ("The Department, as a party wishing to deviate from the standard method of apportionment," "bears the burden of proving the gross receipts formula does not fairly represent [taxpayer's] business activity in South Carolina" and "the burden of proving its alternative accounting method is reasonable and more fairly represents [taxpayer's] business activity in South Carolina.") In fact, the Department filed a Motion for Summary Judgment on the Manufacturing Issue claiming it is a question of law, not of fact.

The Court of Appeals attempted to justify its holding by summarily noting that the "Legislature intended a taxpayer like Duke Energy, whose business depends on

significant capital investment and employment to apportion . . . using the multi-factor apportionment formula.” (App. p. 8443; Op. at 9.) The Court of Appeals offers no explanation or authority for this remarkable proposition. Indeed, the Court of Appeals’ reasoning suggests that all service providers with infrastructure and employment in the state, including many taxpayers in the technology sector, should be treated as manufacturers. And the South Carolina Legislature’s most recent actions directly contradict the court’s analysis. Effective for tax years after 2006, South Carolina law requires all taxpayers engaged in business in South Carolina to apportion their income based on the single-factor gross-receipts method. S.C. Code Ann. § 12-6-2252.⁹

In sum, the Court of Appeals erred in considering, *sua sponte*, the amount of corporate income Duke Energy would apportion to South Carolina in determining whether it is required to apportion based on the single-factor or multi-factor formula. If left unchanged, the Court of Appeals’ decision will give the Department unrestrained authority to modify taxpayers’ apportionment results without any legal or factual justification. Therefore, this Court should grant certiorari to review the Court of Appeals’ Opinion.

II. This Court should grant certiorari because the Court of Appeals erred in narrowing the definition of “receipts” for South Carolina corporate income tax purposes by holding that Duke Energy’s receipts from sales of securities earned in its ordinary course of business were not “total gross receipts” or “total sales” for South Carolina income tax purposes.

This Court should grant certiorari because the Court of Appeals held that Duke Energy’s proceeds from sales of securities are not “receipts” even though South Carolina

⁹ In 2006, the South Carolina Legislature enacted a change whereby the multi-factor apportionment method was eliminated and effective for tax years after 2006, all taxpayers are required to apportion based on the single-factor apportionment method (with a phase-in period beginning in 2007 through 2010). *See* Rev. Rul. No. RR-09-15, 2009 S.C. Tax LEXIS 126 (S.C. Dep’t of Rev. Nov. 17, 2009).

apportionment statutes plainly require taxpayers to include their “total sales” or “total gross receipts” from business activities in South Carolina. The Court of Appeals’ ruling creates a new, more limited test to determine whether receipts are included in the calculation of South Carolina apportionment. Under the Court of Appeals’ new test, first, one must look to whether the taxpayer received proceeds from a sale. In this case, Duke Energy sold securities and received the proceeds from its sales. Next, to determine whether particular receipts are included in the definition of “total gross receipts” or “total sales,” taxpayers must look to the effect of including (or excluding) the receipt in question and whether it fairly reflects a taxpayer’s South Carolina business. And in this case, the ALC and the Court of Appeals reached a factual conclusion, on a motion for summary judgment, that the second prong of the Court of Appeals’ new test (whether the inclusion of the receipts reflect Duke Energy’s business activity in the state) was met without any evidence from the parties. As a result, this case raises important, novel issues that impact not only Duke Energy but all taxpayers in South Carolina, further necessitating a grant of certiorari by this Court.

- 1. This Court should grant certiorari because the Court of Appeals’ holding usurped the power of the South Carolina Legislature by rendering the Legislature’s 2007 legislative changes regarding the meaning of “sales” and “gross receipts” meaningless.**

This Court should grant certiorari because the Court of Appeals’ decision effectively legislates from the bench and thereby violates the Separation of Powers Clause of the South Carolina Constitution. S.C. Const. art I, § 8 (“In the government of this State, the legislative, executive, and judicial powers of the government shall be forever separate and distinct from each other, and no person or persons exercising the functions of one of said departments shall assume or discharge the duties of any other.”)

Prior to 2007, South Carolina law required the inclusion of “total gross receipts” or “total sales” in the South Carolina apportionment calculation. In 2007, the South Carolina Legislature changed the law to exclude several types of receipts including receipts from sales of securities.¹⁰ The 2007 law change was fundamental and substantially altered South Carolina apportionment law. Yet, the Court of Appeals did not address at all the import of this change. Instead, the court simply found that “total gross receipts” and “total sales” could not mean what they say because including receipts from the sales of securities “would artificially reduce the ‘base which reasonably represents the proportion of the trade or business carried on within this State.’” (App. p. 8446; Op. at 12.) However, that holding cannot be reconciled with the substantial changes to the definition of “gross receipts” and “sales”. Indeed, the uncontroverted record in this case shows that the Department acknowledged that the treatment of several categories of receipts were impacted by the 2007 law change and thus, the actions of the legislature could not have been a mere clarification of the law. As a result, the Court of Appeals retroactively changed the law of its own accord for periods spanning more than a decade before the Legislature chose to act.

¹⁰ Effective for tax years after 2006, the Legislature enacted sweeping changes to the South Carolina apportionment statutes. Rather than require the inclusion of all of a taxpayer’s receipts in the sales factor numerator, the Legislature’s amendment carved out ten new categories of receipts to be excluded from “gross receipts” and “sales.” 2007 S.C. Laws Act 110 § 51.A (enacted as S.C. Code Ann. § 12-6-2295(B)) (emphasis added). Indeed, the plain language of the title to the 2007 amendment indicates that the purpose of the enactment of S.C. Code Ann. § 12-6-2295 was to add a new definition of gross receipts for apportionment purposes. See *Demas v. Convention Motor Inns*, 268 S.C. 186, 190, 232 S.E.2d 724, 726 (1977) (recognizing propriety of discerning legislative intent from the title of an act). These changes, for the first time, excluded sales of securities from the South Carolina income apportionment formula. S.C. Code Ann. § 12-6-2295(B)(1) (“gross receipts” or “sales” excludes “repayment, maturity, or redemption of the principal of a loan, bond, or mutual fund or certificate of deposit or similar marketable instrument”).

2. **This Court should grant certiorari because the Court of Appeals erred in failing to consider the plain meaning of the terms “total gross receipts” and “total sales” and in failing to apply the long-settled principle that tax statutes must be construed against the State in cases of doubt.**

This Court should grant certiorari because the Court of Appeals failed to consider the plain meaning of “total gross receipts” and “total sales” as used in the income apportionment statutes, S.C. Code Ann. §§ 12-6-2280 and 12-6-2290, and held that Duke Energy’s proceeds from its sales of securities are not “receipts,” despite the plain meaning of the terms and the evidence in the record to the contrary.

None of the terms “gross receipts,” “total sales” or “receipts” is defined for South Carolina corporate income tax purposes. Accordingly, the Court of Appeals should have looked to the plain meaning of the statute:

The language of a tax statute must be given its plain ordinary meaning in the absence of an ambiguity therein.... [I]f a legislative intent is clearly apparent from the language of the statute there is no occasion for resort to the rule of statutory construction.

Beach v. Livingston, 248 S.C. 135, 139, 149 S.E.2d 328, 330 (1996) (citation omitted); *see also Alltel*, 399 S.C. at 320, 731 S.E.2d at 873 (same); *Duke Power Co. v. S.C. Tax Comm’n*, 292 S.C. 64, 66, 354 S.E.2d 902, 903 (1987) (“Where a statute is clear and unambiguous, there is no room for construction and the terms of the statute must be given their literal meaning.”). Applying this standard to the apportionment statutes at issue in this case, “gross receipts” or “total sales” does not mean less than all receipts or “profits”. These terms mean exactly what they say: gross means gross and total means all. Neither of these terms can be interpreted as including only “profits” simply based on the *allegation* that to include all of the receipts or sales would not clearly reflect South Carolina income. If the Legislature decided to limit the scope of “gross receipts” by only

including the net receipts from certain transactions, it was free to do so. In fact, the Legislature subsequently did do so with regard to certain types of receipts in 2007.

The Court of Appeals addressed arguments neither asserted nor preserved by the Department. The Court of Appeals adopted the *Webster's* definition of the term “receipt” as “something received” and reasoned that “[i]n the business context, ‘receipt’ means money the business receives from its products or services – for what it does in its business.” (App. p. 8446; Op. at 12.) The court noted that “Duke Energy is in the business of selling electricity, which includes the sale of electricity itself on a wholesale or retail bases or the sale of capital it uses to conduct its business,” but then held that when Duke Energy “sells the investment [securities] for a profit,” its receipts other than the profit “are not money it received for its products and services” and therefore, are not “receipts” for income apportionment purposes. (*Id.*) The Court of Appeals’ reasoning is incorrect for several reasons.

First, the Court of Appeals’ holding that a portion of Duke Energy’s proceeds from sales of securities are not “money received from its product and services” is not only factually incorrect, but is contrary to South Carolina law and the Department’s own statements. Indeed, the record demonstrates that Duke Energy sells securities as part of its ordinary business operations and its sales of securities are connected with its trade or business. (App. p. 3002, lines 5-15; App. pp. 8213-8214, 8215 ¶¶ 11, 17; App. pp. 8195-8197 § 5.A; App. p. 51.) Duke Energy’s treasury department was an integral part of the company’s primary business operations. (App. pp. 8213-8214, 8215 ¶¶ 11, 17.) If Duke Energy’s treasury department fails to precisely coordinate Duke Energy’s cash needs, the activities of the entire company could grind to a halt. (*Id.*; App. p. 3010, lines 7-19.)

Furthermore, the Department previously acknowledged that the income from the sale of securities is related to Duke Energy's primary operations and produces business income. (App. p. 173.) The Department has not argued otherwise and there is nothing in the record to suggest that Duke Energy's receipts from its sales of securities are non-apportionable non-business income.¹¹ Therefore, the Court of Appeals' reasoning departs from South Carolina law that requires receipts from all transactions producing business income to be included in the sales factor. S.C. Code Ann. §§ 12-6-2280 and 12-6-2290. Contrary to the Court of Appeals' consideration and finding, Duke Energy's receipts from sales of securities constitute "money it received from its products and services."

Second, the Court of Appeals appears to suggest, without providing any explanation or legal authority, that Duke Energy's receipts other than the profit from its sales of securities are "the principal of the investment" and "its own money," and not "receipts" for income apportionment purposes. (App. p. 8446; Op. at 12.) When a security is sold or redeemed, the entire amount is received from the relinquishment of a commodity. *See Gen. Motors Corp. v. Franchise Tax Bd.*, 39 Cal. 4th 773, 786-87, 139 P.3d 1183, 1190-91 (2006). As the California Supreme Court succinctly put it:

To better understand this basic distinction and how it applies even in the case of debt instruments like bonds and Treasury bills, consider the case of a security (a \$ 10,000 Treasury bill, say) bought on the market from a securities dealer, then redeemed with the issuer, the United States government. The price the purchaser/taxpayer receives on redemption, \$ 10,000, is dependent on the value of the

¹¹ In order for the Court of Appeals to conclude that Duke Energy's sales of securities are unrelated to its primary operations, it would have essentially had to conclude that proceeds from such sales constitute non-business income that was allocable, and not subject to apportionment. S.C. Code Ann. §§ 12-6-2230 and 12-6-2220(5). During the course of this controversy, the Department has never contended that Duke Energy's receipts from sales of securities constitute allocable non-business income. Indeed, the Department has conceded, and the ALC and Court of Appeals both concluded that some portion of the receipts from Duke Energy's sales of securities are includable in the apportionment formula, thereby agreeing that receipts from those transactions are business income subject to apportionment.

commodity it holds and independent of the price it paid to the broker. The taxpayer is not being repaid for money it lent; it had, in fact, paid nothing and lent nothing to the United States government. The entire amount received is properly treated as gross receipts....

Id. (emphasis added). Unlike a transaction that involves a return of principal, sales of marketable securities are highly dependent on market environment and the amount of money received, if any, when a security is sold. Duke Energy was not protected from fluctuations in the value of the securities it had acquired and the purchase/redemption price was dependent on the market rates for the purchased securities. Therefore, the Court of Appeals failed to apply the plain meaning of the term “receipt.” *Beach*, 248 S.C. at 139; *Duke Power Co.*, 292 S.C. at 66. The plain meaning of “total gross receipts” for purposes of the single-factor apportionment statute means all receipts, not some receipts.¹²

Even if the Court of Appeals had doubt with regard to the interpretation of those terms and found them ambiguous, the court was required to resolve that doubt in favor of Duke Energy. This Court has consistently held that any ambiguities in tax statutes must be resolved in favor of the taxpayer. *See S.C. Nat’l Bank v. S.C. Tax Comm’n*, 297 S.C. 279, 281, 376 S.E.2d 512, 513 (1989) (“In the enforcement of tax statutes, the taxpayer should receive the benefit in case of doubt.”) Most recently, this Court has confirmed this principle and held that “the existence of an ambiguity in [a tax statute] raises substantial doubt regarding the section’s application to Petitioners [taxpayers]. This doubt must be resolved in favor of petitioners.” *Id.*; *Alltel*, 399 S.C. at 321, 731 S.E.2d at 873 (2012).

¹² The Court of Appeals’ own definition of a “receipt” further supports that conclusion – all of Duke Energy’s receipts from sales of securities are “money the business receives from its products or services.” (App. p. 8446; Op. at 12.)

In sum, this Court should grant certiorari because the Court of Appeals' Opinion raises a novel issue concerning the meaning of "gross receipts" and "total sales" for South Carolina corporate income apportionment purposes. Furthermore, certiorari is warranted because the Court of Appeals' decision is inconsistent with prior decisions of this Court.

3. **This Court should grant certiorari because the Court of Appeals erred in considering, whether including Duke Energy's sales of securities in its sales factor denominator reasonably represents Duke Energy's business in South Carolina when the Department did not allege or provide evidence to support that conclusion, and erred in concluding that sales of securities cannot be "total gross receipts" or "total sales" for South Carolina corporate income tax purposes.**

Although the only question before the Court of Appeals with respect to the Gross Receipts Issue was whether, as a matter of law, all receipts from sales of securities should be included in the single-factor or multi-factor apportionment formula, the Court of Appeals *sua sponte* considered arguments that are neither raised nor preserved by the Department. Specifically, in determining whether, as a matter of law, Duke Energy is required to include all proceeds from its sales of securities in its apportionment formula, the Court of Appeals considered the factual question of whether including all of Duke Energy's receipts in its South Carolina apportionment would clearly reflect its income. The Court of Appeals' holding is predicated on the assumption that "allowing Duke Energy to include its gross receipts from short-term investment instruments would artificially reduce the 'base which reasonably represents the proportion of the trade or business carried on within this State,' . . . by artificially inflating the denominator of the formula." (App. p. 8446; Op. at 12.) Not only is this assumption premised on a factual question not before the Court of Appeals, but it is also not based on the evidence in the record.

The Court of Appeals' review is limited to the ALC's holding whether, as a matter of law, "gross receipts" and "total sales" include all proceeds from sales of securities for income apportionment purposes. Whether the inclusion of all proceeds from sales of securities would "artificially inflat[e] the denominator of the formula" (*Id.*) or "artificially reduce the base which reasonably represents the proportion of the trade or business carried on within the State" (*Id.*) is a factual question to be addressed only after the standard apportionment formula results are determined. *Media Gen. Commc'ns.*, 388 S.C. 138, 694 S.E.2d 525; *CarMax*, 397 S.C. at 611, 725 S.E.2d at 714. The Court of Appeals' holding presumes that the inclusion of all receipts from Duke Energy's sales of securities does not fairly represent Duke Energy's business activities in South Carolina. The Court of Appeals, thus, imputed, for the second time in its Opinion, an *ipso facto* alternative apportionment mechanism into the standard apportionment provisions. The Court of Appeals must first apply South Carolina's apportionment provisions – including a calculation of "gross receipts" or "total sales." Alternative apportionment, an issue not before the Court of Appeals, is determined only after the apportionment results are calculated. *See CarMax*, 397 S.C. at 611, 725 S.E.2d at 714.

Moreover, because the ALC decided the Gross Receipts Issue on motions for summary judgment (App. pp. 71-84), neither party has presented evidence regarding whether including all receipts from Duke Energy's sales of securities is a reasonable representation of its business activities in the State.

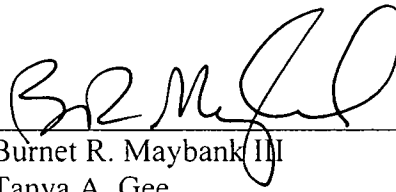
If left unreviewed, the Court of Appeals' Opinion will afford the Department with unrestrained authority to recreate taxpayers' apportionment results anytime the standard apportionment formula does not result in the amount of tax liability desired by the

Department. Accordingly, this Court should grant certiorari to review the Court of Appeals' Opinion.

CONCLUSION

For the above-stated reasons, Duke Energy respectfully requests that this Court issue a writ of certiorari to review the Court of Appeals' Opinion in this matter.

Respectfully submitted:



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Columbia, South Carolina
December 22, 2014

THE STATE OF SOUTH CAROLINA
in The Supreme Court

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APPEAL FROM THE ADMINISTRATIVE LAW COURT

S.C. Supreme Court

Ralph K. Anderson III, Administrative Law Judge

Opinion No. 5274 (S.C. Ct. App. Filed October 8, 2014)

Duke Energy Corporation.....Petitioner,

v.

South Carolina Department of Revenue..... Respondent.

PROOF OF SERVICE

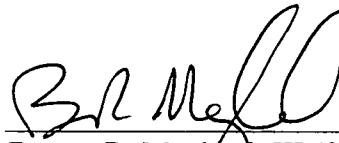
I certify that I have served Petitioner's Petition for a Writ of Certiorari on counsel of record for the South Carolina Department of Revenue and to the Clerk of the Court of Appeals by depositing a copy of it in the United States Mail, postage prepaid, on December 22, 2014, addressed to:

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The Honorable Jenny Abbott Kitchings
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Admitted in SC

December 22, 2014

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S.C. Supreme Court

HAND DELIVERED

The Honorable Daniel E. Shearouse
Clerk, South Carolina Supreme Court
1231 Gervais Street
Columbia, SC 29201

Re: *Duke Energy Corporation vs. South Carolina Department of Revenue*
Docket No.: 10-ALJ-17-0270-CC
Court of Appeals Opinion No. 5274

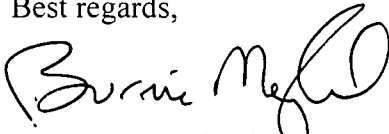
Dear Mr. Shearouse:

Charleston
Charlotte
Columbia
Greensboro
Greenville
Hilton Head
Myrtle Beach
Raleigh

Enclosed for filing are the original and seven (7) copies of the Petition for a Writ of Certiorari for review of Opinion No. 5274 and Proof of Service of same on counsel for South Carolina Department of Revenue and the Clerk of the Court of Appeals in the above-referenced matter. Also enclosed for filing are the original and one bound copy of the Appendix, along with a copy of the Appendix cover page. Please return a clocked-in copy of each to us via our courier. We are also enclosing our firm's check for \$100 in payment of the filing fee.

Thank you for your assistance in this matter.

Best regards,

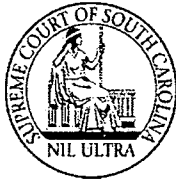

Burnet R. Maybank III

Enclosures

cc: The Honorable Jenny Abbott Kitchings
Milton G. Kimpson
John M.S. Hoefer

The Honorable Daniel E. Shearouse
December 22, 2014
Page 2

Tracey C. Green
John W. Roberts
Harry A. Hancock



The Supreme Court of South Carolina

Nexsen Pruett

12/22/2014

RECEIPT #74573

Fee Type:	Case Initiation Fee
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