

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. 2012-21-22203

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

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

JOINT APPENDIX - VOLUME IV

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**JOINT APPENDIX
INDEX**

VOLUME I

Record on Appeal – Volume I	00001
-----------------------------------	-------

VOLUME II

Record on Appeal – Volume II	00474
------------------------------------	-------

VOLUME III

Record on Appeal – Volume III	00934
Final Brief of Appellant, January 14, 2011	01058
Final Brief of Respondent, January 14, 2011.	01112
Final Reply Brief of Appellant, January 14, 2011	01148
Court of Appeals Opinion, March 14, 2012, ...	01168
Appellant's Petition for Rehearing, March 29, 2012	01173
Respondent's Petition for Rehearing, March 29, 2012	01182
Appellant's Response to Respondent's Petition for Rehearing, April 29, 2012	01196
Order Denying Appellant's Petition for Rehearing, May 7, 2012	01206
Order Denying Respondent's Petition for Rehearing, May 7, 2012	01208

VOLUME IV

Amicus Curiae Brief of Council on State Taxation ("COST"), September 27, 2010	01210
Amicus Curiae Brief of South Carolina State Chamber of Commerce ("Chamber"), December 1, 2011	01232
Appellant's Petition for Writ of Certiorari, June 6, 2012	01254

Respondent's Petition for Writ of Certiorari, June 6, 2012.....	01278
Appellant's Return to Petition for Writ of Certiorari, July 5, 2012	01295
Respondent's Return to Petition for Writ of Certiorari, July 5, 2012	01307
Appellant's Reply to Return to Petition for Writ of Certiorari, July 16, 2012	01324
Respondent's Reply to Return to Petition for Writ of Certiorari, July 16, 2012	01338
Amicus Curiae Brief of Chamber in Support of Certiorari Petitions, November 16, 2012	01346
Amicus Curiae Brief of COST in Support of Petition for Writ, 29, 2013.....	January 01364
Order, August 29, 2013.....	01398

**THE STATE OF SOUTH CAROLINA
In The Court of Appeals**

APPEAL FROM THE ADMINISTRATIVE LAW COURT

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

CarMax Auto Superstores West Coast, Inc.

vs.

South Carolina Department of Revenue

**AMICUS CURIAE BRIEF OF COUNCIL ON STATE TAXATION
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TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES	ii, iii
I. THE ALC ERRED IN PLACING THE BURDEN OF PROOF ON THE TAXPAYERS	3
II. THE ALC ERRED IN ALLOWING THE USE OF ALTERNATIVE APPORTIONMENT THAT WAS UNPRECEDENTED AND EVISCERATED UDITPA OF ITS OBJECTIVE TO PROVIDE UNIFORMITY, CONSISTENCY AND PREDICTABILITY TO TAXPAYERS	6
III. THE DEVIATION FROM THE STANDARD FORMULA WITHOUT ANY PRIOR GUIDANCE BY THE DEPARTMENT VIOLATES THE APA, IS FUNDAMENTALLY UNFAIR AND RUNS COUNTER TO SOUND TAX POLICY	11

Cases

<i>American Tel. & Tel. Co. v. Huddleston</i>	5
<i>Amoco Prod. Co. v. Arnold</i>	9
Appeal of Crisa Corporation, WL 1400003 (2002).....	5
<i>Bellsouth Adver. & Publ'g Corp. v. Chumley</i>	5
<i>CBS, Inc. v. Comptroller</i>	13
<i>Colgate-Palmolive Co., Inc. v. Bower</i>	9
<i>Donald M. Drake v. Dep't of Revenue</i>	9
<i>HMN Fin., Inc. v. Comm'r of Rev.</i> , 782 N.W.2d 558 (Minn. 2010).....	11
<i>Media General Communications, Inc. v. South Carolina</i> <i>Department of Revenue</i> , 694, S.E.2d 525, 528-29 (2010).....	3
<i>Metromedia, Inc. v. Dir., Div. of Taxation</i>	14
<i>Microsoft Corp. v. Franchise Tax Bd.</i>	5
<i>NCR Corp. v. Comptroller of the Treasury</i>	10
<i>Pacific Coca-Cola Bottling Co. v. Dep't of Revenue</i>	9
<i>Union Pac. Corp. v. Idaho State Tax Comm'n</i>	5

Statutes

Code §1-23-10	12
Code §12-4-320	12

Other Authorities

I Hellerstein & Hellerstein, <i>State Taxation</i> ¶ 9.20 [7]	4
Keesling and Warren, <i>California's Uniform Division</i> <i>of Income for Tax Purposes Act</i> , 15 UCLA L. Rev. 156, 171 (1967)	7, 8
W. Pierce, "The Uniform Division of Income for State Tax Purposes," 35 Taxes 747, 781 (1957).....	8

Model Statutes and Regulations

The Multistate Tax Commission Regulations, MTC Reg. IV.18.(a).....	8
Uniform Division of Income for Tax Purposes Act.....	Passim

INTEREST OF THE AMICUS

The Council On State Taxation ("COST") is a nonprofit trade association based in Washington, D.C. COST was formed in 1969 as an advisory committee to the Council on State Chambers of Commerce. Today COST has grown to an independent membership of nearly 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 do business in South Carolina and own and lease property in South Carolina.

South Carolina apportions the income of multistate corporate taxpayers by using a set of rules based upon the Uniform Division of Income for Tax Purposes Act ("UDITPA"). UDITPA has been adopted by a majority of other states as well, and the states that have adopted UDITPA often look to court decisions in their sister states when called upon 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 members. COST is concerned that the Administrative Law Court's holding in this case will not only negatively impact how South Carolina administers income tax on COST members, but also will negatively impact how other states administer their tax laws and that, if allowed to

stand, the decision in this case will inevitably lead to the very lack of uniformity and uncertainty that UDITPA was designed to prevent.

COST submits this *amicus curiae* brief to stress the overall importance of this case and to aid this Court in understanding how the decision of the Administrative Law Court—allowing the Department to deviate from statutory rules in a very common situation—undermines the certainty that accompanies uniform multistate apportionment and equates to unstable and indiscriminate taxation by the State of South Carolina. The South Carolina legislature long ago adopted UDITPA in its statutes. It was designed to use a uniform measure to determine how much income from a taxpayer doing business in multiple states is apportioned and subject to tax in South Carolina. Those statutes apply in virtually every circumstance and with every taxpayer so that the multistate income can be uniformly and consistently divided, consistent with the other states that have adopted UDITPA. In a few circumstances, promulgated regulations can vary the statutory rules in those instances where a group of taxpayers or an entire industry have unique facts. It is only in the rarest and most unusual circumstances that the Department can justifiably vary from the standard apportionment methodology provided for in South Carolina's statutes and rules. The Administrative Law Court decision below threatens to disrupt this long-standing South Carolina structure. In essence, the decision below arms the Department with the power to

deviate from the strict statutory scheme not just in rare and unusual circumstances, but even in situations where the facts are commonplace.

ARGUMENT

Review of the Administrative Law Court's decision by this Court is warranted in this case because of the potentially 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 single interstate taxpayer. The latitude the Administrative Law Court granted the Department to deviate from the standard statutory apportionment formulae will have a significant impact on taxpayers across South Carolina. Of equal, if not greater, importance is the fact that that action of the Department threatens the consistency and uniformity that the South Carolina legislature has sought to achieve in the area of state taxation of interstate commerce.

I. THE ALC ERRED IN PLACING THE BURDEN OF PROOF ON THE TAXPAYERS.

As very recently noted by the South Carolina Supreme Court in *Media General Communications, Inc. v. South Carolina Department of Revenue*, 694, S.E.2d 525, 528-29 (2010):

The statute in contention here, section 12-6-

2320(A), provides for alternative methods of allocation and apportionment when the standard provisions in the South Carolina Code do not fairly represent the taxpayer's business activity in South Carolina:

* * *

Section 12-6-2320(A) of the South Carolina Code is identical to the Uniform Division of Income for Tax Purposes Act (UDITPA), section 18, Equitable Adjustment of Formula, and was passed by the South Carolina General Assembly in 1995.

As stated by our Supreme Court above our Code Section is identical to UDITPA Section 18. The ALC Order put the burden of proof on the taxpayer to refute the Department's application of Section 18.

The ALC order states

The standard of proof is a preponderance of the evidence. *Anonymous v. State Bd. Of Med. Exam'rs*, 329 S.C. 371, 496 S.E.2d17 (1998). Additionally, the burden of proof is generally upon the party asserting the affirmative in an adjudicatory administrative proceeding. 2 Am. Jur. 2d *Administrative Law* § 354 (2004). The taxpayer in this matter requested a contested case hearing to challenge the Department's proposed assessment; *thus, the taxpayer bears the burden of proof.* (emp added)

This is plain error. I 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).

II. THE ALC ERRED IN ALLOWING THE USE OF ALTERNATIVE APPORTIONMENT THAT WAS UNPRECEDENTED AND EVISCERATED UDITPA OF ITS OBJECTIVE TO PROVIDE UNIFORMITY, CONSISTENCY AND PREDICTABILITY TO TAXPAYERS.

The Department's ad hoc deviation from the statutory apportionment formula in this case is truly unprecedented. To Amicus's knowledge, this case represents the only time that a state tax administrator has ever used the alternative apportionment clause of a UDITPA-based formula to randomly sever a viable arm of a business in order to increase a state's tax liability. Such a radical departure from the way in which other states have routinely interpreted an identical provision should not be allowed to stand without this Court's scrutiny.

South Carolina adopted a modified version of the UDITPA and accompanying regulations in order to join other states in applying a standard statutory apportionment formula. The goal of UDITPA, and the South Carolina statutes modeled on it, is to provide consistent and uniform rules across the nation to ensure that each state taxes only an appropriate portion of a corporation's income in order to avoid duplicative taxation. Uniform rules are intended to address virtually every situation, and deviation from the rules should be used in the rarest of circumstances. As the primary technical drafter of UDITPA noted:

There are completely compelling reasons for giving the [alternative apportionment] provisions a narrow construction. Under a broad construction the purposes of obtaining uniformity through the

adoption of the Uniform Act would be defeated. If a choice of methods is permitted, different administrators in different states inevitably will choose different methods. As a result, even if all the states imposing taxes on or measured by income should adopt the Uniform Act, the chaotic condition heretofore existing would continue to exist.

Keesling and Warren, California's Uniform Division of Income for Tax Purposes Act, 15 UCLA L. Rev. 156, 171 (1967) (emphasis added). The ad hoc approach, if allowed to stand, will open the door to the "chaotic condition" that UDITPA seeks to ameliorate.

The ALC Order correctly notes that the statutory authority of the Department to require an alternative method is triggered *only* if the standard formulas contained in Title 12, Chapter 6 fail to fairly represent the extent of the taxpayer's business activity in South Carolina. The ALC Order fails to apply the correct "fair representation" standard. 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 take a similar position. MTC Reg. IV.18.(a) provides:

[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 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 and in 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) While the distortion requirement has often been interpreted to be satisfied at a level of less than what is unconstitutional, the intent of the UDITPA drafters is clear—the provision should be used sparingly.

Other states that have invoked the alternative apportionment methodology have done so under much different circumstances than those at issue here. The

use of alternative apportionment by either taxpayers or administrators in other states has typically been limited to very narrow circumstances.

Some early equitable apportionment cases arose out of attempts by taxpayers or tax administrators to utilize alternative apportionment based solely on large disparities between tax liability under separate accounting and apportionment. *See, e.g., Donald M. Drake v. Dep't of Revenue*, 500 P.2d 1041 (Or. 1972) (rejecting administrator's attempt to impose separate accounting on in-state portion of unitary business based on profits); *Amoco Prod. Co. v. Arnold*, 518 P.2d 453 (Kan. 1974). Alternative apportionment has also been invoked to exclude amounts from an out-of-state capital gain, an issue which would have been more appropriately addressed based on unitary business principles. *See, e.g., Stan Musial & Biggies, Inc. v. State*, 363 So.2d 375 (Fla. Dist. Ct. App. 1978); *Roger Dean Enterprises Inc. v. State*, 387 So.2d 358 (Fla. 1980) (holding that alternative apportionment is inapplicable to exclude gain).

Courts have hesitated to allow either taxpayers or administrators to invoke alternative apportionment whenever economists might disagree on the appropriateness of the standard apportionment formula. *See, e.g., Colgate-Palmolive Co., Inc. v. Bower*, Ill. Cir. Ct. No. 01 L 50195, 2002 WL 31628400 (2002) (denying Section 18 claim that a fourth factor representing contribution of international trademarks should be added to formula); *Pacific Coca-Cola Bottling*

Co. v. Dep't of Revenue, 773 P.2d 1290 (Or. 1989) (denying factor adjustment for value of trade names, finding that value already reflected in costs of tangibles); *NCR Corp. v. Comptroller of the Treasury*, 544 A.2d 764 (Md. 1988) (denying factor relief claim for foreign-source income absent gross disparity in tax liability). The courts recognize that without any limitations based on exceptionality, relief petitions and litigation would certainly increase in frequency.

The case here is very similar to many of the other cases where the expanded use of alternative apportionment was justifiably curtailed. Simply stated, no circumstances warrant the use of alternative apportionment in this case. Neither side contends that application of the standard apportionment formula produced an unconstitutional result. Neither was there any substantive showing that the standard UDITPA formula failed to fairly represent the extent of CarMax's activities in South Carolina because of some unusual circumstances. No unusual circumstances existed. To the contrary, the standard applicable formula operated in this case precisely as it was intended to by the drafters of UDITPA and—more to the point—by the South Carolina Legislature.

The Department essentially determined that the taxpayer had different types of receipts and income—retail and intangibles—and that some of that income and receipts should not be reported on a South Carolina return. Every

multistate taxpayer has different types of receipts and income, and consequently could be subject to a similar ad hoc determination. As the Minnesota Supreme Court recently noted in a decision that prevented the Minnesota Tax Commissioner from deviating from its statutory tax rules: “[t]he Commissioner clearly dislikes the tax consequences that occur under the relevant statutes, but it is for the legislature, not the Commissioner, to change the law that creates such consequences.” *HMN Fin., Inc. v. Comm’r of Rev.*, 782 N.W.2d 558 (Minn. 2010).

III. THE DEVIATION FROM THE STANDARD FORMULA WITHOUT ANY PRIOR GUIDANCE BY THE DEPARTMENT VIOLATES THE APA, IS FUNDAMENTALLY UNFAIR AND RUNS COUNTER TO SOUND TAX POLICY

South Carolina’s standard statutory and regulatory apportionment rules—like those in other states—are designed to uniformly address virtually every factual situation. However, as discussed above, the rules do allow for limited deviations from the standard formulae on a specific taxpayer basis, but only where there are unusual and nonrecurring fact patterns. The Department refused to follow the standard statutory apportionment formulae in this case, not because the facts were unusual and nonrecurring, but because the Department was dissatisfied with the amount of tax produced by the standard formulae. The Department cannot disregard its statutory obligation to provide advance guidance through rule making in order to increase tax revenue.

There is certainly nothing unusual about the structure of West. The Findings of Facts specifically note that West's structure "shares features with the structures of other multi-state taxpayers who divide their retail operations into 'East' and 'West' operations and similarly benefit from this structure in the form of tax savings" Findings of Fact No. 6. It is unpleasant for taxpayers who must rely on written guidance and interpretations to witness the Department acknowledge that a particular structure is commonplace while at the same time invoke a special rule aimed at unusual, taxpayer-specific circumstances.

The typical state administrative procedure act contains two separate sets of procedures—one for rulemaking and one for adjudication. While agencies delegated authority to issue rules and to decide individual cases normally have broad discretion as to the means by which they may make particular law, they are bound by their state act to follow scrupulously the procedures appurtenant to whatever means of lawmaking they actually choose in a particular instance.

The Department promulgates rules through regulations issued in accordance with the South Carolina's administrative procedures act. Code §1-23-10 *et seq.* and Code §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 Code §§1-23-10(4) and 12-4-320. The legislature obviously recognized that the Department would need to

exercise a great deal of 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. 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.

In *CBS, Inc. v. Comptroller*, 575 A.2d 324 (Md. 1990), the Maryland Supreme Court, addressing a situation not that different from the one here, held that the tax administrator may enact certain tax policies only prospectively, and then only by formal rulemaking. *CBS* dealt with the manner in which a taxpayer apportioned advertising receipts of national broadcasting companies. For a number of years, CBS computed its Maryland income tax pursuant to the three-factor formula. The taxpayer and the tax administrator stipulated that the taxpayer's method of apportionment "was reviewed during the audits of prior years . . . and no adjustment . . . was ever proposed." *Id.* at 325. Despite this 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. *Id.* The question presented was whether the tax administrator's new policy required formal rulemaking. The Court found that "the effect of the tax administrator's audit was to announce a

substantially new generally applicable policy with respect to apportionment of the network advertising income of national broadcasting corporations." *Id* at 330.

The Court 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*, 478 A.2d 742 (N.J. 1984), the Maryland Supreme 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*, 575 A.2d 328. The Court held that the tax administrator's new policy could not be effected through ad hoc adjudication, but only prospectively pursuant to the formal rulemaking procedures of the Maryland Administrative Procedure Act. As a result, the Appellant's position could not be applied retroactively.

The Maryland Supreme Court's reasoning in *CBS* seamlessly flows into the analysis to 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. 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 are aware of and have the ability to fully understand the Department's intent to sever parts of a company at the time a taxpayer files its return.

The importance of clear regulatory guidance that is available to all taxpayers prior to the time they file a return cannot be overstated. The ability to make reasonably accurate forecasts of state tax liability is an essential element of informing one's investors. Such 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 upon expected tax liabilities becomes impossible.

CONCLUSION

COST respectfully urges this Court to grant Petition so that it can review the decision of the Administrative Law Court. Review is appropriate for all the reasons detailed in the Petition, and, for the reasons explained in this brief, review is especially appropriate because the decision, if allowed to stand, will jeopardize and undermine the uniformity, fairness, and consistency of state taxation that

South Carolina law was designed to offer to multi-state taxpayers.



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I certify that I served the Motion Committee on State Taxation (COST) for Leave to File a Brief as Amicus Curiae on the Appellants and Respondents by depositing it in the United States Mail, postage prepaid, on September 27, 2010 addressed to their attorney of record as follows:

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South Carolina Department of Revenue, ...Respondent.

AMICUS CURIAE BRIEF OF
SOUTH CAROLINA STATE CHAMBER OF COMMERCE

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TABLE OF CONTENTS

Table of Authorities	iii
Statement of Issues	1
Statement of Case	1
Summary of Principal Arguments	1
Background Law & Facts	3
Arguments.....	7
I. SCDOR's unpublished "income isolation" rule for multi-state businesses is an impermissible amendment to the "gross receipts" apportionment statute – any such change in the statute must be made by the General Assembly through an amendment to the statute or the approval of a regulation submitted by SCDOR	7
II. The party seeking to deviate from the standard apportionment statute bears the burden of proving that the statute does not fairly represent the taxpayer's business activity in South Carolina; the proponent of any alternative apportionment method bears the burden of proving that the alternative method fairly represents the taxpayer's business activity in South Carolina; and all of these matters must be proven by a preponderance of the evidence	10
III. SCDOR failed to prove that application of the General Assembly's chosen method for determining the Taxpayer's South Carolina taxable income did not fairly represent Taxpayer's business activity in South Carolina and also failed to prove its alternative method did so.....	15
Conclusion	18

TABLE OF AUTHORITIES

Cases

<i>Brown v. James</i> , 697 S.E.2d 604 (S.C. App. 2010)	3
<i>Butler Bros. v. McColgan</i> , 315 U.S. 501 (1942).....	13
<i>Colgate-Palmolive Co. v. Franchise Tax Bd.</i> , 13 Cal. Rptr. 3d 761 (Cal. App. 4 th Dist. 1992).....	13
<i>Container Corp. of America v. Franchise Tax Board</i> , 463 U.S. 159 (1983).....	12
<i>In re Richland County Magistrate's Court</i> , 699 S.E.2d 161 (S.C. 2010)	8
<i>Limited Stores, Inc. v. Franchise Tax Bd.</i> , 62 Cal. Rptr. 3d 191 (Cal. App. 1 st Dist. 2007)	12, 13
<i>McDonnell Douglas Corp. v. Franchise Tax Bd.</i> , 446 P.2d 313 (Cal. Sup. Ct. 1968)	13
<i>Media General Communication, Inc. v. SCDOR</i> , 694 S.E.2d 525 (S.C. 2010)	8, 15
<i>Microsoft Corp. v. Franchise Tax Bd.</i> , 139 P.3d 1169 (Cal. Sup. Ct. 2006)	13
<i>Moorman Mfg. Co. v. Blair</i> , 437 U.S. 267 (1978).....	12
<i>Mull v. Ridgeland Realty, LLC</i> , 693 S.E.2d 27 (S.C. App. 2010)	3
<i>Ward v. West Oil Co., Inc.</i> , 692 S.E.2d 516 (S.C. App. 2010)	3

South Carolina Statutes

§ 12-4-10 (2000)	7
§ 12-4-310(2) (2000).....	7
§ 12-4-320(1) (2000).....	7
§ 12-6-20 (Rev. 2000).....	7
§ 12-6-530 (2000).....	4
§ 12-6-535 (2000 & Supp. 2010).....	4
§ 12-6-540 (2000 & Supp. 2010).....	4
§ 12-6-550 (2000 & Supp. 2010).....	4
§ 12-6-610 (2000).....	4
§§ 12-6-1110 to -1220 (2000 & Supp. 2010)	4
§ 12-6-2210(A), (B) (2000 & Supp. 2010).....	4, 5
§§ 12-6-2220 to -2230 (2000 & Supp. 2010)	4
§ 12-6-2240 (2000 & Supp. 2010).....	4
§ 12-6-2250 (2000 & Supp. 2010) to -2280	4
§ 12-6-2290 (2000 & Supp. 2010).....	5, 6
§ 12-6-2295(Supp. 2010).....	1
§ 12-6-2300 (2000 & Supp. 2010).....	4
§ 12-6-2310 (2000 & Supp. 2010).....	4
§ 12-6-2320(A) (2000).....	5, 8
§ 12-22-740(D) (2000).....	14
§ 12-45-185 (Supp. 2010).....	14

STATEMENT OF ISSUES

1. SCDOR cannot rely on an unwritten and unpublished rule to deviate from the plain mandate of a statute – any such deviation must be based upon an amendment to the statute by the General Assembly or a regulation submitted to and approved by the General Assembly.

2. The party seeking to deviate from the standard apportionment statute bears the burden of proving that the statute does not fairly represent the taxpayer's business activity in South Carolina; the proponent of any alternative apportionment method bears the burden of proving that the alternative method fairly represents the taxpayer's business activity in South Carolina; and all of these matters must be proven by a preponderance of the evidence.

3. SCDOR failed to prove that application of the General Assembly's chosen method for determining Taxpayer's South Carolina taxable income did not fairly represent Taxpayer's business activity in South Carolina and also failed to prove its alternative method did so.

NOTE: The Chamber takes no position on the financing receipts issue, because S.C. Code Ann. § 12-6-2295 (Supp. 2010) defines "receipts" for the future.

STATEMENT OF CASE

This is a corporate income tax case. CarMax West (Taxpayer) is a multi-state business that earns its income partly within and partly without South Carolina. The South Carolina Department of Revenue (SCDOR) audited Taxpayer's tax return, rejected it, and assessed a new tax amount with penalties. Taxpayer challenged the assessment in the Administrative Law Court (ALC), which accepted SCDOR's new tax amount but rejected the imposition of penalties. Taxpayer appealed – SCDOR did not cross-appeal.

SUMMARY OF PRINCIPAL ARGUMENTS

The most important factor in tax planning for any business is the ability to predict its tax obligations with reasonable accuracy. The General Assembly provided that predictability with the "gross receipts" apportionment statute at issue here. SCDOR, however, has developed an unwritten rule that it applies to an internally defined class of multi-state businesses to avoid application of the statute enacted by the General

Assembly. These businesses do not and cannot know this rule and therefore cannot plan accordingly, because SCDOR has not published this rule by regulation or otherwise.

As argued herein, if SCDOR wants to change the scope of the "gross receipts" apportionment statute to exclude certain types of multi-state businesses and apply a different rule to those businesses, it must obtain an amendment from the General Assembly or submit a regulation to the General Assembly for its approval. SCDOR cannot be permitted to develop unwritten rules and apply them to an unwary taxpaying public, and then subject that public to claims for interest and penalties in addition to higher taxes based on the failure to follow the unwritten rule. This is particularly true when, as here, the General Assembly has mandated SCDOR to publish regulations in this area of tax law. The merits of SCDOR's unwritten rule may be subject to debate, but the obligation of SCDOR to obtain proper legislative approval of the rule is beyond debate. Otherwise, the taxpaying public is left to guess if, when, and how SCDOR will deviate from the tax laws established by the General Assembly.

Another essential component of taxation generally is fairness, including procedural fairness. This case presents the procedural questions of who bears the burden of proving the "gross receipts" apportionment statute does not fairly reflect the business's activity in South Carolina, and by what standard of proof this burden of proof must be satisfied. As argued herein, SCDOR proposes a burden and standard of proof system that is manifestly unfair – the burdens and standards change depending on the identity of who is challenging the application of the "gross receipts" apportionment statute. SCDOR's proposed system deviates from the normal burden and standard of proof rules, frustrates the General Assembly's intent in enacting the statutes at issue here, and insulates

SCDOR's decisions from meaningful review. As argued herein, this Court should reject SCDOR's use of shifting burdens and standards in favor of the standard rules for such matters, particularly when there is no indication the General Assembly intended otherwise and application of the standard rules best promotes the intent and purpose of the General Assembly in enacting these tax laws.

BACKGROUND LAW & FACTS

I. Rules for Statutory Interpretation

This case involves the interpretation and application of the South Carolina Income Tax Act (the Act).¹ The controlling inquiry is the intent of the General Assembly. "All rules of statutory construction are subservient to the one that legislative intent must prevail if it can be reasonably discovered in the language used, and that language must be construed in the light of the intended purpose of the statute." *Brown v. James*, 697 S.E.2d 604, 611 n.13 (S.C. App. 2010). "The Court should give words their plain and ordinary meaning, without resort to subtle or forced construction to limit or expand the statute's operation." *Ward v. West Oil Co., Inc.*, 692 S.E.2d 516, 519 (S.C. App. 2010). The statute "must be read in a sense which harmonizes with its subject matter and accords with its general purpose," and "[a]ny ambiguity in a statute should be resolved in favor of a just, equitable, and beneficial operation of the law." *Mull v. Ridgeland Realty, LLC*, 693 S.E.2d 27, 30 (S.C. App. 2010). "Courts will reject a statutory interpretation which would lead to a result so plainly absurd that it could not have been intended by the Legislature or would defeat the plain legislative intention." *Id.* "[S]tatutes dealing with the same subject matter are in pari materia and must be construed together, if possible, to produce a single, harmonious result." *Brown*, 697 S.E.2d at 611 n.13.

¹ See generally §§ 12-6-10 to -5595 (2000 & Supp. 2010).

II. The South Carolina Taxable Income of a Multi-State Business

The Act imposes a 5% tax on the "South Carolina taxable income" of corporations doing business in South Carolina. § 12-6-530 (2000).² If a corporation conducts its "entire business" in South Carolina, then its "entire net income" is taxed by South Carolina. § 12-6-2210(A) (2000 & Supp. 2010) (emphasis added): If a corporation conducts its business "partly within and partly without" South Carolina (a multi-state business), then its income is taxed under a mathematical formula established by the General Assembly in the Act. This formula has four basic steps.

The first step is to determine the business's "South Carolina net income," which is its "federal taxable income" plus-or-minus adjustments made under Article 9 of Title 12 of the South Carolina Code. § 12-6-610 (2000).³ There are no Article 9 disputes in this case. Notably, a business's "federal taxable income" includes its income from all states.

The second step is to adjust the "South Carolina net income" figure by allocating certain income items to a particular state (South Carolina or some other state). The South Carolina allocations become part of the business's "South Carolina taxable income" and the non-South Carolina allocations are excluded from further consideration. See §§ 12-6-2220 to -2230 (2000 & Supp. 2010).⁴ There are no allocation disputes in this case.

The third step is to apportion all un-allocated "South Carolina net income" under one of several statutes. § 12-6-2240 (2000 & Supp. 2010).⁵ Here, the applicable statute is

² There are exceptions not applicable here. See, e.g., §§ 12-6-535, -540, and -550 (2000 & Supp. 2010).

³ Article 9 appears at §§ 12-6-1110 to -1220 (2000 & Supp. 2010).

⁴ Allocation results in specified types of income being treated as income taxable in the state specified by statute, either South Carolina or a different state that satisfies the particular statutory requirements (e.g., some "items of income" are allocated to the state of the corporation's principal place of business).

⁵ If a multi-state business is a particular type of business (e.g., railroad companies), or if it is engaged in particular types of business activity (e.g., manufacturing), its unallocated net income is apportioned according to other, statutorily-specified formulae. See §§ 12-6-2250 to -2280, -2300, and -2310 (2000 and Supp. 2010).

the “gross receipts” apportionment statute, which establishes an apportionment factor based on the business’s “gross receipts *from within* this State” divided by the business’s “*total* gross receipts *from everywhere*.” § 12-6-2290 (2000 & Supp. 2010) (all emphasis added). The business’s un-allocated “South Carolina net income” is multiplied by this apportionment factor and the resulting figure, plus any South Carolina allocations, is the business’s “South Carolina taxable income.”

The fourth step is dependent upon the outcome of the foregoing calculations. The General Assembly’s intent is to produce a “South Carolina taxable income” figure “which reasonably represents the proportion of the trade or business carried on within [South Carolina].” § 12-6-2210(B) (2000) (emphasis added). If the calculations under the standard allocation and apportionment statutes “do not *fairly* represent the *extent* of the taxpayer’s business *activity* in [South Carolina],” then a reasonable alternative method may be used. § 12-6-2320(A) (2000) (emphasis added). The purpose of any alternative method is to “*fairly* represent the taxpayer’s business activity in the State” and “to effectuate an *equitable* allocation and apportionment of the taxpayer’s income.” § 12-6-2320(A)(3), (A)(4) (2000) (emphasis added). The focus is on the proportionate amount of business done in South Carolina, not the amount of tax due. This distinction is important, because SCDOR has adopted an unpublished rule that focuses on maximizing tax revenues rather than fairly and reasonably determining the amount of business done in South Carolina.

III. SCDOR’s Alternative Apportionment Method.

Taxpayer’s principal business is the retail sale of used cars and trucks in the western half of the country – it does not sell cars and trucks in South Carolina. Taxpayer

also receives income from CarMax Business Services (CBS), which conducts its business in Georgia.⁶ Taxpayer filed an amended return under the “gross receipts” apportionment statute and, as required by that statute, included its income from car sales in its “total gross receipts from everywhere.” § 12-6-2290 (2000 & Supp. 2010)

SCDOR audited Taxpayer and determined Taxpayer had under-reported its South Carolina taxable income. SCDOR applied a rule that eliminated all gross receipts from car sales, because Taxpayer did not sell cars in South Carolina. (R. 311-312).⁷ SCDOR applies this “income isolation” rule when a multi-state business has income streams that are not pursued in South Carolina. (R. 277, 300, 318). In other words, SCDOR treated Taxpayer as if its only business activity everywhere was identical to the business activity in South Carolina. Nothing in the Act supports this income isolation method.

The “gross receipts” apportionment statute is clear and straightforward. It apportions unallocated net income under the following calculation:

$$\begin{array}{rcl} & \text{“gross receipts from within this State”} & \\ + & \text{“total gross receipts from everywhere”} & \\ & \text{apportionment factor} & \\ \times & \text{unallocated South Carolina net income} & \\ & \text{South Carolina taxable income} & \end{array}$$

See § 12-6-2290 (2000 & Supp. 2010) (emphasis added). SCDOR’s “income isolation” rule alters this calculation by changing the statutory definition of the divisor above to “total gross receipts from everywhere *for the same business activity conducted in this State.*” In short, SCDOR has amended the statute with an unwritten rule that when a

⁶ CBS is a Georgia LLC that is owned by Taxpayer and CarMax East – it is a pass-through entity for tax purposes. CBS owns and manages the intellectual property used by Taxpayer and CarMax East. CBS also provides other centralized management services to both, e.g., human resources and information technology. Taxpayer and CarMax East pay CBS a management fee for all of these services on a per-vehicle-sold basis. CarMax East pays taxes in South Carolina and takes a deduction for these management fees.

⁷ As a result, SCDOR isolated Taxpayer’s total gross receipts from CBS and used that figure for the divisor. SCDOR admitted that it essentially taxed CBS as a taxable entity doing business in South Carolina, even though it is a non-taxable entity doing business in Georgia. (R. 293-294; R. 232, 255).

multi-state business has more than one product line or income stream, then the apportionment factor is to be determined based solely on the product line or income stream that is pursued in South Carolina. This "income isolation" rule will always increase the tax, because it always reduces the divisor, which always increases the resulting apportionment factor.

ARGUMENTS

- I. SCDOR's unpublished "income isolation" rule for multi-state businesses is an impermissible amendment to the "gross receipts" apportionment statute – any such change in the statute must be made by the General Assembly through an amendment to the statute or the approval of a regulation submitted by SCDOR.

The statutes creating SCDOR direct it to administer and enforce the tax laws with a goal of "*just taxation*." S.C. Code Ann. §§ 12-4-10 and 12-4-310(2) (2000) (emphasis added). These statutes provide generally that SCDOR "*may* make rules and promulgate regulations, not inconsistent with law, to aid in the performance of its duties." § 12-4-320(1) (2000) (emphasis added). The Act, however, is more specific and mandatory – SCDOR "*shall* make and publish rules and regulations, not inconsistent with [the Act], necessary to enforce its provisions" § 12-6-20 (2000) (emphasis added). Despite the Act's mandatory language, SCDOR has not submitted any regulations reflecting SCDOR's "income isolation" rule for multi-state businesses. If the General Assembly had intended any such deviation from the statute, it could have and would have provided for it in the statute. Indeed, the first step in calculating the South Carolina tax for a multi-state business is the federal taxable income of the business, which manifestly includes all income from all sources. Here, it manifestly includes Taxpayer's retail car sales. SCDOR simply ignores this first step.

SCDOR is an agency of the executive branch and is thus held to a higher duty than private litigants. Just as a prosecutor's duty is to do justice rather than simply present a case for conviction (even if the evidence creates a jury question), SCDOR has a statutory duty to seek fair and just taxation rather than simply maximize its revenue. See, e.g., *In re Richland County Magistrate's Court*, 699 S.E.2d 161 (S.C. 2010) (prosecutor cannot act as a private litigant). SCDOR, however, has a history of seeking to maximize the tax to be paid by a multi-state business rather than ensure fair and just taxation.

In *Media General Communications, Inc. v. SCDOR*, 694 S.E.2d 525 (S.C. 2010), SCDOR conceded that the standard "gross receipts" apportionment statute "did not fairly represent the Taxpayer's income" and that the alternative method requested by the taxpayer "did fairly measure the Taxpayer's business activity in South Carolina." *Id.* at 529. SCDOR nevertheless refused to accept the alternative and applied the standard statute despite the admitted unfairness of that approach, thereby claiming taxes due of \$3,758,320.00 rather than \$863,179.00. *Id.* at 527, 529. SCDOR justified its dogmatic adherence to this unfairness by claiming it could not accept the taxpayer's alternative method. It took this astonishing position despite the General Assembly's unequivocal directive in § 12-6-2320(A)(4) that permitted "the employment of *any other method* to effectuate an *equitable* allocation and apportionment." (Emphasis added).

The only rational explanation for SCDOR's position in *Media General* is an unpublished approach to multi-state businesses that focuses on maximizing the amount of tax to be paid. The Supreme Court rejected SCDOR's position and approved the taxpayer's alternative method, because SCDOR had "not established that another method would be more appropriate." *Id.* at 532. SCDOR had not proposed any alternative

method – rather, it had doggedly adhered to the admitted unfairness of the standard statute to advance its objective of maximizing its revenue.

SCDOR's treatment of multi-state businesses generally, and its treatment of Taxpayer here, demonstrates that SCDOR continues to pursue maximization of revenue rather than satisfying its statutory duty of securing just, fair, reasonable, and equitable taxation. It has developed a standard – but unpublished and unwritten – rule that deviates from the applicable “gross receipts” apportionment statute (at issue here) and silently amends the statute's definition of the divisor (denominator) to exclude “total gross receipts from everywhere” that is not identical to the income stream that produces gross receipts in South Carolina. SCDOR applies this standardized deviation from the statute when the multi-state business has disparate income streams. (R. 277, 300, 318). This “income isolation” rule is not in any statute or regulation, nor is it in any tax return instructions or other written materials produced by SCDOR and available to the tax-paying public. Despite this secrecy, SCDOR also sought to impose penalties for Taxpayer's failure to file a return using the unpublished rule's deviation from the applicable statute. This further demonstrates SCDOR's revenue maximization approach to multi-state businesses. The ALC denied SCDOR's claims for penalties, because it was impossible for any taxpayer to have known that it should have filed under SCDOR's “alternative” method. SCDOR does not appeal this ruling.

In short SCDOR has created the following unwritten rule as an amendment to the apportionment statutes: If the multi-state business's “federal taxable income” and “total gross receipts from everywhere” includes income streams that are different from its South Carolina income stream, then federal taxable income is no longer the baseline for the

South Carolina tax calculation, and the "gross receipts" apportionment statute is not applicable. If SCDOR wants to amend the Act in this manner, it must be by regulation and not by internal, unwritten and unpublished policy decisions that have no support in the language of the statutes. SCDOR's failure to submit its "income isolation" rule to the General Assembly for approval further demonstrates SCDOR's revenue maximization approach to multi-state businesses in lieu of its statutory duties of fair and just taxation.

II. The party seeking to deviate from the standard apportionment statute must prove the statute does not fairly represent the taxpayer's business activity in South Carolina; the proponent of any alternative apportionment method bears the burden of proving that the alternative method fairly represents the taxpayer's business activity in South Carolina; and all of these matters must be proven by a preponderance of the evidence.

Legislative intent controls the questions of burden of proof and standard of proof.

The Act does not answer these questions directly. Your Amicus respectfully submits this

Court should adopt the following rules:

The party seeking to avoid the standard allocation and apportionment statutes bears the burden of proving by a preponderance of evidence that application of the standard statute does not fairly represent the taxpayer's business activity in South Carolina. The proponent of any alternative apportionment method bears the burden of proving by a preponderance of evidence that the proposed alternative is reasonable and more fairly represents the taxpayer's South Carolina business activity.

These rules best serve the General Assembly's intent to tax multi-state businesses on a basis that fairly and reasonably represents the taxpayer's South Carolina business activity.

A. SCDOR's Shifting Burdens and Standards Argument

SCDOR contends there is a shifting burden of proof with different standards of proof at each stage of the analysis:

1. SCDOR must show that the taxpayer's "*chosen* method of apportionment" is not reasonable by a preponderance of the evidence. (Resp. Br. 7) (emphasis added).
2. SCDOR may then choose an alternative method of apportionment. (*Id.*).
3. The taxpayer then bears the burden of proving by clear and convincing evidence that SCDOR's chosen alternative method results in attributing income to South Carolina that is "out of all proportions to the business transacted" in South Carolina or has led to a "grossly distorted result." (Resp. Br. 7-8).

There are several problems with SCDOR's contentions.⁸ First, SCDOR repeatedly and incorrectly refers to Taxpayer's tax return as using Taxpayer's "chosen method of apportionment." Taxpayer did not "choose" or "select" an apportionment method – it simply used the "gross receipts" apportionment method established by the General Assembly and set forth in the Act. The only "chosen" method at issue here is the alternative method "chosen" by SCDOR under its unwritten and unpublished "income isolation" rule. Thus, SCDOR contends that when a taxpayer follows the law set forth by the General Assembly, SCDOR can overrule the General Assembly with a preponderance of the evidence, but a taxpayer must present clear and convincing evidence to overrule SCDOR. This is yet another symptom of SCDOR's erroneous revenue maximization approach to its statutory duty of fairness, reasonableness and equity.

Second, SCDOR offers no explanation and cites no authority for its shifting burden of proof analysis. Nothing in the statute hints at this shifting burden, and it has no basis in logic. The reason is clear. Having not submitted its "income isolation" rule for approval as a regulation, SCDOR also seeks to insulate this rule from judicial review.

⁸ SCDOR does not address the situation where a taxpayer seeks to employ an alternative apportionment method. It would undoubtedly disagree that a taxpayer need only prove the standard statute is not reasonable by a preponderance of the evidence and that it (SCDOR) would have to challenge the taxpayer's proposed alternative method under the clear and convincing evidence standard.

Third, SCDOR offers no explanation for its shifting standards of proof. SCDOR cites the Supreme Court decision in *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983) for its “clear and convincing – out of all proportions – grossly distorted” standard of proof for challenging SCDOR’s chosen alternative method of apportionment. The *Container* case, however, applied the federal constitutional standard for striking down a state tax statute under the United States Constitution. It has nothing to do with the state law statutory questions presented here, and nothing in the statutes or logic supports this standard of proof for these state law questions.

B. The Taxpayer’s Argument

Taxpayer argues that the party seeking to deviate from the standard apportionment statute must prove “why the standard method should not be followed and that the alternative method is reasonable,” and it must prove this with clear and convincing evidence. (App. Br. 13). Taxpayer correctly cites numerous decisions from other states applying similar statutes on the burden of proof question. (App. Br. 13-14). SCDOR does not dispute these citations, and it does not cite any case applying a similar state law statute in support of its shifting-burden argument.

Taxpayer cites two cases for the proposition that the standard of proof is clear and convincing evidence: *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978) and *Limited Stores, Inc. v. Franchise Tax Bd.*, 62 Cal. Rptr. 3d 191 (Cal. App. 1st Dist. 2007). (App. Br. 14-15). The *Moorman* case, like the *Container* case cited by SCDOR, is a Supreme Court opinion applying the federal constitutional standard to the federal question of striking down a state tax statute under the federal constitution – it has no bearing on the

state law questions presented here.⁹ The *Limited Stores* case is a California appellate court decision that applies the clear and convincing evidence standard to a state law case. This California rule is based on a 1968 California Supreme Court decision that silently adopted the federal standard for state law questions by citing and applying a 1942 Supreme Court opinion that applied the federal standard in a federal constitutional case. See *McDonnell Douglas Corp. v. Franchise Tax Bd.*, 446 P.2d 313, 316 (Cal. Sup. Ct. 1968) citing and applying *Butler Bros. v. McCollgan*, 315 U.S. 501, 507 (1942).¹⁰

C. An Alternative to the Parties' Arguments

The parties agree that the party challenging the statute bears the burden of proving the "gross receipts" apportionment statute does not fairly represent a taxpayer's business activity in South Carolina. From this single point of agreement, the parties diverge to polar-opposite positions that best protect and advance their ultimate litigation position on the tax amount to be imposed. Taxpayer seeks to protect the lesser amount imposed under the standard statute—SCDOR seeks to protect the higher amount imposed under its "income isolation" rule. The real question, however, is one of legislative intent, and neither party addresses this issue directly.

1. The standard of proof should be a preponderance of the evidence.

The statutes do not provide a standard of proof, so this Court must determine the General Assembly's intent. That determination rests in significant part on the purpose of the statute, which is to tax multi-state businesses upon a base that fairly,

⁹ Ironically, SCDOR chastises Taxpayer for relying on a federal constitutional case to argue for a clear and convincing evidence standard but SCDOR does the same thing, albeit citing a different federal case. (See Resp. Br. 9-12).

¹⁰ *Limited Stores*, 62 Cal. Rptr. 3d at 196, cites *Microsoft Corp. v. Franchise Tax Bd.*, 139 P.3d 1169, 1178 (Cal. Sup. Ct. 2006), which cites *Colgate-Palmolive Co. v. Franchise Tax Bd.*, 13 Cal. Rptr. 3d 761, 773 (Cal. App. 4th Dist. 1992), which cites *McDonnell Douglas Corp. v. Franchise Tax Bd.*, 446 P.2d 313, 316 (Cal. Sup. Ct. 1968), which cites *Butler Bros. v. McCollgan*, 315 U.S. 501, 507 (1942).

reasonably, and equitably reflects the proportionate amount of business done in South Carolina. To that end, the Act includes the “alternative method” statute for cases in which the standard statutes fail to achieve that purpose. Absent clear legislative intent to the contrary, it is illogical to assume the General Assembly intended to constrain the “fairness” purposes of the Act with the clear and convincing evidence standard, which is the highest standard of proof known to the civil law. The General Assembly has repeatedly shown that it will specify this highest of standards when deemed necessary for the purposes of the statute, including tax statutes.¹¹ Nothing in the Act indicates a legislative intent to do so in this case. Accordingly, and to better serve the “fairness” purposes of the Act, the standard of proof should be the generally applicable civil standard of the preponderance of the evidence.

2. The burden of proof should be placed upon the party challenging the standard statute and upon the party proposing an alternative method.

The General Assembly has determined that a straightforward application of the “gross receipts” apportionment statute in combination with a multi-state business’s federal taxable income, both of which include all income from all sources everywhere, will generally produce a fair and reasonable base for taxation in South Carolina. It is only logical that if a party seeks to override this legislative determination, then that party should bear the burden of doing so. By the same token, any party that proposes an alternative method as being better than the General Assembly’s determination should also bear the burden of proving that. This complies with the general manner in which the law assigns the burden of proof – placing it upon the advocate of a particular position – and

¹¹ See, e.g., S.C. Code Ann. § 12-22-740(D) (2000) (clear and convincing evidence required in claiming statutory exception) and § 12-45-185 (Supp. 2010) (clear and convincing evidence required for waiver of penalties on delinquent taxes).

nothing in the statute indicates a legislative intent to deviate from this standard approach. Moreover, any other approach would fail to protect the General Assembly's legislative determination – and it is the General Assembly's determination, not that of a taxpayer or SCDOR, that should be respected and protected by the courts.

In *Media General, supra*, it was undisputed that the gross receipts apportionment statute “did not fairly represent the [multi-state] Taxpayer's income.” 694 S.E.2d at 529. It was also undisputed that the alternative method proposed by the multi-state taxpayer “did fairly measure the Taxpayer's business activity in South Carolina.” *Id.* at 529. Under this evidence, the Supreme Court upheld the taxpayer's alternative method, because “the Department *has not established* that another method would be *more appropriate.*” *Id.* at 532 (emphasis added). Thus, our Supreme Court has noted that the proponent of an alternative apportionment method must establish that its alternative is not only appropriate, but more appropriate than any competing proposals.

III. SCDOR failed to prove that application of the General Assembly's chosen method for determining Taxpayer's South Carolina taxable income did not fairly represent Taxpayer's business activity in South Carolina and also failed to prove its alternative method did so.

The fundamental issue here is whether Taxpayer's car sales should be included in the apportionment calculation. SCDOR contends that it should not be included, because Taxpayer does not sell cars in South Carolina. If the General Assembly had intended this approach of isolating particular income streams, it would not have used a multi-state business's “federal taxable income” and “total gross receipts from everywhere” – both of which include all income streams by definition – as the cornerstones for determining a multi-state business's South Carolina taxable income. It must be presumed that the General Assembly knew what it was doing when it included all income streams. SCDOR

cannot overcome this presumption with an unwritten and unpublished rule that is the exact opposite of the General Assembly's statute and is based upon SCDOR's general view of multi-state businesses rather than a particularized consideration of an individual taxpayer. Allowing SCDOR's approach permits it to presume the General Assembly did not know what it was doing – a violation of fundamental principles of law.¹²

SCDOR never undertakes a particularized consideration of Taxpayer in this case. More importantly, it never undertakes a particularized consideration of the statutory benchmark, *i.e.*, Taxpayer's business activity in South Carolina. Doing so, as required by the Act, demonstrates SCDOR has not shown that the Act's standard apportionment method fails to fairly represent Taxpayer's business activity in South Carolina.

Taxpayer has no physical presence in South Carolina. It does not own any personal or real property in South Carolina – it does not have an office in South Carolina – it does not have any employees in South Carolina. In short, Taxpayer has very little activity in South Carolina. It is thus not surprising that application of the Act does not produce a large income tax debt. Moreover, Taxpayer's lack of presence in South Carolina means it does not burden the government services funded by tax revenues. It is thus not unfair that Taxpayer does not have a large income tax debt in South Carolina.

SCDOR never argues any evidence specifically showing that Taxpayer's business activity is not fairly represented by applying the "federal taxable income" and "total gross receipts from everywhere" cornerstones established by the General Assembly. Its entire "burden of proof" argument is set forth in a single paragraph:

¹² As noted earlier, any such general exception to the General Assembly's determination must be made by regulation submitted to and approved by the General Assembly, something SCDOR has not done despite the Act's mandate that SCDOR shall do so.

The Department clearly met its initial burden to show that the taxpayer's chosen apportionment formula did not fairly represent its business activities in the State of South Carolina. At page 8 of the Order, the ALC judge notes that in 2008, the calculation using the taxpayer's method which included the taxpayer's *unrelated retail sales to inflate* the denominator [devisor] to be divided in the numerator made up of intangible income received from South Carolina resulted in an apportionment ratio of 0.972%. The Department's alternate formula, which included South Carolina intangible income divided by intangible income from everywhere (*thus excluding retail sales*), produced an apportionment ratio of .2537% for royalty receipts and 1.0054% for other intangible receipts such as financing receipts.

(Resp. Br. 8) (all emphasis added). The General Assembly, not Taxpayer, chose the apportionment method used by Taxpayer. The General Assembly, not Taxpayer, decided to include all income from all sources by establishing the calculation cornerstones of "federal taxable income" and "total gross receipts from everywhere." To overcome these legislative choices, SCDOR simply describes what it did rather than cite any evidence justifying what it did. In other words, to satisfy its admitted burden of proof, SCDOR relies solely on its unwritten and unpublished "income isolation" rule, which ignores the General Assembly's calculation cornerstones of "federal taxable income" and "total gross receipts from everywhere."

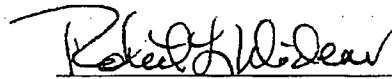
If the General Assembly had intended this approach, it would not have used "federal taxable income" and "total gross receipts from everywhere" as the calculation cornerstones. SCDOR plainly disagrees with the General Assembly on this point, but its recourse is to obtain a change in the law or submit a regulation to obtain legislative approval of its "income isolation" rule. SCDOR cannot satisfy its admitted burden of proof by simply applying this rule and thereby avoid producing any evidence focusing on the particular circumstances of a particular taxpayer. The Act plainly requires that any alternate method be based on principles of fairness, reasonableness, and equity – and

these controlling statutory standards for any alternative method plainly require particularized consideration of each taxpayer on a case by case basis. SCDOR never did this and, therefore, it manifestly failed to satisfy its burdens of proof.

CONCLUSION

For all of the foregoing reasons, it is respectfully submitted that this Court should rule that SCDOR bore the burden of proof in this case by a preponderance of the evidence and it failed to meet that burden of proof.

Respectfully Submitted,



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December 1, 2011
Columbia, SC

THE STATE OF SOUTH CAROLINA
In The Supreme Court

RECEIVED

APPEAL FROM THE ADMINISTRATIVE LAW COURT JUN - 6 2012

Carolyn C. Matthews, Administrative Law Judge

S.C. Supreme Court

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

CarMax Auto Superstores West Coast, Inc.....Petitioner
v.

South Carolina Department of Revenue.....Respondent

PETITION FOR A WRIT OF CERTIORARI

Pursuant to Rule 242 of the South Carolina Appellate Court Rules, petitioner CarMax Auto Superstores West Coast, Inc. ("CarMax West"), petitions the Court to issue a writ of certiorari to review the decision of the Court of Appeals styled CarMax Auto Superstores West Coast, Inc. v. South Carolina Department of Revenue, 2012 WL 832985, Op. No. 4953 (Ct. App. March 14, 2012). (Appendix ("App.") p. 1168) For the reasons set forth below, the petition should be granted and the decision of the Court of Appeals should be reversed.

CERTIFICATION REGARDING REHEARING

The undersigned hereby certifies that a Petition for Rehearing was made and finally ruled on by the Court of Appeals on May 7, 2012. (App. p. 1206.)

APP_01254

QUESTIONS PRESENTED FOR REVIEW

- I. Did the Court of Appeals Err in Failing to Determine that Remand to the Administrative Law Court ("ALC") is Not Necessary Because there is No Evidence in the Record that Could Support a Decision in Favor of the South Carolina Department of Revenue's ("SCDOR") Use of an Alternate Apportionment Formula and Therefore Judgment Should Have Been Entered in Favor of CarMax West?
- II. Did the Court of Appeals Err in Failing to Rule that CarMax West was a Unitary Business?
- III. Did the Court of Appeals Err in Failing to Rule that the Financing Receipts at Issue Should Not Be Sourced to South Carolina?
- IV. Did the Court of Appeals Err in Failing to Rule that SCDOR's Assessment Violates CarMax West's Constitutional Rights?
- V. In the Alternative to I, if the Case is Remanded to the ALC, Did the Court of Appeals Err in Failing to Instruct the ALC that it Must Consider whether CarMax West is a Unitary Business and Must Consider the South Carolina Cases Holding that Separate Accounting is Not Appropriate for a Unitary Business?
- VI. In the Alternative to I, if the Case is Remanded to the ALC, Did the Court of Appeals Err in Failing to Rule that the ALC's Review of the Issues on Remand Should be Confined to the Record in the Case and thereby Clarify that the Remand is Not for a New Trial as a New Trial would Promote Duplicative Proceedings and Judicial Inefficiency and Would Be Unjust?

STATEMENT OF THE CASE

Procedural History and Case Issues

A. CarMax West's Protest of SCDOR Assessment

This case involves a protest by CarMax West of an assessment of corporate income taxes and penalties imposed by SCDOR for the income tax years ending in 2002-2007. CarMax West asserted the following basic claims before the ALC regarding the income taxes assessed by SCDOR: (1) SCDOR should not have deviated from the standard statutory apportionment method for multi-state taxpayers, which would impose a tax based on South Carolina's fair share of all of CarMax West's net income and instead applied an erroneous attempt at separate accounting to tax only a portion of CarMax West's income consisting of royalty payments by an affiliate, CarMax Auto Superstores East, Inc. ("CarMax East") (which does business in South Carolina) for the use of intellectual property owned by CarMax West;¹ (2) SCDOR 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; (3) SCDOR's assessment violated CarMax West's constitutional rights; (4) SCDOR should not have assessed a penalty against CarMax West.

B. The ALC's Decision

On April 22, 2010, the ALC found in favor of SCDOR on all issues except the penalty, which the ALC dismissed. See App. pp. 4-21, Order. Despite universal authority to the contrary, the ALC held that the burden of proof was on CarMax to

¹ This issue involved numerous sub-issues, including whether the relevant CarMax entities were unitary businesses, whether SCDOR could separate a unitary business, whether the standard apportionment method reasonably reflected CarMax West's business activities in this State and whether SCDOR's alternative formula failed to do so.

prove that the standard apportionment method reflected CarMax West's business activities in this State and that the method chosen by SCDOR did not. Id. at 9. Additionally, although numerous South Carolina cases (both Supreme Court and Court of Appeals) hold that a unitary business may not be segregated and its parts separately taxed, the ALC's Order did not make any findings as to whether CarMax operated a unitary business stating that it was "not outcome determinative" (see App. p. 13, Order; App. pp. 993-994, CarMax West's Motion for Reconsideration (section B)) and then upheld SCDOR's separate accounting based on its finding that CarMax West failed to show that the standard method reasonably reflected its in-state activities and that the method chosen by SCDOR did not. Id. at 10-15. The ALC also held that the financing receipts should be sourced to South Carolina. Id. at 15-16. Finally, the ALC held that the assessment did not violate CarMax West's constitutional rights. Id. at 18-21.

C. The Appeal of the ALC's Decision

CarMax West appealed the ALC's decision to the Court of Appeals, which issued its decision in this matter on March 14, 2012. See CarMax Auto Superstores West Coast, Inc. v. South Carolina Department of Revenue, 2012 WL 832985, Op. No. 4953 (S.C. Ct. App. March 14, 2012) (App. p. 1168). In its opinion, the Court of Appeals correctly concluded that the burden of proof should have been placed on SCDOR to establish by a preponderance of the evidence that the standard statutory apportionment method used by CarMax West did not reflect its business activities in South Carolina and that SCDOR's alternative accounting method is reasonable. Id. at 6. The Court of Appeals reversed and remanded the case to the ALC for "for a reconsideration of all issues." Id. at 7. Although, several issues in this case are not

impacted by the change in the burden of proof, the Court did not consider or rule upon any of these other issues, including the sourcing of financing receipts, whether the relevant CarMax entities were unitary, whether a unitary business can be subjected to a separate accounting method and the constitutionality of the assessment.

Summary of Facts

A. CarMax West's Royalty Income

CarMax West sells cars in the western United States and does no business in South Carolina. App. p. 77, line 24 - p. 78, line 8. It has no employees, no facilities and no tangible property in South Carolina. App. p. 78, lines 2-6. Due to the absence of a physical presence in the state, CarMax West neither requires nor receives any substantive services or benefits from the State of South Carolina. App. p. 78, lines 9-11. Its only connection to this State is the royalty payments it has received from CarMax East for the use of the CarMax intellectual property that CarMax East uses to sell cars in this state.² App. p. 78, line 12 - p. 79, line 6.

B. CarMax West's Financing Income

CarMax West (via its interest in another CarMax entity) also generates income through the out-of-state activities of its car financing division. When a vehicle is sold in South Carolina, all income from that sale is reported to South Carolina by CarMax East and is taxed by South Carolina. Subsequent activity related to servicing and securitizing these retail installment contracts *after* the initial sale takes place *outside the state of South Carolina*. App. p. 110, lines 15-22; p. 111, lines 12-15.

² This income is received via payments directly to CarMax West from 2002-2004 and, subsequently, via its partnership interest in another entity, which has received such payments from CarMax East since 2004.

C. Unitary Nature of the Taxpayer

The CarMax companies³ and their operations are highly integrated and interrelated. They have shared ownership and management, and they also have a number of shared services and systems that create efficiencies and cost savings across the companies, including the centralized management functions, retail functions and intangible asset management. See App. p. 79, line 20 - p. 81, line 9; pp. 657-660, CarMax FY 2005 Officers and Directors List (as to shared ownership/management); p. 72, line 18 - p. 74, line 14; p. 605-656, Sample CarMax, Inc. Annual Report (as to shared services/systems). In addition, the various activities of the CarMax companies, including retail sales, financing, marketing and intellectual property management, contribute to and depend upon one another. App. p. 82, lines 19-24; see also pp. 605-656, Sample CarMax, Inc. Annual Report.⁴ CarMax West's expert witnesses also provided testimony supporting the conclusion that the CarMax businesses are unitary.

SCDOR provided no testimony or evidence to refute that the businesses are unitary. Indeed SCDOR's lone fact witness testified that he thought that the entire CarMax group of companies (which would include the entities at issue in this case as well as others not at issue) were a unitary business (App. p. 298, lines 20-24 and p. 301, line 18 - p. 302, line 1), while SCDOR's expert economist refused to answer

³ A detailed discussion of the formation of CarMax and its business structure is contained in CarMax West's Final Brief. The structure changed during the audit period, and therefore, the entities generating the income at issue changed over time; however, to simplify matters for this petition, CarMax West will not distinguish between them and will simply make generic references to the relevant CarMax entities (or similar references).

⁴ For example, as CarMax sells more cars, the value of its intellectual property increases, and as the value of the intellectual property increases and the brand becomes more well-known, CarMax sells more cars. App. p. 83, lines 1-17. Similarly, because CarMax's financing division can offer financing options to customers, it is able to sell more cars, and it is able to provide financing because it has access to CarMax customers. App. p. 83, line 18 - p. 84, line 19.

whether or not the businesses were unitary as he believed this question was irrelevant.

App. p. 396, lines 15-22 and p. 416, line 19 - p. 417, line 7.

D. CarMax West's Tax Reporting Method

CarMax West filed the tax returns at issue using the standard apportionment method for multi-state taxpayers. Specifically, CarMax West followed the tax return instructions and the guidance in the returns themselves, which dictate that the starting point for determining taxable income is a taxpayer's *federal taxable income*. App. p. 85, lines 20-25; p. 89, lines 4-9; p. 90, lines 14-25; and p. 91, lines 16-21.⁵ CarMax West then made the following statutorily dictated calculation to determine the amount of taxes due to South Carolina:

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

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

E. SCDOR's Alternative Method for Separately Taxing Royalties

SCDOR rejected CarMax West's use of the standard statutory method claiming that it does not fairly reflect CarMax West's activity in this State because its income is distorted under that method. SCDOR instead applied what it calls an "alternative method." App. p. 96, lines 4-9. This alternative method does not use federal taxable income as a starting point (see App. pp. 477-485, SCDOR Report of Field Audit), but

⁵ See also App. p. 549, Sample SCDOR Corporate Tax Return Instructions (Basis of Return section) and pp. 503-543, CarMax West Amended Tax Returns 2002-2007 (page 1, line 1 of each return).

rather separates and taxes only CarMax West's royalty receipts and thus is an attempt at separate accounting. App. p. 96, lines 4-9 and p. 96, line 20 - p. 97, line 10.

F. SCDOR's Method of Taxing Financing Income

SCDOR also rejected CarMax West's exclusion of the financing income from its apportionment factor numerator.⁶ CarMax West did not source this income to South Carolina because the activity producing this income occurred out-of-state. SCDOR asserted that financing income should be sourced to the state where the customer making payments on the retail installment contract resides rather than the place where the activity producing the income occurs. App. p. 282, lines 9-12; see also pp. 477-485, SCDOR Report of Field Audit; pp. 904-929, Amended SCDOR Audit Report.

SUMMARY OF GROUNDS FOR CERTIORARI

Rule 226 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:

- Where there are novel questions of law;
- Where there is a dissent in the decision of the Court of Appeals;
- Where the decision of the Court of Appeals is in conflict with a prior decision of the Supreme Court; and
- Where substantial constitutional issues are directly involved.

Rule 226(b); State v. Lyles, 2009 S.C. LEXIS 39 (S.C. Sup. Ct. Feb. 19, 2009) (outlining reasons for granting certiorari and standards for this Court to grant same).

Three of the four above-listed reasons are present in this matter and are discussed more fully below.

⁶ CarMax had reported the financing income as part of its corporate net income but not included it in the numerator of the apportionment formula as "receipts from within this State."

First, this case involves novel issues related to SCDOR's ability to apply an alternative apportionment formula and related to the sourcing of financing income where all activities related to earning that income take place out-of-state. Second, the ALC's decision and, by inference, the Court of Appeals' decision conflict with prior decisions of this Court providing that a unitary business may not be segregated into parts and those parts taxed separately. Third, substantial constitutional issues are involved because if the decisions of the ALC and the Court of Appeals are upheld, income will be taxed that has no connection to South Carolina. Such a result would be a gross miscarriage of justice and manifestly unfair. Accordingly, important reasons exist for this Court to issue a writ and review the Court of Appeals' decision in this matter, and this Court should grant this petition.

ARGUMENT

- I. **The Court of Appeals Erred in Failing to Determine that Remand to the ALC is Not Necessary Because there is No Evidence in the Record that Could Support a Decision by the ALC in Favor of SCDOR.**

The Court of Appeals erred in remanding the case to the ALC. Pursuant to the Court of Appeals' decision, the case is being reversed and remanded for the ALC to correctly place the burden of proof on SCDOR to establish that the standard statutory apportionment method used by CarMax West did not reflect the extent of its business activities in South Carolina and that the Department's alternative accounting method did reasonably reflect these activities. However, because there is no evidence in the record upon which the ALC could find in favor of SCDOR on either issue, the Court of Appeals should have entered judgment for CarMax West.

SCDOR argues that distortion results from CarMax West's inclusion of all its western vehicle sales in its apportionment formula denominator as directed by the statute. The only factual evidence submitted by SCDOR (and thus in the record for the ALC to consider on remand) in support of this argument was its "distortion" example. App. p. 484, SCDOR Report of Field Audit (Distortion Example) and pp. 931-933, SCDOR Distortion Example for FY 2006. This example showed two things: (1) under the standard apportionment formula, CarMax West had a lower apportionment ratio and thus lower taxable income than CarMax East, and (2) CarMax West paid less tax under the standard formula than under SCDOR's customized, alternative method. Neither of these facts has anything to do with the extent of CarMax West's activities in South Carolina or the income derived from those activities. One would expect CarMax East to have a significantly higher income and thus higher tax revenue in this State because, as the record shows, it has a much greater level of business activity here than does CarMax West. To the contrary, it is the method used by SCDOR that produces a distorted result by imposing a tax on the minimal activities of CarMax West that was greater than the tax on CarMax East, the entity with substantial activities in South Carolina. See App. at pp. 1090-1091, Appellant's Brief.

Furthermore, this Court should rule that as a matter of law, SCDOR's method of apportionment was not proper as its own regulation requires a unitary business to be apportioned in its entirety and not subdivided (see S.C. Code Ann. Regs. 117-710.1 (West Supp. 2009); App. p. 1096, Appellant's Brief) and because South Carolina law prohibits separate accounting as to a unitary business. See App. pp. 1093-1097, Appellant's Brief; pp. 1155-1158, Reply Brief.

Under S.C. Code Ann. § 1-23-610(B), an appellate court may reverse a decision of the ALC if it is "clearly erroneous in view of the reliable, probative, and substantial evidence on the whole record." See S.C. Code Ann. § 1-23-610(B); Sierra Club v. South Carolina Dep't of Environmental Control, 387 S.C. 424, 431, 693 S.E.2d 13, 16 (2011). "Substantial evidence" is defined as evidence "that would allow reasonable minds to reach the same conclusion as the [ALC] and is more than a mere scintilla of evidence." Id. Because there is no evidence in the record upon which the ALC could base a decision in favor of SCDOR on this issue, particularly now that SCDOR has the burden of proof, the Court of Appeals should simply have reversed the decision of the ALC as the record can only support a ruling in favor of CarMax West.

II. The Court of Appeals Erred in Failing to Determine that CarMax West was a Unitary Business.

The Court of Appeals erred in failing to rule that CarMax West is a unitary business. The evidence was uncontested at trial on this issue. See App. pp. 1083-1086, Appellant's Brief, and p. 1158, Reply Brief. SCDOR argued at trial and the ALC agreed that whether CarMax West operates a unitary business was irrelevant in this matter. See App. p. 13, Order (stating that the "question of whether a taxpayer is 'unitary' or 'non-unitary' is not outcome determinative" and making no finding as to whether CarMax West was unitary). To the contrary, this factual and legal issue is critical to determining two key issues in this case: (1) whether the standard apportionment method is a fair reflection of CarMax West's activities in South Carolina; and (2) whether the separate accounting method applied by SCDOR to CarMax West, a unitary business, is reasonable. Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159, 181

(1983) (quoting, Mobil Oil Corp. v. Comm. of Taxes of Vt., 445 U.S. 425, 438 (1980)); Exxon Corp. v. S.C. Tax Comm'n, 273 S.C. 594, 599, 258 S.E.2d 93, 96 (1979); Eastman Kodak Co. v. S.C. Tax Comm'n, 308 S.C. 415, 418 S.E.2d 542 (1992); Lowenstein Corp. v. S.C. Tax Comm'n, 298 S.C. 93, 378 S.E.2d 272 (Ct. App. 1989).

CarMax West presented substantial, uncontested evidence at trial that it operates a unitary business. In determining whether a business is unitary, South Carolina courts apply two main tests: (1) the three unities test; and (2) the contribution-dependence test. Exxon, 273 S.C. at 598, 258 S.E.2d at 95. These tests are not mutually exclusive, and the courts often apply both. Id.; see also Allied-Signal, Inc. v. Director, Div. of Taxation, 504 U.S. 768, 789 (1992) (discussing unitary business tests of "functional integration, centralization of management, and economies of scale"). Under the three unities test, courts look at whether the business or businesses have unity of ownership, unity of management and unity of operation. Exxon, 273 S.C. at 598, 258 S.E.2d at 95. Under the contribution-dependence test, the court considers whether the "activities of the business in question contribute to or depend on the other activities of the business." Id. at 600, 258 S.E.2d at 96. The courts do not require that it be "necessary" or "essential" that the business or businesses be operated together; cost savings or increased profits gained by operating together are acceptable reasons. Id. at 599-601, 258 S.E.2d at 96-97.

The Exxon case provides a model for how to analyze whether a taxpayer operates a unitary business. The Court noted the following regarding Exxon's operations: it held itself out to the public as one company; it employed central staff on

which all companies were dependent; it used centralized purchasing techniques that resulted in cost savings throughout the company; it had strong, centralized management over all segments of the company; the structure provided profit stability, reduced risk and insured full capacity utilization of the company's facilities; it made no attempt to segregate earnings or funds of the various segments; and the various operating activities of the company (exploration, production, refining and marketing) contributed to and depended upon each other. Exxon, 273 S.C. at 601, 258 S.E.2d at 96-97. Based on these findings, the Court held that the taxpayer satisfied both the three unities test and the contribution-dependence test. Id. at 602, 258 S.E.2d at 96-97.⁷

The facts presented at trial through the testimony of CarMax West's Tax Director support the conclusion that the relevant CarMax entities are unitary. See supra Summary of Facts, § C, at pp. 6-7. In addition, both CarMax West's expert economist and expert tax accountant testified that from an economic standpoint and a tax accounting standpoint respectively, the CarMax businesses at issue are unitary. See App. p. 159, line 8 - p. 169, line 9 (testimony of expert tax accountant); and p. 203, line 11 - p. 204, line 14 and p. 205, lines 7-21 (testimony of expert economist).

⁷ See also Eastman Kodak, 308 S.C. 415, 418 S.E.2d 542 (finding that multi-national camera and film corporation that was also doing safe harbor lease transactions involving tangible personal property was a unitary business not capable of separation where only a small portion of leased assets were in South Carolina, the funding for the leasing came from the general corporate treasury and the income benefited the company as a whole); Texaco v. Wasson, 269 S.C. 255, 237 S.E.2d 75 (1977) (finding multi-state oil and gas company that also contracted on a royalty basis with third parties to mine salt and sulphur discovered on prospective oil lands was a unitary business where salt and sulphur was discovered during oil exploration process, which was an integral part of the business); Lowenstein, 298 S.C. 93, 378 S.E.2d 272 (finding affiliated New York textile manufacturing companies that also earned interest income from inter-company loans were unitary where funding for leasing came from general corporate treasury, interest income and loan payments were deposited in general company accounts and used for normal business operations and income benefited company as a whole).

Moreover, the evidence and testimony regarding the unitary nature of the businesses were un rebutted.⁸

Because the overwhelming and uncontested evidence establishes that the relevant CarMax entities are unitary businesses, the royalty and financing income as well as the income from vehicle sales thereby constitute CarMax West's unitary income, and CarMax West respectfully requests that this Court enter such a finding.

III. The Court of Appeals Erred in Failing to Rule that the Financing Receipts at Issue Should Not Be Sourced to South Carolina.

The Court of Appeals erred in failing to rule that CarMax West's financing receipts should not be sourced to South Carolina when all services related to producing that income were performed out-of-state. The parties agreed in their briefing before the Court of Appeals that the ALC applied the proper burden and standard of proof on this issue (CarMax West had the burden of proof); however, the Court of Appeals failed to rule upon this issue.

In Lockwood Greene Engineers v. S.C. Tax Commission, 293 S.C. 447, 448, 361 S.E.2d 346, 347 (Ct. App. 1987), the Court of Appeals adopted the "place of activity" test, under which, for purposes of South Carolina's apportionment statutes, "receipts" are sourced to the state where the services are performed. The taxpayer in Lockwood Greene was an engineering firm with employees in South Carolina and customers in and out-of-state. Lockwood Greene argued that the Court should apply

⁸ As previously stated, SCDOR's witness testified that he thought that the entire CarMax group of companies was a unitary business (App. p. 298, lines 20-24 and p. 301, line 18 - p. 302, line 1); SCDOR's expert economist refused to answer whether or not the businesses were unitary as he believed this question was irrelevant (App. p. 396, lines 15-22 and p. 416, line 19 - p. 417, line 7); and SCDOR presented no evidence that CarMax West did not operate a unitary business.

the "origin of payment" test and source the receipts to the location of its customers, but SCDOR and the Court rejected this test in favor of the "place of activity" test. Id. The Court reasoned that out-of-state clients were paying the firm for the expertise and time of the employees who were located in South Carolina. Id. at 449, 361 S.E.2d at 347.

Under the Lockwood Greene "place of activity" test, the financing receipts in this case should be sourced outside of South Carolina. It was uncontested that all of the activity producing these receipts takes place outside of the state (App. p. 111, lines 12-15), and that such activity adds value. (App. p. 210, line 24 - p. 212, line 2.) Moreover, sourcing the receipts outside of South Carolina does not deprive South Carolina of its fair share of the tax revenue from the transactions that actually occur within the state. As previously explained, all income from the initial vehicle sales is reported in South Carolina by CarMax East and taxed by South Carolina. (App. p. 107, lines 6-11.) The financing income at issue here is related only to the subsequent activity of servicing and securitizing the loans after the initial sale, all of which occurs in Georgia.

The alternative "but for" test proposed by SCDOR is unsupported, is flawed, would produce irrational results and should be rejected. SCDOR's position is that all receipts from post-sale financing activities related to vehicles sold in South Carolina should be sourced to South Carolina because that is where the initial transaction takes place; as SCDOR's expert testified, "but for" the initial sale in South Carolina, there would be no financing receipts. (App. p. 423, lines 14-21.) Neither SCDOR nor its expert supplied any basis for this test in the law or economic literature. A more persuasive application of the "but for" test is that "but for" the activities of the out-of-

state employees who service and securitize the loans, there would be no income to source. SCDOR's expert failed to even address much less explain why the activities that directly generate the income at issue should be ignored.

As support for its ruling, the ALC references dicta in Lockwood Greene stating that the "place of activity" test might not apply to a finance company. That language obviously does not constitute binding precedent and should not guide resolution of this issue. The principles supporting the sourcing of the engineering services revenue to the place of activity in Lockwood Greene apply equally to the finance employees in this case.

The ALC also cites Geoffrey, Inc. v. S.C. Tax Commission, 313 S.C. 15, 437 S.E.2d 13 (1993) in support of its decision on this issue, but that case simply has no bearing on where CarMax West's financing receipts should be sourced. In Geoffrey, the South Carolina Supreme Court held that the royalty income earned by an out-of-state holding company affiliate had a sufficient nexus to the state to support the assessment of income tax. CarMax West does not contest its economic nexus to South Carolina as evidenced by its years of income tax return filings and payments to the state. Geoffrey provides no guidance whatsoever as to where financing revenue generated out-of-state after an in-state sale should be sourced, and it does not displace the "place of activity" test adopted in Lockwood Greene.⁹

Based on the above and under the "place of activity" test in Lockwood Greene, CarMax West established by a preponderance of the evidence that income from the

⁹ Additionally, Geoffrey provides further support to CarMax West's argument that separate accounting is inappropriate as the tax assessed in that case was based on Geoffrey's total unitary net income as measured by its sales activities (the exploitation of trademarks) that took place in this State and not by separate geographical accounting as SCDOR has imposed here.

financing services activities that take place after the initial sale to South Carolina should not be sourced to South Carolina because the economic activity that produces these additional revenues (thereby adding value to the process) take place out-of-state, and the ALC erred in finding otherwise. CarMax West therefore respectfully requests that this Court reverse the ALC's ruling in favor of SCDOR on this issue and dismiss the portion of the assessment related to the sourcing of financing receipts.

IV. The Court of Appeals Erred in Failing to Determine that SCDOR's Assessment Violates CarMax West's Constitutional Rights.

The ALC determined that SCDOR's assessment did not violate CarMax West's constitutional rights. The parties agreed in their briefing before the Court of Appeals that the ALC applied the proper burden and standard of proof (i.e. CarMax West bore the burden of proof) on this issue; however, the Court of Appeals failed to rule upon it. CarMax West contends that SCDOR violated its constitutional rights by applying separate accounting to a unitary business and by sourcing the finance receipts at issue to South Carolina and would ask that this Court reverse the ALC on this issue.

SCDOR has erroneously applied the South Carolina income tax laws to CarMax West in such a way as to reach an unconstitutional result. The method of taxation employed by SCDOR violates the Due Process Clause of the South Carolina and United States Constitutions and the Interstate Commerce Clause of the United States Constitution because, *inter alia*, it taxes income with no connection to South Carolina, taxes income out of all proportion to CarMax West's activities in South Carolina, is not fairly apportioned and is not fairly related to the services provided by the taxing state.

The four-part test for determining whether a state taxing statute violates the commerce clause is set forth in Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977). To be sustained, a tax must: (1) be applied to an activity with a substantial nexus to the taxing state; (2) be fairly apportioned; (3) not discriminate against interstate commerce; and (4) be fairly related to the services provided by the taxing state. Id. at 279. In evaluating the fairness prong, one of the tests the courts apply is an external consistency test. See Container Corp., 463 U.S. at 169 (discussing fairness issue under both Commerce Clause and Due Process Clause). External consistency requires that the factors used by the state in the apportionment formula "must actually reflect a reasonable sense of how income is generated." Id. A formula will not satisfy this test if it attributes income to the state that is "out of all appropriate proportions to the business transacted . . . in that State" (id. at 170 (citations omitted)) or has "led to a grossly distorted result." Id. (citations omitted).¹⁰

As applied to CarMax West in this case, the tax assessment at issue fails the Complete Auto test and runs afoul of the law as set forth in Container Corp., Exxon and similar cases because it taxes income with no connection to South Carolina (as to financing income only), is not fairly apportioned, and is not fairly related to the services provided by the taxing state. More specifically, as to the fairness prong, SCDOR's alternative formula in this case fails the external consistency test because it does not actually reflect a reasonable sense of how income is generated by CarMax West, a unitary business, in

¹⁰ See also Amerada Hess Corporation v. Director, Division of Taxation, 490 U.S. 66 (1989) (applying Complete Auto test and due process analysis and holding that expenses and income associated with the taxpayer's crude oil production activities were part of the taxpayer's unitary business and accordingly were not assignable out-of-state but rather were properly subject to apportionment); Trinova Corp. v. Michigan Department of Treasury, 498 U.S. 358 (1991); Exxon Corp. v. S.C. Tax Comm'n, 273 S.C. 594, 607 258 S.E.2d 93, 99 (1979) (stating that due process clause requires there be some fiscal relation to the protections, opportunities and benefits provided by the state).

South Carolina. Finally, SCDOR's alternative formula is not fairly related to the services provided by South Carolina, which are *de minimus* in this case. The irrationality and unfairness of the proposed assessment on CarMax West is further illustrated by the fact that SCDOR would be imposing a greater tax liability on CarMax West (\$102,303), which has virtually no contact with South Carolina, than CarMax East (\$94,452), which performs substantial business in South Carolina. See App. pp. 931-933, SCDOR Distortion Example for FY 2006. CarMax West established by a preponderance of the evidence that SCDOR's assessment results in liability that is distortive and taxes CarMax West out of all proportion to and does not fairly represent its business conducted in South Carolina (see Container Corp., 463 U.S. at 170; Hans Rees', 283 U.S. at 135), and the ALC's finding to the contrary is in error and should be reversed.

V. **In the Alternative to I above, if this Court Determines that Remand to the ALC is Appropriate, then the Court of Appeals Erred in Failing to Instruct the ALC that it Must Consider whether CarMax West is a Unitary Business and Must Consider the South Carolina Cases Holding that Separate Accounting is Not Appropriate for a Unitary Business.**

In the alternative, if this Court believes that a remand is necessary in this case, then the Court should instruct the ALC that it must consider whether CarMax West is a unitary business and must consider the South Carolina cases holding that separate accounting is not appropriate for such a business. Such instructions will ensure that the ALC properly considers all relevant facts and law on remand, which will promote judicial economy and avoid duplicative proceedings and multiple appeals.

The decisions of the United States Supreme Court, the South Carolina Supreme Court and the South Carolina Court of Appeals firmly establish that a determination of

whether a business is unitary is critical to identifying and applying the proper apportionment method. As the United States Supreme Court has explained:

[When] a unitary business exists, "separate [geographical] accounting, while it purports to isolate portions of income received in various States, may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale. Because these factors of profitability arise from the operation of the business as a whole, it becomes misleading to characterize the income of the business as having a single identifiable 'source.'"

Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159, 181 (1983) (quoting, Mobil Oil Corp. v. Comm. of Taxes of Vt., 445 U.S. 425, 438 (1980)). Once the determination is made that a business is unitary, "a State must then apply a formula apportioning the income of that business within and without the State." Id. at 169 (emphasis added).

Consistent with this analysis, the South Carolina Supreme Court has definitively held that a unitary business cannot be subject to a separate accounting like the one imposed by SCDOR here, which seeks to isolate and tax only CarMax West's royalty income derived from the use of its trademarks and trade names in South Carolina. In the seminal unitary business case in this State, the South Carolina Supreme Court rejected the taxpayer's argument to separate out and exclude from taxation income from certain out-of-state business activities citing an earlier decision for the proposition that the income of a unitary business "is attributable to all incidents of the business and not to any single activity." Exxon Corp. v. S.C. Tax Comm'n, 273 S.C. 594, 599, 258 S.E.2d 93, 96 (1979), quoting Covington Fabrics v. S.C. Tax Comm'n, 264 S.C. 59, 68, 212 S.E.2d 574, 578 (1975). The taxpayer in Exxon sought to separate income

generated by its oil exploration and production activities in other states from its retail sales income from gas stations in South Carolina. The Department opposed this separate accounting method, and the South Carolina Supreme Court agreed holding that the taxpayer could not divide its unitary income producing activities. Id.¹¹

Thus, CarMax West would ask that this Court instruct the ALC that it should consider and rule upon whether CarMax West is unitary, and, if it is unitary, then the ALC should consider the above-discussed case law on the impropriety of applying separate accounting to a unitary business when evaluating whether the standard apportionment method accurately reflects its unitary business activities and whether the Department's alternative separate accounting method is reasonable.

VI. In the Alternative to I above, if this Court Determines that Remand to the ALC is Appropriate, then the Court of Appeals Erred in Failing to Clarify that the Remand Should be on the Record in the Case versus a New Trial as a New Trial would Promote Duplicative Proceedings and Judicial Inefficiency and Would Be Unjust.

As previously stated, the Court of Appeals held that the ALC erred in determining that CarMax West had the burden of proof and reversed and remanded the case to the ALC for "for a reconsideration of all issues." CarMax Auto Superstores West Coast, Inc. v. South Carolina Department of Revenue, 2012 WL 832985, Op. No. 4953, at * 4 (S.C. Ct. App. March 14, 2012) (App. p. 1168). Although this statement appears to provide that reconsideration should be based on the facts in the record and does not order a new trial, SCDOR has indicated that it does not agree with

¹¹ For a complete discussion of South Carolina law on the unitary business issue, please see Appellant's Brief at App. pp. 1094-1101; Reply Brief at App. pp. 1155-01157 and 1159-1161.

CarMax West's reading of the decision on that point.¹² Therefore, CarMax West requested (via its Petition for Rehearing) that the Court of Appeals confirm that the ALC should simply apply the proper burden of proof and the law to the facts already in the record and not conduct a new trial. However, the Court of Appeals declined to further address the nature of the remand. Guidance on this question is essential to avoid a multiplicity of litigation and appeals in this matter.

At trial, SCDOR agreed that it should bear the burden of proof. See Appellant's Brief at App. p. 1078 (citing App. 464, lines 3-9). It only changed its position after the trial had concluded when it provided its proposed order to the ALC, which proposed that CarMax West should bear the burden of proof (which the ALC erroneously adopted in its decision). Thus, during the trial, SCDOR believed it bore the burden of proof and could and should have presented any and all evidence it needed to meet this burden. It would be fundamentally unfair to now require the parties to bear the burden and expense of another trial and to give SCDOR a second bite at the apple. See Lewis v. Lewis, 392 S.C. 381, 709 S.C. 650 (2011) (reversing Court of Appeals decision, which found that the value of the marital home was not supported by the record and which remanded the case with instructions that invited the lower court to accept additional evidence, and noting that "Given Respondent's incomplete presentation at trial, it would be fundamentally unfair to Petitioner to give Respondent a second bite at the apple"); Sierra Club v. South Carolina Dep't of Environmental Control, 387 S.C. 424, 693 S.E.2d 13 (2011) (remanding case to ALC with instructions to apply its factual findings to the proper regulations, which the ALC had

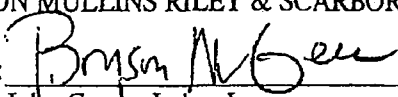
¹² In its Petition for Rehearing, SCDOR requested that the Court of Appeals remand the case "for trial on all issues" if it denied SCDOR's Petition. See App. p. 1193, n.9.

not addressed in its order). Therefore, if this Court determines that a remand is necessary, CarMax West respectfully requests that the Court instruct the ALC that its reconsideration of the issues in light of the proper burden of proof is to be done on the record as it now exists and that no new testimony or evidence is to be taken.

CONCLUSION

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

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June 6, 2012

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.....Petitioner
v.

South Carolina Department of Revenue.....Respondent

PROOF OF SERVICE

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

Pleadings:

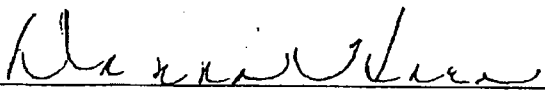
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June 6, 2012

APP_01277

THE STATE OF SOUTH CAROLINA
In The Supreme Court

APPEALED FROM THE SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

RECEIVED

JUN - 8 2012

Carolyn C. Matthews, Administrative Law Judge, S.C. Supreme Court

Opinion No. 4953 (S.C. Ct. App. Filed March 14, 2012)

CarMax Auto Superstores West Coast, Inc. Respondent,

v.

South Carolina Department of Revenue Petitioner.

PETITION FOR WRIT OF CERTIORARI

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APP_01278

INDEX

Page No.

Certificate of Counsel	1
Questions Presented	1
Statement of the Case	1
Arguments:	
I. THE COURT OF APPEALS ERRED BY IGNORING THE PLAIN LANGUAGE OF S.C. CODE ANN. § 12-6-2320 (SUPP. 2009) BY FINDING THAT THE DEPARTMENT OF REVENUE HAS THE BURDEN OF PROOF TO SHOW AN ALTERNATIVE ACCOUNTING METHOD IS "MORE APPROPRIATE THAN ANY COMPETING METHODS."	4
II. THE COURT OF APPEALS ERRED BY IGNORING THE PLAIN LANGUAGE OF S.C. CODE ANN. § 12-6-2320 (SUPP. 2009) BY FINDING THAT THE DEPARTMENT HAS THE BURDEN OF PROOF TO SHOW AN ALTERNATIVE ACCOUNTING METHOD IS "MORE APPROPRIATE THAN ANY COMPETING METHODS."	7
III. THE COURT OF APPEALS ERRED IN REFUSING TO FIND THAT THE RECORD SUPPORTED THE ADMINISTRATIVE LAW COURT'S RULING THAT THE DEPARTMENT MET ITS BURDEN UNDER § 12-6-2320.	10
Conclusion	14

CERTIFICATE OF COUNSEL

Counsel for Petitioner certifies that the Petition for Rehearing was made and finally ruled upon by the Court of Appeals on May 7, 2012.

QUESTIONS PRESENTED

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

STATEMENT OF THE CASE

CarMax Auto Superstores West Coast, Inc., (CarMax or taxpayer) is a multi-state corporation which owns a 93.5% interest in CarMax Business Services, LLC (CBS). CBS manages intangibles and enters into car financing (secured transactions) within South Carolina. CBS then securitizes the consumer finance contracts and sells them to third party investors. The other owner of CBS is CarMax Auto Superstores, Inc., (East) which owns 6.5% of CBS. East operates retail auto sales locations within South Carolina. East pays a royalty fee to CBS, and then takes that fee as a deduction against its South Carolina taxable income. CBS is treated as a pass-through entity for tax purposes and pays no taxes in this State. All income from CBS flows to East and this taxpayer based on the percentage of ownership interest. The taxpayer does not sell cars

in South Carolina, such that its only South Carolina income, and thus only business activity within the state, is derived from CBS' royalty and financing activities.

The taxpayer filed amended returns for the tax years 2002-2007 employing its chosen apportionment method under S.C. Code Ann. § 12-6-2290 (Supp. 2009) - also referred to as the gross receipts method. This formula calculated the taxpayer's apportionment ratio by dividing its gross receipts from financing and intangibles in South Carolina by the taxpayer's gross receipts from financing, intangible, and retail sales everywhere the taxpayer does business. The taxpayer's gross receipts method yielded the following income tax due:¹

2002:	\$14,717
2003:	\$11,532
2004:	\$7,840
2005:	\$6,883
2006:	\$3,879
2007:	\$3,670
Total:	\$48,523

The Department audited the taxpayer for corporate income tax years 2002, 2003, 2004, 2005, 2006, and 2007. The resulting proposed assessment, including penalties and interest, totaled \$829,490.00.² This was summarized as follows:

Income Tax	\$488,300.00
Interest	\$129,828.00
Penalty	\$211,362.00
Total	\$829,490.00

¹See Tr. Ex.4, CarMax West Amended Tax Returns, 2002-2007 (R., p. 497). The taxpayer filed its original South Carolina corporate income tax returns for years 2002-2007 utilizing S.C. Code Ann. § 12-6-2250 (Supp. 2009) - the three-factor or three-factor double weighted sales formula. This formula calculates a taxpayer's taxable income in South Carolina by computing a ratio of taxpayer's total property, payroll, and sales.

²See Department Determination (R., p. 490).

The Department employed an alternative apportionment formula under the provisions of § 12-6-2320(A)(4) finding that the taxpayer's use of the standard gross receipts apportionment formula failed to fairly represent its business activity within this State. The Department's alternative formula calculated an apportionment ratio based on the taxpayer's South Carolina income from intangibles and financing over the taxpayer's intangibles and financing income from everywhere. By focusing on the kind of business the taxpayer conducted within South Carolina, this alternative method of apportionment essentially denied the taxpayer's efforts to inflate the denominator of its apportionment ratio by including sales of autos from its retail operations in California, Utah, and Nevada. The proposed assessment also included the income from the sale of securitized consumer lending contracts in the taxpayer's South Carolina income. The taxpayer filed a timely protest and the Department issued its Determination upholding the proposed assessment. The taxpayer thereafter filed for a contested case hearing before the Administrative Law Court (ALC).

The ALC issued its ruling after a full hearing of all issues. In its Order, the ALC upheld the Department's audit findings. However, the ALC did not award the penalties as assessed.

The Court of Appeals heard the case and issued an order reversing and remanding the case to the ALC. The crux of the Court of Appeals' opinion concerned the burdens of proof under § 12-6-2320(A). That is, when a multistate taxpayer files a South Carolina return using a standard apportionment formula, it must accurately reflect its business activity within this State. In the event the standard formula fails to fairly reflect the

extent of the taxpayer's business activity within this State, the Department may require the use of any of the statutorily enumerated methods.

The Court of Appeals ruled that the Department has both the initial burden to prove that the taxpayer's chosen method does not accurately reflect its business activity within this State, and the burden of proving that the its alternative method is "more appropriate than any competing methods."³ The provisions of § 12-6-2320 do not support the latter conclusion.

The Department respectfully requests that this Court issue a Writ of Certiorari pursuant to Rule 242, SCACR, to review the decision of the Court of Appeals in this matter inasmuch as it is inconsistent with this Court's formulations of the burdens of proof in Media General Communications, Inc. and Media General Holdings, Inc. v. South Carolina Department of Revenue, 388 S.C. 138, 694 S.E.2d 525 (2010). Further, the case presents important and novel questions of law concerning those burdens of proof that should be decided by this Court.

I. THE COURT OF APPEALS ERRED BY IGNORING THE PLAIN LANGUAGE OF § 12-6-2320 BY FINDING THAT THE DEPARTMENT OF REVENUE HAS THE BURDEN OF PROOF TO SHOW AN ALTERNATIVE ACCOUNTING METHOD IS "MORE APPROPRIATE THAN ANY COMPETING METHODS."

Section 12-6-2320(A) provides as follows:

(A) If the allocation and apportionment provisions of this chapter do not fairly represent the extent of the taxpayer's business activity in this State, the taxpayer may petition for, or the department may require, in respect to all or any part

³The requirement to show that an alternative method is "more appropriate than any competing methods" is inconsistent with an earlier statement in the Court of Appeals' opinion "... the Department bears the burden of proving its alternative accounting method is reasonable and more fairly represents CarMax West's business activity in South Carolina."

of the taxpayer's business activity, if reasonable:

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

(emphasis added).

According to the statute, once there is an adequate showing that standard allocation and apportionment formulas ["the allocation and apportionment provisions of this chapter"] do not fairly represent the extent of the taxpayer's business in this State, the Department may require any of the accounting methods enumerated in subparagraphs (1) - (5) of § 12-6-2320(A), if "reasonable." The statute does not require that the proponent of an alternative accounting method - whether the Department or even the taxpayer - show that the proffered method is more appropriate than any other "competing methods."⁴ Instead, in the absence of evidence to the contrary, an alternate accounting method should be upheld if "reasonable."

When construing a statute, the cardinal rule is to ascertain the intent of the Legislature. Georgia-Carolina Bail Bonds, Inc. v. County of Aiken, 354 S.C. 18, 22, 579 S.E.2d 334, 336 (Ct. App. 2003). "All rules of statutory construction are subservient to the one that legislative intent must prevail if it can be reasonably discovered in the language used, and that language must be construed in the light of the intended purpose

⁴In practice, such evidence could be part of any case the proponent of an alternate apportionment method pursues under the terms of § 12-6-2320, but only in response to the introduction of some competing method by the party opposing alternative apportionment. In the event an opposing party does not come forward with evidence of a competing method, the proponent's showing that the alternative formula is reasonable necessarily satisfies the statute.

of the statute.” Id. at 23, 579 S.E.2d at 336. The words of the statute must be given their plain and ordinary meaning without resorting to subtle or forced construction to limit or expand the statute’s operation. Hitachi Data Sys. Corp. v. Leatherman, 309 S.C. 174, 178, 420 S.E.2d 843, 846 (1992).

Here, § 12-6-2320(A) is clear that once the first prong is satisfied - that the standard formula fails to fairly represent the extent of the taxpayer’s business activity in this State -- an alternative apportionment formula may be required by the Department if “reasonable.” The second prong of the proponent’s burden of proof is therefore met once the proponent shows that its alternative method is “reasonable.”⁵ The statute does not require the proponent to show that the chosen apportionment method is more appropriate than competing methods.⁶ With both prongs under § 12-6-2320(A) thus satisfied, the proponent of the alternative method has met its burden of proof and use of the alternative

⁵It is significant to note that the taxpayer has characterized the second prong of the burden of proof in similar terms. The taxpayer urged the Court of Appeals to require the Department to “establish by clear and convincing evidence that the standard statutory apportionment method does not reflect the extent of the taxpayer’s business in South Carolina and that the alternative separate accounting method is reasonable.” (Appellant’s Final Brief, p. 13). Aside from the taxpayer’s use of an incorrect standard of proof, the Department is in agreement with CarMax’s characterization of the substantive burden of proof under § 12-6-2320(A).

⁶This interpretation of § 12-6-2320(A)’s two pronged burden of proof is straightforward, logical, and avoids absurd results. By proving that the standard method of apportionment fails to fairly reflect the extent of a taxpayer’s business within South Carolina and proposing a “reasonable” alternative, the proponent of any alternative method will have already shown that at least one method of apportionment is not proper. In the absence of specific evidence of competing formulas produced by the party opposing the proffered alternative method, the proponent should not be required to speculatively defend against endless permutations of alternate formulas. To hold otherwise would work an absurd result not intended by the General Assembly. State ex rel. McLeod v. Montgomery, 244 S.C. 308, 136 S.E.2d 778 (1964) (A statute must be interpreted so as to avoid absurd results.).

formula should be upheld.

II. THE COURT OF APPEALS ERRED IN INTERPRETING MEDIA GENERAL TO REQUIRE THE DEPARTMENT TO SHOW THAT ITS ALTERNATIVE METHOD OF APPORTIONMENT FOR TAXES, PURSUANT TO § 12-6-2320 IS "MORE APPROPRIATE THAN ANY COMPETING METHODS."

Media General is the most recent case issued by this Court interpreting § 12-6-2320. The Court ruled that the language in § 12-6-2320(A)(4) providing for "the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income" allowed the taxpayer therein to use a combined entity apportionment method to determine its tax liability. Heretofore, inasmuch as South Carolina had always been a "separate entity" state, combined entity reporting had not been recognized as a proper method for apportionment of income, even as an alternative method under § 12-6-2320. Media General, 388 S.C. at 149-150; 694 S.E.2d at 530-531.

For the purposes of the instant case, it is important to recognize that the taxpayer in Media General was the proponent of the alternative method of apportionment, meaning the taxpayer bore the burden of justifying its use of a formula other than standard apportionment. The taxpayer satisfied its initial burden under § 12-6-2320(A) by virtue of the parties' stipulation that the standard statutory methods of apportionment did not fairly measure the taxpayer's business activity in South Carolina. Id., 388 at 146, 694 S.E.2d at 529. Secondly, based upon its audit findings, the Department acknowledged that the combined entity apportionment method propounded by the taxpayer "did fairly measure the taxpayers' business activity in South Carolina." Id.⁷ This was tantamount to

⁷The Department's role is to fairly administer the tax laws. S.C. Code Ann. § 12-4-10 (2000). In particular, S.C. Code Ann. § 12-6-2210(B) (2000) provides in pertinent part: "[i]f a taxpayer is transacting or conducting business partly within and partly

a showing by the taxpayer that its chosen alternative method of apportionment was "reasonable" within the meaning of § 12-6-2320(A) – the second prong of the burden of proof test to be satisfied by the proponent of an alternative apportionment method.⁸

After the Media General taxpayer satisfied both its initial and second level burdens of proof under § 12-6-2320(A), the burden then shifted to the Department to show that a more appropriate method of apportionment existed. This burden shifting is illustrated by the following excerpt:

We emphasize that, as a general rule, the Department need not automatically use the method requested by a taxpayer, as it has the discretion to select an alternative method that fairly measures the taxpayer's income in South Carolina. In this case, however, the Department never recalculated Taxpayers' incomes using any other alternative method, and the Department stipulated that use of the combined entity apportionment method proposed by Taxpayers does result in a fair computing of Taxpayers' business activities in South Carolina. Accordingly, we uphold the ALC's determination that the combined entity apportionment method should be utilized by the Department for the tax period in question.

* * *

The Department concedes the standard apportionment

without this State, the South Carolina income tax is imposed upon a base which reasonably represents the proportion of the trade or business carried on within this State" (emphasis added).

⁸The Court's modified restatement of the statutory language in § 12-6-2320 underscores that reasonableness is the touchstone for use of an alternative formula:

[t]his statute [§ 12-6-2320(A)(4)] provides that if the allocation and apportionment provisions do not fairly represent the taxpayer's business activities in South Carolina, the taxpayer may petition for, or the Department may require, if reasonable, the employment of any other method to effectuate the equitable allocation and apportionment of the taxpayer's income.

Id., 388 SC at 143; 694 S.E.2d at 527 (emphasis added).

formulas allowed under South Carolina law result in a statutory distortion of Taxpayers' incomes and that the combined entity apportionment method would fairly represent their business activities in South Carolina. We agree with the ALC that the legislature has placed no explicit limitation on the alternative methods that may be used under section 12-6-2320(A)(4), and consequently we affirm the ALC's ruling that the Department is authorized to use the combined entity apportionment method. Although the Department has the discretion to select an alternative method, the ALC has ordered in this case that the method be applied and we affirm this determination as the Department has not established that another method would be more appropriate. This ruling is limited to the tax period in question, and the Department may employ any other appropriate alternative method for future tax years.

Id., 388 S.C. at 151-152; 694 S.E.2d at 531-532 (emphasis added).

Once the taxpayer in Media General met the requirements of § 12-6-2320(A) by showing that the standard apportionment method did not “fairly represent the extent of the taxpayer's business activity in this State” and that the chosen apportionment method resulted in a fair measure of its in-state business activities, i.e., the method was “reasonable,” the Department then had the further opportunity, as the party opposing use of the proffered method, to show that a more appropriate alternative method existed. In Media General, the Department did not make such a showing and thus, the Court determined that the combined entity apportionment method, because it was reasonable, was the method to be used to calculate the taxpayer's South Carolina income tax liability. Id.⁹ In the instant case, once the Department demonstrated that the standard

⁹In such cases, in the event the Department responds to the taxpayer's proffer of an alternative formula with an alternative equally as reasonable, arguably the Department's method may enjoy some presumption of correctness based on § 12-6-2210(B), and the Media General Court's observation that “the Department need not automatically use the method requested by a taxpayer, as it has the discretion to select an

apportionment method used by the taxpayer did not fairly reflect the taxpayer's business activity within South Carolina and that the proffered alternative method was reasonable, the burden then lay with the taxpayer, the opponent of the proffered alternative method, to show that a more appropriate alternative method existed. The taxpayer failed to make such a showing.¹⁰ In the absence of evidence propounded by the taxpayer that the reasonable alternative apportionment method selected by the Department was not as well suited to measure the taxpayer's business activity as some competing formula, the Department's proffered method of apportionment should be upheld.

III. THE COURT OF APPEALS ERRED IN REFUSING TO FIND THAT THE RECORD SUPPORTED THE ALC's FINDING THAT THE DEPARTMENT MET ITS BURDEN UNDER § 12-6-2320(A).

A careful review of the ALC Order and the Record indicates that the Department met its two pronged burden of proof regarding use of the alternative apportionment method. As such, any error of the ALC in the characterization of the Department's burden of proof under § 12-6-2320(A) in the context of this case was harmless.

alternative method that fairly measures the taxpayer's income in South Carolina." Id. (emphasis added).

¹⁰In fact, the ALC order recites that CarMax raised:

... two primary arguments challenging the reasonableness of the Department's method. First, the taxpayer argues that a unitary business, or a portion of one, cannot be subject to a separate accounting. Second, the taxpayer argues that the Department's method in this case attempts to reach extraterritorial income; that is, income that is not properly taxable in South Carolina.

(ALC Order, p. 11). These counter arguments appear to fall woefully short of the kind of specific evidentiary challenges to reasonableness contemplated by the Media General Court.

As the Court of Appeals observed, the ALC noted that "the burden of proof is generally upon the party asserting the affirmative in an adjudicatory administrative proceeding. . . . The taxpayer in this matter requested a contested case hearing to challenge the Department's proposed assessment; thus, the taxpayer bears the burden of proof." (ALC Order, p. 6). This is a correct statement of law as it relates to the overall burden of proof in tax cases under the Revenue Procedures Act; however, this broad statement does not address the specific burdens under § 12-6-2320(A). At a later point in its Order, the ALC clearly articulated the two-pronged burdens under this statute:

The statute provides broad authority for the Department to deviate from the standard formulas laid out by other apportionment statutes under limited conditions. Under the statute there are two significant checks on the Department's ability to deviate from statutory formulas. First the statutory authority of the Department to require an alternative method is triggered only if the standard formulas of Title 12, Chapter 6 fail to fairly represent the extent of the taxpayer's business activity in South Carolina. Second, whatever method the Department proposes, it must be reasonable. The Court [ALC] discusses each of these requirements in turn below.

(ALC Order, p. 7).¹¹

The ALC thereafter made findings concerning the burdens, and significantly, relied on evidence adduced by the Department on these issues:

The standard apportionment formulas utilized by the taxpayer in this matter did not fairly represent the extent of its business in this State for a number of reasons. The Department's audit supervisor testified that Department auditors are instructed to closely examine taxpayers whose business structures may be linked with tax minimization strategies.

¹¹This language plainly shows that the ALC placed the burden of activating the two "triggers" authorizing the use of an alternative apportionment formula under § 12-6-2320(A) squarely on the Department.

A significant element of the business structure involved is the payment of a royalty by one division of a retail operation (in this case, East) to a different division (in this case, the taxpayer), and the mixing of that intangible income with the retail income earned by the latter entity for state tax reporting purposes. This payment provides a deduction to East, reducing its overall tax burden in those states in which it operates, including South Carolina. The mixing of the royalty payments with retail income produced a significantly lower apportionment ratio than that of the taxpayer's royalty income considered alone.⁵ The Department described this as a dilution of apportionment ratio, and described the consequent reduction of the taxpayer's tax liability as a distortion of the tax owed.

[5]The taxpayer's retail income was included in the denominator of its apportionment ratio in its amended income tax returns. In a demonstrative exhibit, the Department showed that in tax year 2006, the taxpayer's filings reported a South Carolina ratio of .0972%. The Department compared the type of income actually earned in South Carolina to that type of income earned everywhere to arrive at a South Carolina ratio of .2537% for royalty receipts and 1.0054% for other tangible receipts (i.e. financing receipts).

(ALC Order, pp. 7-8).

In deciding that the use of an alternative apportionment formula was warranted in this case, the ALC concluded its analysis of the first prong of the burden of proof under § 12-6-2320 by quoting the testimony of a Department witness:

The Department's expert witness explained the propriety of the Department's application of § 12-6-2320 using a simile:

...[T]hink of the taxpayer – and so the activity, business activity in South Carolina as an apple. I mean, you see something going on. By an "apple," I mean a certain type of activity. Then you see it being mixed with a larger business that's got apples and oranges...So simply recognizing that the taxpayer was an apple company and that the other companies that have been in the denominator

it was being mixed with was a fruit company, an apples and oranges company, that's -- that leaps out at you [T]he apples here are the franchise payment, the royalties for intellectual property and financing later on, in the last couple of years; whereas, the oranges in this case were the retail sales. There were no oranges in South Carolina One's an apple company; the other's a fruit company. They shouldn't be compared.

(ALC Order, p. 9, fn. 7).

The ALC relied on this same body of Department evidence in reaching its decision that the second prong of the § 12-6-2320 test -- that the alternative apportionment method was reasonable -- had been satisfied:

The Department's proposed method calculates the taxpayer's South Carolina ratio by dividing the income earned within South Carolina by the total derived from that type of income everywhere the taxpayer does business. The Department's method does not include the retail income earned by the taxpayer in other states in its ratio calculation. That income, and the taxpayer's retail operations, are not connected to South Carolina, and § 12-6-2320 is concerned with the taxpayer's business in this State. The taxpayer has described the Department's alternative method as a form of separate accounting. Because the Department's method considers only the business conducted in this State, and because separate accounting is a method expressly permitted by § 12-6-2320(A)(1), the Department's apportionment method applied to this taxpayer is reasonable.

(ALC Order, p. 11) (emphasis in original).

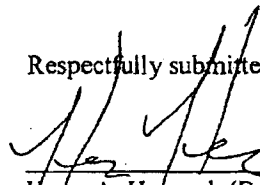
The Department submits that a full reading of the ALC Order shows that the ALC properly stated the Department's burden of proof with regard to its use of an alternative apportionment formula under § 12-26-2320(A). Furthermore, the Record shows that the ALC's determination that the Department met its burdens -- that the taxpayer's standard gross receipts apportionment formula failed to fairly represent the taxpayer's business

activity within this State and that the Department's alternative apportionment formula was reasonable – is supported by substantial evidence. To the extent the ALC committed any error in its characterization of the respective burdens of proof borne by the taxpayer and the Department, the Department submits that such error was harmless as the ALC relied extensively on evidence the Department produced at trial to make the required findings under § 12-6-2320.

CONCLUSION

For the reasons specified herein, the South Carolina Department of Revenue respectfully requests that this Court grant its Petition for Writ of Certiorari to review the Court of Appeals' decision in this matter.

Respectfully submitted,



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June 6, 2012

THE STATE OF SOUTH CAROLINA
In The Supreme Court

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JUN - 6 2012

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

CAROLYN C. MATTHEWS, ADMINISTRATIVE LAW JUDGE

Opinion No. 4953 (S.C. Ct. App. Filed March 14, 2012)

CarMax Auto Superstores West coast, Inc.,.....Respondent,

v.

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

PROOF OF SERVICE

I, Jean M. O'Connor, hereby certify that I have caused to be mailed, postage prepaid, a copy of the Department of Revenue's Petition for Writ of Certiorari and Appendix regarding the above-referenced matter to John c. von Lehe, Jr., Esquire and Bryson M. Geer, Esquire, PO Box 1806, Charleston, SC 29402-1806, this 6^h day of June 2012.


Jean M. O'Connor

THE STATE OF SOUTH CAROLINA
In The Supreme Court

RECEIVED

JUL 06 2012

APPEAL FROM THE ADMINISTRATIVE LAW COURT

S.C. Supreme 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

RETURN TO PETITION FOR WRIT OF CERTIORARI

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

COUNTER QUESTIONS PRESENTED FOR REVIEW

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

COUNTER STATEMENT OF THE CASE

Please see Car Max West's Petition for Writ of Certiorari at pp. 3-8 for a statement of the case and facts in this matter.

SUMMARY OF GROUNDS FOR DENYING CERTIORARI

In its ruling, the Court of Appeals correctly set forth the proper burden of proof and the two underlying statutory elements of proof that SCDOR has failed to overcome in proposing an alternative apportionment method. Under the plain language of the pertinent statute, S. C. Code Ann. § 12-6-2320, the party wishing to deviate from the standard apportionment formula must show two things: (1) that the standard

apportionment formula does not fairly represent the taxpayer's business activity in this State, and (2) that the method chosen by the party wishing to deviate from that standard formula is reasonable and does fairly and reasonably reflect those activities. In referring to a "competing method," the Court of Appeals only directly addressed the legislatively-determined, *standard formula* advocated by CarMax West. To the extent the Court of Appeals' language could be interpreted to require SCDOR to prove that its method was more appropriate than any other method, such would be dicta, not relevant and harmless error, as that issue was not before the Court.

In addition, the Court of Appeals was correct in holding (1) that the burden of proof rests with SCDOR, and (2) what SCDOR must show to meet that burden. All parties now agree that the ALC had improperly placed the burden on the taxpayer. Despite SCDOR's assertions to the contrary, there is no support that the ALC used a different burden of proof to analyze the evidence. Rather, the ALC applied the wrong burden of proof and its application of the burden was not harmless error. Therefore, CarMax West requests that this Court deny SCDOR's Petition for Writ of Certiorari.

ARGUMENT

- I. The Court of Appeals Correctly Found that SCDOR Bore the Burden of Proving that (1) the Standard Apportionment Method Did Not Fairly Reflect the Business Activities of the Taxpayer in South Carolina, and (2) that SCDOR's Method was Reasonable and Did Reflect those Activities.
 - A. The Only Competing Method in this Case is the Standard Statutory Apportionment Method Proposed by CarMax West, and the Court of Appeal's Discussion of a Competing Method is a Reference to this Standard Method.

The Court of Appeals held that SCDOR, as the proponent of an alternative method authorized by § 12-6-2320(A), had the burden of proving that (1) the standard

apportionment formula did not fairly represent the taxpayer's business activity in this state, and (2) the method chosen by the SCDOR was reasonable and more fairly represents the taxpayer's activities in this state. App. at 1172. Which party bore the burden of proof and what that party must prove to deviate from the standard method were the only burden of proof questions before the Court of Appeals.

SCDOR does not dispute these two holdings. Rather, SCDOR finds fault with a statement by the Court of Appeals that based on Media General, the alternative formula chosen by SCDOR must be "not only appropriate, but more appropriate than any other competing methods." App. at 1172. SCDOR is apparently concerned that this could be construed to mean it must exhaustively consider and rule out all other possible competing methods. However, this is an illogical interpretation of the Court of Appeals' statement. A more logical reading is that the Court of Appeals is referring to the competing method or methods at issue in the case. The "competing" method in this case is the standard apportionment method. CarMax West's position is and always has been that the statutory apportionment method fairly represents its business activity in South Carolina. CarMax West has not proposed any other "competing" method, and it is not required to do so. Because the only "competing" method to SCDOR's alternative method was the standard method in this case, the Court of Appeals' language is simply stating that SCDOR had the burden of showing that its alternative method was more appropriate than the statutory method. It correctly recites this burden both before and after the statement about which SCDOR complains. App. at 1172.

To the extent that the Court of Appeals' language could be interpreted as requiring that SCDOR prove that its method was more appropriate than *any* other

method, such a ruling would be dicta, not relevant and harmless error, as that issue was not before the Court.

B. CarMax West Has No Burden to Propose an Alternative Apportionment Method if the Statutory Method Suffices.

Under the plain language of the statute, a taxpayer has the initial and obvious right to rely on the standard apportionment method provided by the Legislature. If SCDOR disagrees with this method, the statute then appropriately requires that SCDOR show that the standard method does not fairly represent the extent of the taxpayer's business activities in this State and that its alternative is reasonable. See S.C. Code Ann. §12-6-2320(A). As the Court of Appeals stated: "It is only logical that a party seeking to override the legislatively determined apportionment method bears the burden of proving that method is not appropriate and an alternative method more accurately reflects the taxpayer's business activity within the state". App. at 1172.

Moreover, there is no requirement that the taxpayer propose a third competing method. Nevertheless, SCDOR's argument concerning a "competing method" implies that CarMax West had a duty to propose a third formula, as though South Carolina law requires the following sequence of events: (1) the taxpayer files using the standard formula; (2) SCDOR objects and proposes an alternative method; (3) the taxpayer must then come forward with a third "competing" method. There is no such requirement under South Carolina statutes or case law.

C. Media General is Factually Inapposite to the Question of Whether the Standard Apportionment Formula Suffices.

SCDOR's reliance on the case of Media General Communications v. S.C. Dept. of Revenue, 388 S.C. 138, 694, S.E.2d 525 (2010) is misplaced. In Media General,

both the taxpayer and SCDOR *agreed* that the standard apportionment formula did not fairly represent the extent of the taxpayer's business activities in South Carolina. The parties further agreed that the method proposed by the taxpayer (the combined method) fairly represented those activities. Because SCDOR did not propose another (or third) method of calculation in that case, the Court adopted the taxpayer's method as that was the only method proposed by either party.

By contrast, in the case at hand, CarMax West never proposed a method other than the standard apportionment method. Had both parties agreed (as they did in Media General) that the statutory method was not appropriate, then CarMax may have had the burden of proposing a competing method. CarMax West continues to submit that the standard statutory method fairly represents its activities in South Carolina.

In sum, the only two methods in the matter before the Court were the CarMax West-proposed standard method and SCDOR's alternative method. Notably, Media General did not address which party had the burden of proof. Thus, Media General has no bearing on the burden of proof issue before the Court in this case, which involves two competing methods.

SCDOR now agrees that it had the burden of proof in this case, and it agrees with the Court of Appeals' recitation of the two elements SCDOR must establish to prevail, i.e. that the standard method does not fairly reflect the taxpayer's in-state activities and SCDOR's method is reasonable. See SCDOR's Petition for Writ of Certiorari at pp. 5-6. SCDOR's assignment of error to the Court of Appeals' reference to a "competing" method is without merit and, in any case, would be a

harmless error as the only "competing" method in this case is the standard apportionment method.

II. The Court of Appeals Correctly Concluded that the ALC's Error Concerning the Burden of Proof was Not Harmless.

A. The ALC Order Demonstrates that the ALC Incorrectly Placed the Burden of Proof on CarMax West and then Applied It.

The ALC's articulation of the two elements that needed to be satisfied (which SCDOR cites in support of its assertion that Court applied the correct burden) does not say *who* has the burden; it simply states what must be shown, i.e., that the standard formula does not fairly represent the taxpayer's activities in this State and that the alternative formula proposed by SCDOR is reasonable. With respect to *who* has the burden, the ALC Order expressly holds that the law requires the burden of proof to be placed on the taxpayer. App. at 1172. SCDOR broadly asserts that despite the clear language of who has the burden of proof, the Court actually ignored its own holding and analyzed the evidence as if the Department had the burden. Nothing in the record indicates the ALC did not apply the burden of proof as it stated the law required it to do. The ALC obviously weighed the evidence assuming that CarMax West bore the burden. Furthermore, the ALC's misapplication of the burden of proof cannot be viewed as harmless. An accurate factual finding such as the finding of whether the standard formula does not accurately reflect the taxpayers business activities in this state and the alternate formula does, cannot be made when the ALC, as the trier of fact, places the burden of proof on the wrong party.

B. A Plain Review of the ALC Record Shows that SCDOR Failed to Satisfy the Burden of Proof that Should Have Been Placed Upon It.

SCDOR did not satisfy the burden of proof that should have been placed on it in support of an alternative apportionment method. There is no evidence in the record upon which the ALC could find in favor of SCDOR such that the Court of Appeals should have entered judgment for CarMax West. See CarMax West Petition for Writ of Certiorari at pp. 9-11.

Specifically, SCDOR incorrectly argues that distortion results from CarMax West's inclusion of all its western vehicle sales in its apportionment formula denominator as directed by the statute. The only purported evidence submitted by SCDOR (and thus in the record for the ALC to consider on remand) in support of this argument was its "distortion" example. App. p. 484, SCDOR Report of Field Audit (Distortion Example) and pp. 931-933, SCDOR Distortion Example for FY 2006. This example showed two things: (1) under the standard apportionment formula, CarMax West had a lower apportionment ratio and thus lower taxable income than CarMax East, and (2) CarMax West paid less tax under the standard formula than under SCDOR's customized, alternative method.

Neither of these examples relates to the extent of CarMax West's activities in South Carolina or the income derived from those activities. One would expect CarMax East to have a significantly higher income and thus higher tax revenue in this State because, as the record shows, it has a much greater level of business activity here than does CarMax West. To the contrary, it is the method used by SCDOR that produces a distorted result by imposing a tax on the minimal activities of CarMax West

that was greater than the tax on CarMax East, the entity with substantial activities in South Carolina. See App. at pp. 1090-1091, Appellant's Brief.

Furthermore, this Court should rule that as a matter of law, SCDOR's method of apportionment was not proper as (1) its own regulation requires a unitary business to be apportioned in its entirety and not subdivided (see S.C. Code Ann. Regs. 117-710.1 (West Supp. 2009); App. p. 1096, Appellant's Brief) and (2) because South Carolina law prohibits separate accounting as to a unitary business. See App. pp. 1093-1097, Appellant's Brief; pp. 1155-1158, Reply Brief.

As there is no evidence in the record upon which the ALC could base a decision in favor of SCDOR on this issue, particularly now that SCDOR has the burden of proof, the Court of Appeals should simply have reversed the decision of the ALC as the record can only support a ruling in favor of CarMax West. In the alternative, the case should be remanded to the ALC to apply the proper burden of proof.

SCDOR asserts that a review of the ALC's Order and Record shows that the ALC error in applying the burden of proof to the wrong party is harmless. This is plainly incorrect, especially because CarMax West only proposed the standard apportionment method that the legislature intended taxpayers to use. SCDOR's unsupported claim that "a full reading of the ALC Order shows that the ALC properly stated the Department's burden of proof with regard to its use of an alternative apportionment formula" fails to recognize the true import of the ALC error. Id. at 13.

CONCLUSION

CarMax West followed the legislatively determined statutory formula. As the party seeking to override the legislatively determined apportionment method, SCDOR bore the burden of proving that the statutory method did not accurately reflect the taxpayer's business activities within this state and that the alternative method that it proposed was reasonable. In evaluating SCDOR's alternative method, the Court of Appeals correctly applied the pertinent statutory analysis, i.e., whether (1) the standard method fairly represented the taxpayer's business activities in the State, and (2) if not, whether the proposed alternative method was reasonable.

SCDOR's interpretation of the Court's dicta related to "a competing method" is misplaced. The Court of Appeals reference to a "competing method" can only be a reference to the method used by CarMax West, the standard method. Thus, SCDOR's arguments related to this language provide no grounds for reversal. Similarly, SCDOR incorrectly attempts to apply the factually inapposite Media General case to excuse its error in rejecting the standard apportionment method. Media General did not even address the question of burden of proof and therefore provides no basis for reversal.

The Court of Appeals also correctly concluded that the ALC's burden of proof holding was not harmless error. An accurate factual finding can not be made when the trier of fact (i.e., the ALC) applied the wrong burden of proof. Moreover, a review of the record shows that even under the proper burden of proof analysis, the evidence does not support SCDOR's competing apportionment method.

Based on the above arguments, this Court should deny SCDOR's Petition for Writ of Certiorari, and rule as a matter of law that the Court of Appeals should have ruled in

CarMax West's favor. In the alternative, the case should be remanded to the ALC to apply the proper burden of proof.

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THE STATE OF SOUTH CAROLINA
In The Supreme Court

RECEIVED

JUL 06 2012

APPEAL FROM THE ADMINISTRATIVE LAW COURT ~~SC~~ Supreme 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

PROOF OF SERVICE

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

Pleadings:

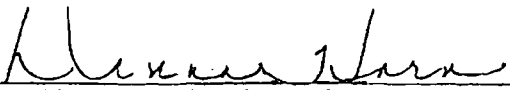
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July 5, 2012

APP_01306

THE STATE OF SOUTH CAROLINA
In The Supreme Court

APPEALED FROM THE SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

Carolyn C. Matthews, Administrative Law Judge

Opinion No. 4953 (S.C. Ct. App. filed March 14, 2012)

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

v.

South Carolina Department of Revenue, ...Respondent.

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INDEX

Statement of the Case	1
Arguments:	
I. THE DEPARTMENT PRESENTED ADEQUATE PROOF THAT THE TAXPAYER'S CHOSEN METHOD OF APPORTIONMENT DID NOT REASONABLY REFLECT ITS BUSINESS ACTIVITIES WITHIN THE STATE OF SOUTH CAROLINA	2
II. THE ALC PROPERLY DISREGARDED THE TAXPAYER'S CORPORATE STRUCTURE IN DETERMINING THAT ITS CHOSEN METHOD OF APPORTIONMENT DID NOT REASONABLY REFLECT ITS BUSINESS ACTIVITY WITHIN SOUTH CAROLINA	4
III. THE ALC PROPERLY SOURCED THE TAXPAYER'S FINANCING RECEIPTS TO SOUTH CAROLINA	8
IV. THE ALC CORRECTLY FOUND THE DEPARTMENT'S ASSESSMENT CONSTITUTIONAL	9
V. THE COURT OF APPEAL DID NOT ERR IN ORDERING THE REMAND OF THIS CASE WITHOUT INSTRUCTIONS TO CONSIDER THE TAXPAYER'S UNITARY BUSINESS MODEL.	12
VI. THE COURT OF APPEALS DID NOT ERR IN ORDERING, IN CONJUNCTION WITH ITS REMAND, A RECONSIDERATION OF ALL ISSUES	13
Conclusion	14

STATEMENT OF THE CASE

CarMax Auto Superstores West Coast, Inc., (Appellant or taxpayer) is a multi-state corporation which owns a 93.5% interest in CarMax Business Services, LLC (CBS) which manages intangibles and enters into car financing (secured transactions) within South Carolina. CBS then securitizes the consumer finance contracts and sells them to third party investors. The other owner of CBS is CarMax Auto Superstores, Inc., (East) which owns 6.5% of CBS. East operates retail auto sales locations within South Carolina. East pays a royalty fee to CBS, which it takes as a deduction against its South Carolina taxable income. CBS is treated as a pass-through entity for tax purposes and pays no taxes in this State. CBS then makes distributions of income to East and the taxpayer based on the percentage of ownership interest. The taxpayer filed amended returns for the tax years 2002-2007 employing its chosen method of apportionment, and its methods yielded the following taxable income:¹

2002:	\$14,717
2003:	\$11,532
2004:	\$7,840
2005:	\$6,883
2006:	\$3,879
2007:	<u>\$3,670</u>
Total:	\$48,523

The Department of Revenue (Department) audited the taxpayer for the corporate income tax years of 2002, 2003, 2004, 2005, 2006, and 2007. The total assessment, including penalties and interest, was \$829,490.00.² This was summarized as follows:

¹See Tr. Ex. 4, CarMax West Amended Tax Returns, 2002-2007.

²See Department's Determination.

Income Tax	\$488,300.00
Interest	\$129,828.00
Penalty	\$211,362.00
Total	\$829,490.00

The Department's auditor employed an alternative apportionment formula under the provisions of S.C. Code Ann. § 12-6-2320(A)(4) (Supp. 2009) as he found that the taxpayer's use of the standard apportionment formula failed to accurately reflect income producing activity within this State. The alternative method of apportionment essentially denied the taxpayer's efforts to inflate its apportionment ratio denominator by including the sales of autos from its retail operations in California, Utah, and Nevada. The auditor also included the income from the sale of securitized consumer lending contracts in the taxpayer's South Carolina income. The taxpayer protested the Department's proposed assessment and the Department issued its Determination upholding the proposed assessment. The taxpayer timely protested the Determination by filing for a contested case hearing before the Administrative Law Court (ALC).

The ALC issued its ruling after a full hearing of all issues. In its Order, the ALC upheld the Department's audit findings. However, the ALC did not award the penalties as assessed.

ARGUMENTS

I. THE DEPARTMENT PRESENTED CLEAR EVIDENCE THAT THE TAXPAYER'S BUSINESS ACTIVITIES IN SOUTH CAROLINA WERE NOT REASONABLY REFLECTED IN ITS CHOSEN METHOD OF ACCOUNTING.

In essence, what the taxpayer believes is a unitary business is not relevant to the questions of whether or not the income of the entity, or groups of entities, is representative of the portion of trade or business carried on within this State. And, by

raising the issue of "distortion," the taxpayer attempts to raise doubt in the findings of the ALC. However, it fails to mention that it offered no cogent evidence to counter any arguments posed by the Department. Hence, adequate evidence is contained within the record to support the findings of the ALC. Moreover, adequate evidence exists to meet the erroneous burden announced by the Court of Appeals.

First, standard apportionment, as provided for in S.C. Code Ann. §§ 12-6-2250 and 12-6-2290 (Supp. 2009), was challenged by the Department as its audit determined that neither method fairly reflected the true nature of the taxpayer's business in South Carolina. As such, the auditor proposed an alternative apportionment method pursuant to § 12-6-2320(A).³ As has been held by the South Carolina Supreme Court in Media General Communications, Inc. and Media General Holdings, Inc. v. South Carolina Department of Revenue, 388 S.C. 138, 694 S.E.2d 525 (1020), the Department has latitude to do so. Further, as the discussion involving the burden of proof shows, the Department was justified in doing so.

Specifically, the taxpayer, as 93.5% owner of CBS, received a distribution which was comprised of a royalty payment to CBS by East. East took a deduction in South Carolina for paying the royalty to CBS. CBS is a pass-through entity, so it paid no taxes. This leaves the taxpayer receiving income generated in this State. Instead of paying tax on this income in a manner which reasonably reflected its true business activity in this State, the taxpayer then inflated the denominator of its standard apportionment ratio by including its auto retail sales income from western states. The effect being that the numerator portion of the apportionment ratio, being comprised of royalty payments

³ALC Order p. 6.

deducted by East in South Carolina, was made a smaller portion than if had just been compared to royalty income earned nationwide by the taxpayer.⁴ To that end, the taxpayer may fairly be said to have manipulated the requirements of its chosen method to lessen its tax burden in this State, and the Department merely corrected it.

The taxpayer then intimates that despite this dilution of the denominator, “the apportionment is now the general rule and any other system, including the segregated method, is the exception.”⁵ As the authority cited for this proposition was issued in 1957, it is most difficult to see why it should withstand the application of § 12-6-2320, enacted in South Carolina in 1995. Indeed, the taxpayer’s position of defending the inclusion of its distinct business activity of retail auto sales in its apportionment denominator must yield to the principle that its business activity in this State must be fairly representative of the extent of its true activity in South Carolina. This is mandated by § 12-6-2320. Again, insurmountable evidence in the record supports the findings of the ALC.

II. THE ALC PROPERLY DISREGARDED THE TAXPAYER’S CORPORATE STRUCTURE IN DETERMINING THAT ITS CHOSEN METHOD OF APPORTIONMENT DID NOT ADEQUATELY REFLECT ITS BUSINESS ACTIVITY WITHIN SOUTH CAROLINA.

The South Carolina Income Tax Act, as it relates to multistate corporations, has as its introduction S.C. Code Ann. § 12-6-2210 (Supp. 2009) (“Taxation of business; determination whether entirely or partly transacted or conducted within State.”) Subsection (B) announces:

(B) If a taxpayer is transacting or conducting business partly within and partly without this State, the South Carolina income tax is imposed upon a base which reasonably represents the proportion of the trade or

⁴ALC Order p. 8; Joint Exhibit 13; Tr. p. 227.

⁵Taxpayer’s Initial Brief p. 23, para. 1.

business carried on within this State. A taxpayer subject to taxation under this section is considered to have been transacting or conducting business partly within and partly without the State if the taxpayer is subject to a net income tax or a franchise tax measured by net income in another state, the District of Columbia, a territory or possession of the United States, or a foreign country, or would be subject to the net income tax in any other taxing jurisdiction if the other taxing jurisdiction adopted the net income tax laws of this State.

(Emphasis added).

Therefore, the seminal principal in determining the legality of any income tax on a multistate taxpayer is "reasonable representation of the trade or business carried on in this State," and cannot be subservient to a unitary business model, as urged by the taxpayer. Although a unitary business model may comply with the legal requirements of reasonably representing the trade or business activity, in the taxpayer's case it does not.

The taxpayer also urged the ALC to accept its reading of Exxon Corporation v. S.C. Tax Commission, 273 S.C. 594, 258 S.E.2d 93 (1979). The ALC recounted in paragraph 1 of its Order, that the taxpayer operates a retail business for the sale of autos in California, Utah, and Nevada. And, the ALC recognized as significant that the taxpayer received a distribution from the payment of royalties from a subsidiary CBS, which included royalties paid by its affiliate East. It is not disputed that the royalty income at issue was generated in South Carolina as East took a deduction from its South Carolina income tax for this expense. The Exxon opinion states:

A Taxpayer operating a unitary or homogenous business within and without the State and an unrelated business either entirely within or without shall be subject to the allocation formulas with respect to the unitary or homogenous business but not with respect to the unrelated business. The income from the unrelated business shall be directly assignable to the state where such business is

conducted.

The factual issue of whether or not the taxpayer's retail sales are homogenous with its collection of royalties and financing income from South Carolina was answered definitively in the negative by the ALC. In Exxon the court's decision was supported by the fact that a vertically integrated activity defined it as "unitary." The significance of this finding is that the exploration and extraction of the natural resources were costs directly related to the retail sale of gasoline in South Carolina. The record firmly supports the ALC's findings that the royalty income and financing income from CBS was not homogenous with the taxpayer's retail income from auto sales. To that end, the Department was not isolating the royalty income; it was preventing the taxpayer from distorting its true income from within South Carolina by diluting it with income from distinct sources outside of South Carolina.⁶ Lastly, Exxon does not prohibit the use of an alternative method of apportionment inasmuch as that opinion predated the enactment of § 12-6-2320, which, if nothing more, shows the taxpayer simply misapprehends the issues raised.

The taxpayer also urges this Court to find all of its activities as a unitary business by relying upon the decision of Eastman Kodak Corporation v. S.C. Dept. of Revenue, 308 S.C. 415, 418 S.E.2d 542 (1992). In that case, the Court found that the taxpayer's use of short term investments, which accounted for up to 10% of its net worth, were unitary with its business purpose in South Carolina. The taxpayer had invested in "safe harbor lease transactions" which were common at the time, and the taxpayer's investment

⁶See ALC Order p. 9, fn 7.

and returns were of such "magnitude and frequency"⁷ that it made a significant contribution to the taxpayer's general business. The Court specifically found:

Based on Exxon and the testimony of record here, the safe harbor lease transactions cannot be segregated from Kodak's general business operations since: (1) the funding for the safe harbor leases came from the general corporate treasury; (2) no separate staff supervised the transactions; and (3) the magnitude of the transactions and resulting tax benefits suggest a significant contribution to Kodak's general business.⁸

(emphasis added).

The ALC had substantial evidence before it that the taxpayer's retail auto sales in western states were discernible from income received from South Carolina sources⁹ and were indeed subject to separate consideration under the provisions of § 12-6-2320.¹⁰ As such, the Department has much more flexibility in determining a more accurate apportionment of a taxpayer's true South Carolina income which is subject to taxation.¹¹ And, § 12-6-2320 allows the Department to disregard a corporate unitary structure in order to focus on the more imminent and constitutional issue of what activity is conducted in South Carolina.

The critical error of the taxpayer in interpreting the Exxon decision is that the Courts recognized the corporate structures employed did comply with a model for reasonably reflecting business activity within this State. By merely citing the authority,

⁷Id. at p. 418.

⁸Id. at p. 420.

⁹ALC Order p. 9, fn 7.

¹⁰Section 12-6-2320 was enacted in 1995, after the Court's Exxon decision.

¹¹Media General at p. 152, "conclusion" section.

the taxpayer attempts to cloak itself in a "unitary business" model, however it fails to carry the rule to its end- to judge the corporate structure against the law requires a reasonable reflection of business activity within South Carolina. The ALC did so, and rightfully disagreed with the taxpayer.

III. THE ALC PROPERLY SOURCED THE TAXPAYERS FINANCING RECEIPTS TO SOUTH CAROLINA.

The facts of this case are that the financing contracts are entered into by CBS. CBS then "bundled" or securitized the financing contracts for sale to third parties. CBS would then realize income from the sale of the securitized contracts. Then, CBS would make distributions to the taxpayer, as 93.5% owner, and to East as 6.5% owner.

The ALC found that the taxpayer's business of financial services was distinguishable from engineering services. The ALC, relying upon Lockwood Greene v. South Carolina Tax Commission, 293 S.C. 447, 361 S.E.2d 346 (Ct. App. 1987), noted that the Court's holding concerned the "base which reasonably represents the portion of the trade or business carried on within this State."¹² To that end, the sourcing rule announced by this Court is aligned with the alternative apportionment method permitted by § 12-6-2320(A)(4).

The record is strongly supportive of the ALC's ruling and substantial evidence was abundant. The taxpayer's income flowed from intangibles, not professional services. The base value of the intangible income was the South Carolina borrower's good faith adherence to the contractual obligations which are enforced by the courts of this State. In Lockwood Greene, the engineering services performed within this State were the commodity which attracted the income. The taxpayer's own witness testified that the

¹²Lockwood Greene, at p. 449.

value, in part, of the securitized instruments to third party investors, was the borrowers' faithful payments on the financing agreements.¹³ Therefore, the ALC was correct in distinguishing the taxpayer's case from that of a professional engineering firm located and licensed within the State of South Carolina.

As the taxpayer seeks to disassociate its case from Geoffrey, Inc. v. S.C. Tax Commission, 313 S.C. 15, 437 S.E.2d 13 (1993), it must make the critical admission that its financing division has nexus to the state. Like the taxpayer in Geoffrey, the taxpayer here collects payments from an intangible asset from a captive subsidiary. If the taxpayer had sold the securitized financing contracts to third party investors directly, it would still find itself with nexus and liability of taxation to this State. By inserting CBS as a pass through entity, the taxpayer must fully expect the value of its contracts is the payment of monies from South Carolina residents, and enforcement is also sourced in this State. Therefore, the ALC committed no error of fact or law in finding the taxpayer's income from the intangible assets was identical to the royalty agreements of Geoffrey.

IV. THE ALC CORRECTLY FOUND THE DEPARTMENT'S ASSESSMENT CONSTITUTIONAL.

The Department urges that the taxpayer's position that a finding of unitary business structure is not determinative to the application of § 12-6-2320, and its claim of violations of the Due Process and Commerce Clauses is rebutted in the ensuing sections of this brief. In sum, the taxpayer offers no cogent evidence or arguments to rebut the findings of the ALC that the Department's alternative method of apportionment more accurately defines and taxes the income related to its business in this State. And, the taxpayer offers no explanation as to why its attempt to dilute the apportionment

¹³ ALC Order p. 13, fn 12; Tr. pp. 103-105.

denominator under the standard apportionment formula is a better representation of its activities in South Carolina. To that end, the taxpayer's arguments must fail.

First, standard apportionment, as provided for in §§ 12-6-2250 and 12-6-2290, was challenged by the Department as its audit determined that neither method fairly reflected the true nature of the taxpayer's business in South Carolina. As such, the auditor proposed an alternative apportionment method pursuant to § 12-6-2320(A).¹⁴ As has been held by the South Carolina Supreme Court in Media General, the Department has latitude to do so. Further, as the discussion involving the burden of proof shows, the Department was justified in doing so.

Specifically, the taxpayer, as 93.5% owner of CBS, received a distribution which was comprised of a royalty payment to CBS by East. East took a deduction in South Carolina for paying the royalty to CBS. CBS is a pass-through entity, so it paid no taxes. This leaves the taxpayer receiving income generated in this State. Instead of paying tax on this income in a manner which reasonably reflected its true business activity in this State, the taxpayer then inflated the denominator of its standard apportionment ratio by including its auto retail sales income from western states. The effect being that the numerator portion of the apportionment ratio, being comprised of royalty payments deducted by East in South Carolina, was made a smaller portion than if it had just been compared to royalty income earned nationwide by the taxpayer.¹⁵

The taxpayer then intimates that despite this dilution of the denominator, "the apportionment is now the general rule and any other system, including the segregated

¹⁴ALC Order p. 6.

¹⁵ALC Order p. 8; Joint Exhibit 13; Tr. p. 227.

method, is the exception.”¹⁶ As the authority cited for this proposition was issued in 1957, it is most difficult to see why it should withstand the application of § 12-6-2320, enacted in South Carolina in 1995. A more relevant, and authoritative comment on the matter can be found in Container Corp. of American v. Franchise Tax Board, 463 U.S. 159 (1983), when the Court noted that “separate accounting” or other alternative methods of apportionment have been allowed when total formula apportionment, would “not fairly represent the extent of the taxpayer’s business activity in the state.”¹⁷ Indeed, the taxpayer’s position of defending the inclusion of its distinct business activity of retail auto sales in its apportionment denominator must yield to the principle that its business activity in this State must be fairly representative of the extent of its true activity in South Carolina. This is mandated by § 12-6-2320.

Commerce Clause challenges to state tax laws are typically analyzed by employing the four prong test in Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977): 1) a substantial nexus exists between the taxing state and taxed activity; 2) the tax is fairly apportioned to income; 3) the tax does not discriminate against interstate commerce; and 4) the tax is fairly related to the benefits the state provides.¹⁸ The taxpayer is ostensibly alleging that the assessment discriminates against interstate commerce.

The taxpayer complains that its tax burden is heavier than East, which does have retail operations in South Carolina. The evidence clearly shows that East only receives a

¹⁶Taxpayer’s Initial Brief p. 23, para. 1.

¹⁷Id. at p. 167, fn 3.

¹⁸Complete Auto, at p. 279.

flow through distribution from CBS of 6.5%, while the taxpayer receives a 93.5% distribution. Moreover, East benefits from a deduction for royalties paid to CBS. If that deduction were not taken, East would pay the entire tax burden at issue.

Since Complete Auto was decided, the Supreme Court has increasingly employed the "internal consistency test" to determine whether a taxing scheme creates unconstitutional discrimination. See, e.g., Armco, Inc. v. Hardesty, 467 U.S. 638 (1984); Tyler Pipe Industries v. Washington Dep't. of Revenue, 483 U.S. 232 (1987). Simply put, this test asks whether the taxing scheme, if applied in every jurisdiction, would subject more than 100% of a taxpayer's income to taxation. The taxpayer offers no evidence on this point. Again, this argument must fail.

V. **THE COURT OF APPEAL DID NOT ERR IN ORDERING THE REMAND OF THIS CASE WITHOUT INSTRUCTIONS TO CONSIDER THE TAXPAYER'S UNITARY BUSINESS MODEL.**

The unitary business principal is not the panacea for measuring a corporation's business activity within South Carolina. As discussed previously, § 12-6-2210(B) of the South Carolina Code has mandated that the principal for determining the state income tax for a multi-state corporation is: "(B) If a taxpayer is transacting or conducting business partly within and partly without this State, the South Carolina income tax is imposed upon a base which reasonably represents the proportion of the trade or business carried on within this State" (emphasis added). And, nowhere does one find an exception for a "unitary business" principle. Again, the taxpayer is asking this Court to overrule § 12-6-2210 of the South Carolina Code.

The taxpayer again recites its previous arguments that its corporate structure is the equivalent to a "unitary business." This is an issue without significance. The General

Assembly has provided the means to resolving the issues raised by the taxpayer with § 12-6-2210(B). The taxpayer has not argued that this statute is flawed, it merely disagrees with its provisions and applications in this case. And, to avoid restating what has been established in prior sections of this document, it is sufficient to state that a corporate structure which operates and reports its South Carolina income tax in compliance with § 12-6-2210 has complied with the law.

VI. THE COURT OF APPEALS DID NOT ERR IN ORDERING, IN CONJUNCTION WITH ITS REMAND, A RECONSIDERATION OF ALL ISSUES.

In its opinion, the Court of Appeals concluded, "We find that ALC erred in determining CarMax West had the burden of proving the Department's alternative accounting methods was not reasonable, and therefore we reverse the ALC and remand for a reconsideration of all issues." And, although the Department disagrees with this conclusion, it would be prejudiced if the opportunity to conduct additional relevant discovery and to challenge positions of the taxpayer were foreclosed.

The effect of a general and unqualified reversal of a judgment would be to "nullify it completely and leave the cause standing as if it had never been rendered."¹⁹ The Court of Appeals' opinion has the effect of reopening the entire matter. Any effort to limit the record would allow the taxpayer to hide behind a factual limitation while new issues are now relevant. That is, to require the Department to prove its alternative method of accounting was more reasonable than the taxpayer's brings new demands of inquiry that were not previously relevant. In short, the new burden of proof cannot be rendered impotent by excluding a full and relevant inquiry of matters related to that issue.

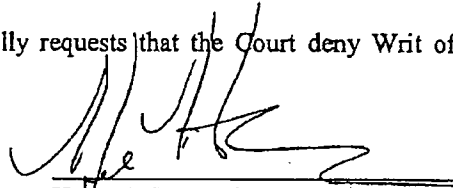
¹⁹Corpus Juris Secundum, § 712, "Court of Appeals"- Title 10 (2012).

And, the Court of Appeals had reason to know this new burden would bring new requirements.

Finally, the taxpayer in filing its appeal requested a remand and a new finding of facts.²⁰ It appears evident that the taxpayer recognized it would need to re-litigate issues which it failed to do in the original litigation. Although the Department disagrees with the Court of Appeals' creation of a new burden of proof, if this Court does require the remand, it is essential to allow full litigation and discovery on all new matters created by the Court of Appeals.

CONCLUSION

The Department of Revenue respectfully requests that the Court deny Writ of Certiorari requested by the taxpayer.



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²⁰Final Brief for Appellant p. 44, "Conclusion" section II.

THE STATE OF SOUTH CAROLINA
In The Supreme Court

APPEAL FROM THE SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

CAROLYN C. MATTHEWS, ADMINISTRATIVE LAW JUDGE

Opinion No. 4953 (S.C. Ct. App. Filed March 14, 2012)

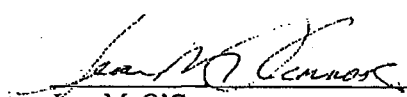
CarMax Auto Superstores West coast, Inc.,.....Respondent,

v.

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

PROOF OF SERVICE

I, Jean M. O'Connor, hereby certify that I have caused to be mailed, postage prepaid, a copy of the Department of Revenue's Return to Petition for Writ of Certiorari regarding the above-referenced matter to John c. von Lehe, Jr., Esquire and Bryson M. Geer, Esquire, PO Box 1806, Charleston, SC 29402-1806, this 5th day of July 2012.


Jean M. O'Connor

THE STATE OF SOUTH CAROLINA
In The Supreme Court

RECEIVED

JUL 17 2012

APPEAL FROM THE ADMINISTRATIVE LAW COURT

S.C. Supreme 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

REPLY TO RETURN TO PETITION FOR WRIT OF CERTIORARI

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APP_01324

Pursuant to Rule 242(g) of the South Carolina Appellate Court Rules, Respondent/Petitioner CarMax Auto Superstores West Coast, Inc. ("CarMax") hereby files this Reply ("CarMax West's Reply") to Petitioner/Respondents' Return to the Petition for a Writ of Certiorari Return to Petition for Writ of Certiorari ("SCDOR's Return") in the above-captioned matter. For the reasons stated herein and in CarMax West's Petition for Writ of Certiorari ("CarMax West's Cert Petition"), this Court should issue a writ of certiorari to review and reverse the opinion of the Court of Appeals.

STATEMENT OF THE CASE

Please see CarMax West's Cert Petition at pp. 3-8 for a statement of the case and facts in this matter.

ARGUMENT

- I. CarMax West Has Not Inflated or Manipulated the Apportionment Formula, and SCDOR Has Again Failed to Point to any Evidence in the Record that Supports its Claim that the Standard Apportionment Formula Does Not Reflect CarMax West's Minimal Business Activities in this State.

In its Cert Petition, CarMax West argued that the Court of Appeals erred in remanding the case to the ALC because there was no evidence in the record that could support a finding in favor of SCDOR (particularly when the proper burden of proof is applied). SCDOR presented no evidence (1) that the standard statutory method used by CarMax West did not reflect the extent of its business activities in South Carolina, and (2) that the Department's alternative accounting method did reasonably reflect these activities. CarMax West Cert Petition at p. 9.

Instead of pointing this Court to the alleged evidence in the record that supports these two required elements of proof, SCDOR's Return resorts to false accusations that

CarMax West's use of the standard apportionment formula, which is *dictated* by statute, is manipulative and distortive. More specifically, SCDOR alleges that CarMax West "inflated the denominator of its standard apportionment ratio" and "manipulated the requirements of its chosen method to lessen its tax burden in this state." SCDOR's Return at pp. 3-4. Neither statement is true. It is uncontested that CarMax West applied the standard apportionment formula. Its "chosen method" is the one set forth in and required by the statute, not something CarMax West had the option of choosing. The auto sales from western states that SCDOR claims CarMax West included to "inflate" the denominator of the standard apportionment ratio are specifically *required* to be included in the denominator by the standard formula. CarMax West followed the requirements of the statutorily dictated method as written and did not "inflate" or "manipulate" the formula in any way. Indeed, query whether *any* taxpayer can manipulate the formula when it follows the exact requirements set forth in the statute. Moreover, SCDOR fails to point this Court to any evidence in the record that supports its contention that the standard apportionment formula does not reflect CarMax West's minimal business activities in this State.

As there is no evidence in the record that could support a decision in favor of SCDOR, this Court should grant CarMax West's Petition for Certiorari to consider whether the Court of Appeals should have simply entered judgment in favor of CarMax West on this issue.

II. The ALC Should Have Considered Whether CarMax West Operated a Unitary Business but Failed to Do So.

In its Cert Petition, CarMax West argued that the ALC erred in failing to consider whether the royalty income at issue was part of CarMax West's unitary income such that it should not be segregated and separately taxed and requested that this Court reverse the ALC and enter a decision in favor of CarMax West. All evidence in the record supported that the royalty income was part of the taxpayer's unitary income. In the alternative, if this Court remands the case to the ALC, then CarMax West requested that that it instruct the ALC to consider whether the royalty income was part of CarMax West's unitary income. If so, then the ALC should further consider whether the standard statutory apportionment method fairly reflected CarMax West's in-state business activities and whether the separate accounting method used by SCDOR did.

In the second argument in its Return, SCDOR argues for the first time in this case that the royalty income is not a part of the unitary income of CarMax West, and it mistakenly implies that the ALC so found. See SCDOR's Return at p. 6 (stating that "[t]he record firmly supports the ALC's findings that the royalty income and financing income [were] not homogenous with the taxpayer's retail income from auto sales"). Contrary to its new position, at trial, SCDOR's own witness, the non-resident corporate tax audit supervisor, testified that he thought that the entire CarMax group of companies was a unitary business (App. p. 298, lines 20-24 and p. 301, line 18 - p. 302, line 1); SCDOR's expert economist refused to answer whether or not the businesses were unitary as he believed this question was irrelevant (App. p. 396, lines 15-22 and p. 416, line 19 - p. 417, line 7); and SCDOR presented no evidence that

CarMax West did not operate a unitary business. Additionally, the ALC did not evaluate whether or not CarMax West was unitary as she believed it was not outcome determinative. App. p. 13, Order (stating that the "question of whether a taxpayer is 'unitary' or 'non-unitary' is not outcome determinative" and making no finding as to whether the income at issue was part of CarMax West's unitary income).

In addition, in the fifth argument in its Return, SCDOR argues that the ALC need not consider the unitary business principle. It also suggests that following South Carolina precedent (like Exxon Corp. v. S.C. Tax Comm'n, 273 S.C. 594, 599, 258 S.E.2d 93, 96 (1979)) would require the ALC or this Court to overrule S.C. Code Ann. §12-6-2210(B), which mandates that a multi-state taxpayer's income tax be "imposed upon a base which reasonably represents the proportion of the trade or business carried on within this State."

To the contrary, determining whether CarMax West's royalty income is part of its unitary income is critical in this case, and making this determination is completely consistent with S.C. Code Ann. §12-6-2210(B), its predecessor S.C. Code Ann. §12-7-250 (1985) (which used the same language), and the apportionment statutes. This Court's decision in Eastman Kodak in 1992, which follows the enactment of both §12-6-2210(B)'s predecessor and 2320, confirms that Exxon remains a valid and critical check on SCDOR's statutory authority. Eastman Kodak Co. v. S.C. Tax Comm'n, 308 S.C. 415, 418 S.E.2d 542 (1992). These cases may prohibit a unitary business from being separately taxed or, at a minimum, would be a determinative factor that must be considered in deciding whether the standard statutory apportionment method or the separate accounting method used by SCDOR fairly reflects CarMax West's in-state

business activities. Exxon Corp. v. S.C. Tax Comm'n, 273 S.C. 594, 599, 258 S.E.2d 93, 96 (1979); CarMax West Cert Petition at pp.11-14. As set forth in detail in CarMax West's Cert Petition, South Carolina precedent strongly supports the conclusion that the royalty income is a part of CarMax West's unitary income in this case, and SCDOR presented no evidence to the contrary. See CarMax West Cert Petition at pp. 11-14.

Thus, this Court should grant CarMax West's Cert Petition to determine if the ALC should have considered whether the royalty income at issue was part of CarMax West's unitary income such that it should not be segregated and separately taxed and should reverse the ALC and enter a decision in favor of CarMax West because all evidence in the record supported that the royalty income was part of the taxpayer's unitary income. Alternatively, if this Court orders a remand, then it should instruct the ALC to consider whether the royalty income is part of CarMax West's unitary income. If so, then the ALC should further consider whether the standard statutory apportionment method fairly reflected CarMax West's in-state business activities and whether the separate accounting method used by SCDOR did.

III. The ALC Should Not Have Sourced CarMax West's Financing Income to South Carolina.

In its Cert Petition, CarMax West asked this Court to review the decision of the Court of Appeals because it failed to address the sourcing issue raised by CarMax West in its appeal at all; it simply remanded the case for re-consideration of all issues in light of the proper burden of proof, which applied only to the apportionment issue and not the sourcing issue. SCDOR does not dispute this in its Return; it simply argues that the ALC's decision was correct. Therefore, this Court should grant the Cert Petition as

there has been a final decision on this claim, and CarMax West is entitled to appellate review thereon.

As to the merits of the sourcing issue, South Carolina applies the "place of activity" test set forth in the Lockwood Greene case, which holds that income should be sourced to the location where the activity producing that income takes place. Lockwood Greene Engineers v. S.C. Tax Commission, 293 S.C. 447, 448, 361 S.E.2d 346, 347 (Ct. App. 1987).¹ It was uncontested at trial that all of the activity producing the financing receipts takes place outside of South Carolina (App. p. 111, lines 12-15), and that such activity adds value. (App. p. 210, line 24 - p. 212, line 2). Under Lockwood Greene, the income cannot be sourced to South Carolina. SCDOR's continued attempts to liken the income resulting from bundling and securitizing activity (not income from mere ownership of a note or receivable) to the passive income from the ownership of intellectual property in Geoffrey v. S.C. Tax Comm'n, 313 S.C. 15, 437 S.E.2d 13 (1993) are without merit and do not provide a basis for distinguishing this case from Lockwood Greene. Finally, SCDOR's argument and the ALC's decision both hinge on dicta in Lockwood Greene that the "place of activity" test might not apply to a finance company. That language obviously does not constitute binding precedent and, in any event, would not apply to CarMax West, which is not a finance company. In sum, the ALC's decision runs contrary to the explicit holding in Lockwood Greene and should be reversed. At a minimum, the sourcing issue presents a novel question of law that this Court should consider.

¹ The holding in Lockwood Greene and the "place of activity" test have now been codified at S.C. Code Ann. § 12-6-2295(5).

IV. The ALC Should Have Found the Tax Unconstitutional Because it is Disproportionate to CarMax West's Activities in this State.

Similar to the sourcing issue, in its Cert Petition, CarMax West asked this Court to review the decision of the Court of Appeals because it failed to address the constitutional issue raised by CarMax West in its appeal at all; it simply remanded the case for re-consideration of all issues in light of the proper burden of proof, which applied only to the apportionment issue and not the constitutional issue. SCDOR does not dispute this in its Return, it simply argues the ALC's decision was correct. Therefore, this Court should grant the Cert Petition as, otherwise, CarMax West would be deprived of appellate review on this issue.

As to the merits of the issue, SCDOR's Return states that CarMax West is "ostensibly alleging that the assessment discriminates against interstate commerce." SCDOR's Return at p. 11. This is not the case. CarMax West has never argued that the tax discriminates against interstate commerce. SCDOR also claims that CarMax West failed to offer evidence of multiple taxation sufficient to satisfy the internal consistency test; however, this is not an internal consistency case, and CarMax West has not argued that the tax produces multiple taxation.

Instead, CarMax West has argued and continues to argue that the tax is unconstitutional because it levies a burden that is out of all proportion to this taxpayer's minimal activities in this State and because it taxes extraterritorial values. SCDOR presented no evidence to support such an exorbitant tax in light of the minimal in-state activities of CarMax West. Thus, CarMax West asks this Court to review the Court of

Appeals' decision to determine whether judgment should have been entered in favor of CarMax West on this issue.

V. The ALC Did Not Order a New Trial, and a New Trial Would Be Duplicative, Inefficient and Unjust.

In CarMax West's Cert Petition, it requested that if this Court determined that a remand was necessary, such a remand should not include a new trial or the taking of additional evidence and testimony but rather should consist only of the ALC applying the correct burden of proof to the record in this case.² The basis for this request included (1) the plain language of the Court of Appeals' decision; (2) SCDOR's position at trial that it bore the burden of proof and thus would have presented all evidence it needed to meet this burden; (3) the prejudice to CarMax West of having the burden and expense of a second trial; (4) judicial time and expense; and (5) South Carolina precedent supporting this result and disfavoring a new trial, *de novo*, in these circumstances. CarMax West Cert Petition at pp. 21-23.

In arguing for a new trial, *de novo*, as well as a new request for discovery, SCDOR fails to address the South Carolina cases cited by CarMax West and instead cites only a general rule from a treatise that is inapplicable to this case. It also claims that it would be prejudiced if it is not allowed to conduct additional discovery and granted a new trial, *de novo*, because new factual issues, apparently based on the burden of proof, are now relevant. See SCDOR's Return at pp. 13-14. None of SCDOR's arguments have merit.

² Because SCDOR advised CarMax West that it interpreted the Court of Appeals' decision to require a new trial, CarMax West asked the Court of Appeals to clarify its ruling (as did SCDOR), but it declined to do so.

Regarding the treatise cited by SCDOR, it states that "[t]he effect of a general and unqualified reversal of a judgment would be to nullify it completely and leave the cause standing as if it had never been rendered." SCDOR Return at p. 13 (citing Corpus Juris Secundum §712, "Court of Appeals"- Title 10 (2012)). But the Court of Appeals did not issue a general and unqualified reversal of judgment. Instead, it stated that "the ALC erred in determining that CarMax West had the burden of proving the Department's alternate accounting method was not reasonable, and therefore, we reverse the ALC and remand for a consideration of all the issues." App. at p. 1172, Order (emphasis added). Thus, the ALC is to consider all issues while applying the proper burden of proof. Id. The Court of Appeals could easily have ordered additional discovery or a new trial. It chose not to do so. SCDOR correctly points out that CarMax West has requested new factual findings, but it draws the wrong conclusion from this request (*i.e.* it believes that CarMax West recognizes that the parties must now "re-litigate" the case). Both sides have presented their evidence, and the record is set. The only question is what factual and legal conclusions should be drawn from that evidence once the proper burden of proof is applied. Making new findings based on the proper standard of proof does not require additional discovery or a new trial. Additionally, South Carolina case law, which SCDOR chose not to address in its Return on this issue, indicates that a "second bite at the apple" is not favored in these circumstances. Lewis v. Lewis, 392 S.C. 381, 709 S.C. 650 (2011) (reversing Court of Appeals decision, which found that the value of the marital home was not supported by the record and which remanded the case with instructions that invited the lower court to accept additional evidence, and noting that "Given Respondent's incomplete

presentation at trial, it would be fundamentally unfair to Petitioner to give Respondent a second bite at the apple").³

As to SCDOR's claim that it would be prejudiced without the opportunity for discovery and a new trial, this is not the case, and it should be estopped from making such an argument in light of its ever-shifting position on the burden of proof issue. As set forth in detail in CarMax West's Cert Petition, SCDOR *agreed* at trial that it should bear the burden of proof. See Cert Petition at pp. 21-23; Appellant's Brief at App. p. 1078 (citing App. 464, lines 3-9). SCDOR's attorney's agreement followed CarMax West's attorney's discussion that this was the law of every court in the country that had considered the issue. App. at p. 435-436. Thus, during the trial, SCDOR not only should have known but did know that it bore the burden of proof, consistent with the case law from all courts that had considered the issue, and could and should have presented any and all evidence it had to meet this burden. If it did not put forth evidence to meet that burden, it was not because it did not have the opportunity. SCDOR's accusation that CarMax West is "trying to hide behind a factual limitation while new issues are now relevant" (see SCDOR Return at p. 13) is quite frankly mystifying. As there are no new issues and SCDOR had every opportunity to present a full and complete case, no prejudice can be shown.

SCDOR only changed its position on which party bore the burden of proof after the trial had concluded. At that point, it inexplicably provided a proposed order to the ALC, which (with no discussion of the cases that had been discussed by CarMax West

³ See also *Sierra Club v. South Carolina Dep't of Environmental Control*, 387 S.C. 424, 693 S.E.2d 13 (2011) (remanding case to ALC with instructions to apply its factual findings to the proper regulations, which the ALC had not addressed in its order).

nor SCDOR's agreement during trial that it bore the burden) stated that CarMax West should bear the burden of proof. The ALC then erroneously adopted this burden of proof in its decision. While SCDOR argued that the ALC was correct in this decision in its Appellate Brief filed with the Court of Appeals,⁴ it later changed its position again and is now apparently back to agreeing that it should bear the burden of proof. See App. p.p. 1183-1186, SCDOR's Petition for Rehearing and SCDOR Petition for Writ of Certiorari at p.p. 5-6. SCDOR should be estopped from arguing prejudice under these circumstances. SCDOR is not faced by a "new burden of proof." It has had that burden since the case was tried, which it recognized at the time of trial and now.

In fact, it is the taxpayer that would be prejudiced if a new trial is required. Such a result would be duplicative, inefficient and unjust as it would give SCDOR two opportunities to prove its case and require the taxpayer and the ALC to invest additional time and expense in re-trying an issue that has already been tried. Thus, if this Court determines that a remand is necessary, it should make clear that such a remand should not include a new trial or the taking of additional evidence and testimony but rather should consist only of the ALC applying the correct burden of proof to the record in this case.

CONCLUSION

For the above-stated reasons and those set forth in CarMax West's Cert Petition, CarMax West respectfully requests that this Court issue a writ of certiorari to review the Court of Appeals' decision in this matter.

⁴ See App. at p. 7, n. 13 (stating that "[i]t is important to note that the ultimate burden of proof in the case, as correctly found by the ALC, is preponderance of the evidence and rests with the taxpayer, the party challenging the assessment").

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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

PROOF OF SERVICE

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

Pleadings:

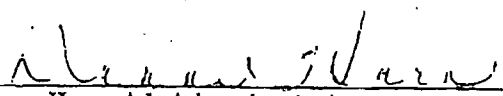
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July 16, 2012

APP_01337

THE STATE OF SOUTH CAROLINA
In The Supreme Court

APPEALED FROM THE SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

Carolyn C. Matthews, Administrative Law Judge

Opinion No. 4953 (S.C. Ct. App. filed March 14, 2012)

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

v.

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

REPLY TO PETITION FOR A WRIT OF CERTIORARI

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In accordance with Rule 242(g), SCACR, the Department of Revenue (Department) files its Reply To Petition For A Writ Of Certiorari.

COUNTER STATEMENT REPLY

- I. The Court of Appeals erred in finding that the Department bares the dual burdens of showing that the standard apportionment did not fairly reflect the business activities of the taxpayer in South Carolina and that the Department's alternative method of accounting was reasonable.
- II. The Court of Appeals made no conclusion, ruling, or factual finding that the Department failed to meet its burdens.

SUMMARY IN REPLY

The taxpayer, in error, alleges that the "plain language" of S.C. Code Ann. § 12-6-2320 (Supp. 2009) requires the party seeking to deviate from the standard apportionment formula, bears the burden of showing that a taxpayer's use of the standard apportionment method does not reasonably reflect its activity in this State, and requires the Department to show the alternative method is the most reasonable.

The plain and ordinary meaning rule, as applied to § 12-6-2320, does not support the position proposed by the taxpayer. Section 12-6-2320, in pertinent part, reads:

(A) If the allocation and apportionment provisions of this chapter do not fairly represent the extent of the taxpayer's business activity in this State, the taxpayer may petition for, or the department may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

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

It is evident that the law is silent as to any of the proposed requirements the taxpayer is claiming are within the "plain language" of the statute.

Further, contrary to the taxpayer's conclusions, the Court of Appeals, did not find, rule, or conclude that the Department failed to meet the burdens it announced in its order. A clear reading of the opinion shows no support for this conclusion. In summary, the taxpayer's contentions are without factual or legal support. Thus, the Department's Petition for Writ of Certiorari is cogent and raises important and significant issues to this Court.

ARGUMENTS

I. THE COURT OF APPEALS ERRED IN FINDING THAT THE DEPARTMENT BARES THE DUAL BURDENS OF SHOWING THAT THE STANDARD APPORTIONMENT DID NOT FAIRLY REFLECT THE BUSINESS ACTIVITIES OF THE TAXPAYER IN SOUTH CAROLINA AND THAT THE DEPARTMENT'S ALTERNATIVE METHOD OF ACCOUNTING WAS REASONABLE.

Again, the Department disputes the legality of the findings of the Court of Appeals. The Department is more concerned with the Court's second requirement that the Department bear the burden of showing its alternative method is more appropriate than any other method.

According to the statute, once there is an adequate showing that standard allocation and apportionment formulas, "the allocation and apportionment provisions of this chapter," do not fairly represent the extent of the taxpayer's business in this State, the Department may require any of the accounting methods enumerated in subparagraphs (1) - (5) of § 12-6-2320(A), if "reasonable." The statute does not require that the proponent of an alternative accounting method - whether the Department or even the taxpayer -

show that the proffered method is more appropriate than any other "competing methods."¹ Instead, in the absence of evidence to the contrary, an alternate accounting method should be upheld if "reasonable." To that end, the Court was without legal authority to impose the requirements upon the Department in this case.

The taxpayer also argues that the Court of Appeals "logically" requires the Department to prove that its alternative method is most appropriate as compared only to the standard apportionment formulas. Again, a clear reading of the statute and the Court of Appeals' ruling does not support this conclusion. Further, the Court of Appeals' opinion is more amorphous than the taxpayer concedes, and its belief of the conclusion is far from certain. To that end, the Department is entitled to have the entire record reviewed by this Court.

Again, the Department's position is that the Court of Appeals' opinion is without any statutory support, and is at odds with the intent of the Legislature. When construing a statute, the cardinal rule is to ascertain the intent of the Legislature. Georgia-Carolina Bail Bonds, Inc. v. County of Aiken, 354 S.C. 18, 22, 579 S.E.2d 334, 336 (Ct. App. 2003). "All rules of statutory construction are subservient to the one that legislative intent must prevail if it can be reasonably discovered in the language used, and that language must be construed in the light of the intended purpose of the statute." *Id.* at 23, 579 S.E.2d at 336. The words of the statute must be given their plain and ordinary

¹In practice, such evidence could be part of any case the proponent of an alternate apportionment method pursues under the terms of § 12-6-2320, but only in response to the introduction of some competing method by the party opposing the alternative apportionment method. In the event an opposing party does not come forward with evidence of a competing method, the proponent's showing that the alternative formula is reasonable necessarily satisfies the statute.

meaning without resorting to subtle or forced construction to limit or expand the statute's operation. Hitachi Data Sys. Corp. v. Leatherman, 309 S.C. 174, 178, 420 S.E.2d 843, 846 (1992).

The Court of Appeals' opinion extrapolates from this Court's ruling in Media General.² In finding support in that opinion for the legislative intent the Court cited: "the Department has not established that another method would be more appropriate." What the use of the language disregards is the fact that the taxpayer petitioned for the use of a separate accounting method. And the Department agreed that separate accounting would more reasonably reflect its activity in this State, but that method was clearly allowed by the legislative intent of § 12-6-2320. Therefore, for the Court of Appeals to find this to mean that the Department would always have this burden, is not properly supported. Again, this is another example of the confusion produced by the ruling of the Court of Appeals, and for the sake of uniformity, this Court must review the matter.

Finally, the taxpayer correctly points out that it did not propose an alternative to the Department's chosen alternative method-separate accounting. Then, using this as a platform to question the Department's reliance on Media General, the taxpayer alleges this case has no import on the current matter. Significantly, this Court sanctioned the use of a separate accounting method. The taxpayer insists that the Department's alternative method somehow runs afoul of its understanding of the unitary business principal by use of such a method. Indeed, Media General does apply to issues resolved by the Court of Appeals.

²Media General Communications, Inc. and Media General Holdings, Inc. v. South Carolina Department of Revenue, 388 S.C. 138, 694 S.E.2d 525 (2010).

II. THE COURT OF APPEALS MADE NO CONCLUSION, RULING, OR FACTUAL FINDING THAT THE DEPARTMENT FAILED TO MEET ITS BURDENS.

The taxpayer, through a series of speculative assertions, asserts that the Court of Appeals has somehow ruled that the Department failed to meet the burdens announced in its opinion. This is incorrect. The Court of Appeals made no such ruling or finding.

Next, the taxpayer argues that the Department offered no cogent evidence of distortion to the ALC. Then, it specifically points to the evidence in the record which shows that the taxpayer's use of the standard apportionment formula yielded less taxes as compared to the Department's alternative method. This evidence, when coupled with the arguments and testimony relating to the taxpayer's business activities in and out of South Carolina was a reasonable basis to conclude that the alternative accounting method employed by the Department more reasonably reflected the actual business conducted within this State.

Again, the taxpayer fails to recognize the legislative mandate of § 12-6-2320. Here, § 12-6-2320(A) is clear that once the first prong is satisfied - that the standard formula fails to fairly represent the extent of the taxpayer's business activity in this State - an alternative apportionment formula may be required by the Department if "reasonable." The second prong of the proponent's burden of proof is therefore met once the proponent shows that its alternative method is "reasonable." The statute does not require the proponent to show that the chosen apportionment method is more appropriate than competing methods.

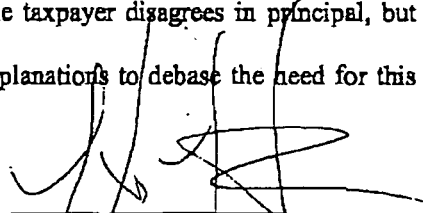
Further, the taxpayer takes issue with the assertion that the record lacks sufficient evidence that the Department has proven that the taxpayer's use of the standard

apportionment method did not reasonably reflect its business activity within this State.

The ALC ruled "[t]he Department's alternative method is reasonable."³ The ALC relied upon the evidence presented by both parties in reaching this finding. The taxpayer may disagree with the ALC's finding, but it cannot re-write or ignore evidence which is found in the record. The record speaks for itself, and it is at odds with the arguments of the taxpayer.

CONCLUSION

The Department has raised significant issues concerning the legality and the application of the ruling by the Court of Appeals. The taxpayer is attempting to explain away the significant issues raised by the Department by drawing conclusions of fact that are not supported by the record and by finding conclusions of law through abstract analysis. In short, the facts raised are disputed and the abstractions differ from the plain language published by the Court of Appeals. The taxpayer disagrees in principal, but does not pose any legal or factual obstacles or explanations to debate the need for this Court's review.



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³Final Order, p. 11, B.

THE STATE OF SOUTH CAROLINA
In The Supreme Court

APPEAL FROM THE SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

CAROLYN C. MATTHEWS, ADMINISTRATIVE LAW JUDGE

Opinion No. 4953 (S.C. Ct. App. Filed March 14, 2012)

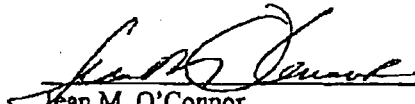
CarMax Auto Superstores West coast, Inc.,.....Respondent/ Petitioner,

v.

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

PROOF OF SERVICE

I, Jean M. O'Connor, hereby certify that I have caused to be mailed, postage prepaid, a copy of the Department of Revenue's Reply to Petition for Writ of Certiorari regarding the above-referenced matter to John c. von Lehe, Jr., Esquire and Bryson M. Geer, Esquire, PO Box 1806, Charleston, SC 29402-1806, this 16th day of July 2012.


Jean M. O'Connor

THE STATE OF SOUTH CAROLINA
In the Supreme Court

APPEAL FROM THE ADMINISTRATIVE LAW COURT
Carolyn C. Matthews, Administrative Law Judge

Opinion No. 4953 (S.C. Ct. App. Filed Mar. 14, 2012)

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

v.

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

AMICUS CURIAE BRIEF OF
SOUTH CAROLINA STATE CHAMBER OF COMMERCE
IN SUPPORT OF CERTIORARI PETITIONS

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INDEX

Questions Presented	1
Introduction	1
Arguments	5
I. The Court of Appeals erred in remanding this case for further proceedings, because the Department failed to carry its burden of proof that application of the applicable statutory apportionment formula (§ 12-6-2290) did not fairly represent Taxpayer's business activity in South Carolina and, therefore, Taxpayer is entitled to judgment in its favor	5
II. The Court of Appeals did not hold that the Department or any proponent of an alternative apportionment method must prove its proposed alternative is more reasonable than any other possible alternative but, assuming the Court did so hold, then the Department correctly argues this was error	8
III. Assuming Taxpayer is not entitled to judgment as a matter of law for the Department's failure to prove that application of § 12-6-2290 does not fairly represent Taxpayer's business activity in South Carolina, any remand should be on the existing record	11
IV. Assuming Taxpayer is not entitled to judgment as a matter of law for the Department's failure to prove that § 12-6-2290 does not fairly represent Taxpayer's business activity in South Carolina, any remand should include an instruction that the ALC consider the undisputed fact that CarMax is a unitary business and apply this Court's opinions on the taxation of a unitary business	13
Conclusion	14

QUESTIONS PRESENTED

1. The Court of Appeals erred in remanding this case for further proceedings, because the Department failed to carry its burden of proof that application of the applicable statutory apportionment formula (§ 12-6-2290) did not fairly represent Taxpayer's business activity in South Carolina and, therefore, Taxpayer is entitled to judgment in its favor.
2. The Court of Appeals did not hold that the Department or any proponent of an alternative apportionment method must prove its proposed alternative is more reasonable than any other possible alternative but, assuming the Court did so hold, then the Department correctly argues this was error.
3. Assuming Taxpayer is not entitled to judgment as a matter of law for the Department's failure to prove that application of § 12-6-2290 does not fairly represent Taxpayer's business activity in South Carolina, any remand should be on the existing record.
4. Assuming Taxpayer is not entitled to judgment as a matter of law for the Department's failure to prove that § 12-6-2290 does not fairly represent Taxpayer's business activity in South Carolina, any remand should include an instruction that the ALC consider the undisputed fact that CarMax is a unitary business and apply this Court's opinions on the taxation of a unitary business.

INTRODUCTION

This is a corporate income tax case. CarMax West (Taxpayer) is a multi-state business that earns its income partly within and partly without South Carolina. The South Carolina Department of Revenue (the Department) audited Taxpayer's tax return, rejected it, and assessed a new tax amount with penalties. Taxpayer challenged the assessment in the Administrative Law Court (ALC), which accepted the Department's new tax amount but rejected the imposition of penalties. Taxpayer appealed – the Department did not cross-appeal. Both parties petitioned for rehearing, and the Court of Appeals denied both petitions. Both parties have petitioned this Court for certiorari. The South Carolina State Chamber of Commerce (Amicus) respectfully files this amicus brief in partial support of both certiorari petitions.

This case involves the application of the South Carolina Income Tax Act (the Act).¹ The Act imposes a 5% tax on the "South Carolina taxable income" of corporations doing business in South Carolina. § 12-6-530 (2000).² If a corporation conducts its "entire business" in South Carolina, then its "entire net income" is taxed by South Carolina. § 12-6-2210(A) (2000 & Supp. 2011) (emphasis added). If a corporation conducts its business "partly within and partly without" South Carolina (a multi-state business), then its South Carolina taxable income is computed under a mathematical formula established by the General Assembly in the Act. This formula has four basic steps.

The first step is to determine the business's "South Carolina net income," which is its "federal taxable income" plus-or-minus adjustments made under Article 9 of Title 12 of the South Carolina Code. § 12-6-610 (2000).³ There are no Article 9 disputes in this case. Notably, a business's "federal taxable income" includes its income from all states.

The second step is to adjust the "South Carolina net income" figure by allocating certain income items to a particular state (South Carolina or some other state). The South Carolina allocations become part of the business's "South Carolina taxable income" and the non-South Carolina allocations are excluded from further consideration. See §§ 12-6-2220 to -2230 (2000 & Supp. 2011).⁴ There are no allocation disputes in this case.

The third step is to apportion all un-allocated "South Carolina net income" under one of several statutes. § 12-6-2240 (2000 & Supp. 2011). Here, the only applicable statute is the "gross receipts" apportionment statute, which establishes an apportionment factor based on the

¹ See generally §§ 12-6-10 to -5595 (2000 & Supp. 2011).

² There are exceptions not applicable here. See, e.g., §§ 12-6-535, -540, and -550 (2000 & Supp. 2011).

³ Article 9 appears at §§ 12-6-1110 to -1220 (2000 & Supp. 2011).

⁴ Allocation results in specified types of income being treated as income taxable in the state specified by statute, either South Carolina or a different state that satisfies the particular statutory requirements (e.g., some "items of income" are allocated to the state of the corporation's principal place of business).

business's "gross receipts *from within this State*" divided by the business's "*total gross receipts from everywhere.*" § 12-6-2290 (2000 & Supp. 2011) (all emphasis added). The business's unallocated "South Carolina net income" is multiplied by this apportionment factor and the resulting figure, plus any South Carolina allocations, is the business's "South Carolina taxable income." Expressed in a formula format, the South Carolina taxable income of a multi-state business is calculated under the "gross receipts" statute as follows;

$$\begin{array}{rcl}
 & \text{"gross receipts from within this State"} & \\
 \div & \underline{\text{"total gross receipts from everywhere"}} & \\
 = & \text{apportionment factor} & \\
 \times & \underline{\text{unallocated South Carolina net income}} & \\
 = & \text{South Carolina apportioned net income} & \\
 + & \underline{\text{South Carolina allocated net income}} & \\
 = & \text{South Carolina taxable income} &
 \end{array}$$

See § 12-6-2290 (2000 & Supp. 2011) (emphasis added). Here, Taxpayer filed an amended return under the "gross receipts" apportionment statute, which is the only applicable apportionment statute.⁵ As required by that statute, Taxpayer included its income from car sales as part of its "total gross receipts from everywhere." § 12-6-2290 (2000 & Supp. 2011). The Department audited Taxpayer and determined Taxpayer had under-reported its South Carolina taxable income. The Department applied a rule that eliminated all gross receipts from car sales, because Taxpayer did not sell cars in South Carolina. (R. 311-312).

The fourth step under the Act is dependent upon the outcome of the foregoing calculations. The General Assembly's intent is to produce a "South Carolina taxable income" figure "which reasonably represents the proportion of the trade or business carried on within [South Carolina]." § 12-6-2210(B) (2000) (emphasis added). If the calculations under the

⁵ If a multi-state business is a particular type of business (e.g., railroad companies), or if it is engaged in particular types of business activity (e.g., manufacturing), its unallocated net income is apportioned according to other, statutorily-specified formulae. See §§ 12-6-2250 to -2280, -2300, and -2310 (2000 and Supp. 2011). Taxpayer does not engage in any of these types of business in South Carolina and, therefore, the only applicable apportionment statute is the "gross receipts" statute.

standard allocation and apportionment statutes “do not *fairly* represent the *extent* of the taxpayer’s business *activity* in [South Carolina],” then a reasonable alternative method may be used. § 12-6-2320(A) (2000) (emphasis added). The purpose of any alternative method is to “*fairly* represent the taxpayer’s business activity in the State” and “to effectuate an *equitable* allocation and apportionment of the taxpayer’s income.” § 12-6-2320(A)(3), (A)(4) (2000) (emphasis added). The focus is on the proportionate amount of business done in South Carolina, not the amount of tax due.

The principal issues on appeal centered on who bore the burden of proof and the standard of proof for challenging the results of the “gross receipts” apportionment statute and any alternative apportionment method. Both parties argued for different “proof systems” that involved shifting burdens of proof and shifting standards of proof. The Court of Appeals set forth the following rules on the burden and standard of proof:

1. The party challenging the results under the apportionment statute (the Department here) bears the burden of proving by the preponderance of the evidence that the taxable income produced by the statutory method does not fairly represent the taxpayer’s business activity in South Carolina.
2. The proponent of any alternative apportionment method (the Department here) bears the burden of proving by the preponderance of the evidence that its proposed alternative is reasonable and more fairly represents the taxpayer’s business activity in South Carolina.

725 S.E.2d at 713-714. The Court of Appeals then remanded the case for application of the proper burden and standard of proof to this case.

The principal question presented here is whether application of the statutory method yields a "South Carolina taxable income" figure that "fairly represent the taxpayer's business activity in the State" and, if not, whether an alternative apportionment method yields a "South Carolina taxable income" figure that "fairly represent the taxpayer's business activity in the State." In the remainder of this brief, these concepts are referenced as whether the statute is "fair" or "unfair" and whether the alternative is "fair" or "unfair."

ARGUMENTS

- I. The Court of Appeals erred in remanding this case for further proceedings, because the Department failed to carry its burden of proof that application of the applicable statutory apportionment formula (§ 12-6-2290) did not fairly represent Taxpayer's business activity in South Carolina and, therefore, Taxpayer is entitled to judgment in its favor.

The question presented here is essentially a "directed verdict" or "summary judgment" question: is there any evidence creating a question of fact on whether § 12-6-2290 is "unfair?" There is not and, therefore, Taxpayer is entitled to judgment in its favor. Thus, the Court of Appeals erred in remanding this case for further proceedings.

The Department bore the burden of proving that § 12-6-2290 (the "gross receipts" statute) is "unfair." The Department presented only two pieces of "evidence." First, the Department determined that the CarMax group had an east-west corporate structure, and the Department believes such corporate structures are used to avoid taxes. (R. 263). Second, the alternative apportionment method advocated by the Department produced a much higher tax. This "evidence" fails to prove anything. The Department may be suspicious of east-west corporate structures, and its suspicions may justify its inquiry, but suspicions do not prove anything. The fact that the Department's alternative method produces a higher tax is not evidence that § 12-6-2290 is "unfair" – it is always possible to produce a higher tax by using a

different calculation method. In short, the Department did not prove that § 12-6-2290 is “unfair,” and the Department’s contrary arguments are based upon a flawed analysis and manifestly without merit.

The Department’s analysis is flawed from the outset – it couches the question as one of whether Taxpayer’s “chosen method of accounting” is “fair”. (Department Cert. Ret. at 2). Taxpayer, however, simply applied § 12-6-2290. The General Assembly, not Taxpayer, chose the accounting method used by Taxpayer. From this false premise, the Department makes several follow-on arguments that have no merit.

First, the Department argues Taxpayer “fails to mention that it [Taxpayer] offered no cogent evidence to counter any *arguments* posed by the [Department].” (Department Ret. at 3) (emphasis added). The Department’s “arguments” are not evidence of anything, because it is axiomatic that arguments by counsel are not evidence of anything. *E.g., McMamus v. Bank of Greenwood*, 171 S.E. 473 (S.C. 1933); *Bowers v. Bowers*, 403 S.E.2d 127 (S.C. App. 1991). Thus, the Department’s arguments do not and cannot satisfy its burden of proof.

Second, the Department argues there is “adequate evidence” and “insurmountable evidence” in the record to satisfy its burden of proof. (Department Ret. at 3, 4). The Department, however, never identifies this evidence. Rather, it makes these sweeping statements and then relies on the ALC’s factual findings. (Id.). Those findings, however, are not evidence – they are the conclusions of the ALC. The question here is what evidence creates a question of fact on whether § 12-6-2290 is “unfair.” There is no such evidence, which is why the Department relies on vague references to the record as a whole rather than any specific evidence.⁶

⁶ In its Reply, the Department again makes this argument: “The taxpayer may disagree with the ALC’s finding, but it cannot re-write or ignore evidence which is found in the record. The record speaks for itself, and it is at odds with the arguments of the taxpayer.” (Department Reply at 6). Again, however, the Department does not cite to any specific evidence creating a question of fact as to whether § 12-6-2290 is “unfair.”

Third, the Department argues that "its audit determined" that § 12-6-2290 did not fairly reflect "the true nature of the taxpayer's business in South Carolina" and, "as the discussion involving the burden of proof shows, the [Department] was justified in doing so." (Department Ret. at 3). The Department's determination, *i.e.*, its conclusion, is not evidence of anything. It was the Department's burden to produce the evidence which led it to this conclusion, and this evidence had to demonstrate there was a question of fact on whether § 12-6-2290 is "unfair." There simply is no such evidence, and the Department does not cite any such evidence. The Department's reference to its discussion of "the burden of proof" issues does not fill this void – that discussion simply relies on the ALC's conclusions and the Department's vague references to the record as a whole in support of those conclusions.

Fourth, the Department argues that the Taxpayer "inflated the denominator of its standard apportionment ratio by including its auto retail sales income from western states" and, as a result, "the taxpayer may fairly be said to have manipulated the requirements of its chosen method to lessen its tax burden in this State, and [the Department] merely corrected it," the "it" being the Department's view that the Taxpayer's "chosen method" rested upon a "dilution of the denominator." (Department Reply at 3-4) (emphasis added). Here again, the Department has misperceived the issue, and it has also mis-stated the facts.

The Taxpayer used the method chosen by the General Assembly, *i.e.*, the method established by § 12-6-2290. The Taxpayer did not "inflate" or "manipulate" the denominator – it simply applied the method established by the General Assembly in § 12-6-2290 according to its plain and express terms. The Department did not "merely correct" anything – it applied a completely different apportionment method without first producing any competent evidence that the General Assembly's chosen method (§ 12-6-2290) was "unfair."

The Department's real complaint here is that the Taxpayer included the income from its retail car sales in the denominator of the calculation under § 12-6-2290. As explained in your Amicus' Brief before the Court of Appeals, doing so was in exact compliance with the express terms of § 12-6-2290. (See Amicus Brief at 4-6, 15-18). If the Department disagrees with the terms and methodology of § 12-6-2290, its remedy is in the General Assembly, not the courts.

Finally, the Department ignores several undisputed facts. Taxpayer has no physical presence in South Carolina. It does not own any personal or real property in South Carolina – it does not have an office in South Carolina – it does not have any employees in South Carolina. In short, Taxpayer has very little activity in South Carolina. It is thus not surprising or unfair that application of § 12-6-2290 does not produce a large income tax debt. Moreover, Taxpayer's lack of presence in South Carolina means it does not burden the government services funded by tax revenues. It is thus not unfair that Taxpayer does not have a large income tax debt in South Carolina, and the Department did not produce any competent evidence that § 12-6-2290 is "unfair." Accordingly, the Court of Appeals erred in remanding this issue, and Taxpayer is entitled to judgment as a matter of law.

II. The Court of Appeals did not hold that the Department or any proponent of an alternative apportionment method must prove its proposed alternative is more reasonable than any other possible alternative but, assuming the Court did so hold, then the Department correctly argues this was error.

As noted earlier, the Court of Appeals set forth the following rules on the burden and standard of proof:

1. The party challenging the results under the apportionment statute (the Department here) bears the burden of proving by the preponderance of the evidence that the taxable income produced by the statutory method does not fairly represent the taxpayer's business activity in South Carolina.

2. The proponent of any alternative apportionment method (the Department here) bears the burden of proving by the preponderance of the evidence that its proposed alternative is reasonable and more fairly represents the taxpayer's business activity in South Carolina.

CarMax, 725 S.E.2d at 713-714. In so ruling, the Court of Appeals discussed this Court's opinion in *Media General Communications, Inc. v. South Carolina Dept. of Revenue*, 694 S.E.2d 525 (S.C. 2010) as follows:

In *Media General* ..., it was undisputed that the gross receipts apportionment statute "did not fairly represent the [multi-state] Taxpayer's income." It was also undisputed that the alternative method proposed by the Taxpayer "did fairly measure the Taxpayer's business activity in South Carolina." Our supreme court upheld the Taxpayer's alternative method, because "the Department has not established that another method would be more appropriate." Thus, based on *Media General*, the Department as the proponent of an alternative apportionment method, must establish that its alternative is not only appropriate, but *more appropriate than any competing methods*.

CarMax, 725 S.E.2d at 714 (emphasis added) (brackets in original) (citations omitted). Seizing upon the above-emphasized language, the Department complains that the Court of Appeals has ruled that the proponent of an alternative method, assuming first that the applicable statute has been overcome (which the Department failed to do here), must also prove its alternative is better than any other possible alternative method, regardless of whether the opponent has proposed a different alternative method. (Department Cert. Pet. at 4-10). The Department has misread the Court of Appeals' opinion.

In *Media General*, the Department did not submit a proposed alternative. Rather, it argued the results of the gross receipts apportionment statute had to be applied, even though the Department admitted those results were not "fair," and even though the Department admitted the taxpayer's alternative method was "fair." Thus, in discussing *Media General* and "competing

methods,” the Court of Appeals obviously meant competing alternative methods. The Court of Appeals did not require the Department to prove its alternative was the best possible of the universe of possible alternatives. If, however, the Court of Appeals did hold this, then your Amicus agrees that the Court of Appeals erred in imposing this burden on the Department, because the following analytical framework is the proper one:

1. The opponent of the statutory apportionment method must first prove that the statutory method is “unfair.” This question has nothing to do with alternative methods, which become relevant if and only if it is first proven that the statutory method is “unfair.”
2. If the statutory method is proven “unfair,” then (and only then) the parties may present alternative methods. Amongst these competing alternatives, each party bears the burden of proving that its alternative(s) is “fair” and is more “fair” than the statutory method and more “fair” than the alternative(s) presented by the other party.

As demonstrated in Argument I, *supra*, the Department failed to present any evidence creating a question of fact on the “fairness” of the statutory method and, therefore, the question of alternative methods is moot in this case. Assuming there is to be a remand on the question of whether the statutory method is “fair,” there will be no question of competing alternatives, because Taxpayer relied on the statutory method and has not presented any alternative methods in the event the statutory method is deemed to be “unfair.” Thus, the Department would need only prove two things on remand: first, that the statutory method is “unfair” and, second, if the statutory method is first proven to be “unfair,” that the Department’s alternative method is “fair.”

Again, because the Department presented no evidence that the statutory method is "unfair," it would not be able to meet its burden in the event of a remand.

- III. Assuming Taxpayer is not entitled to judgment as a matter of law for the Department's failure to prove that application of § 12-6-2290 does not fairly represent Taxpayer's business activity in South Carolina, any remand should be on the existing record.

Taxpayer argues any remand should be on the existing record – the Department argues the remand should include additional discovery and new evidence. Taxpayer is correct under firmly established principles of South Carolina law.

As this Court observed in *Piedmont Natural Gas Co., Inc. v. Hamm*, 389 S.E.2d 655, 656-657 (S.C. 1990), the "controlling law" on this issue is set forth in *Parker v. South Carolina Pub. Serv. Comm'n*, 342 S.E.2d 403 (S.C. 1986), where this Court held that a remand is to be based on the existing record "[u]nless this Court provides for the taking of additional evidence." *Parker*, 342 S.E.2d at 405. Here, the Court of Appeals remanded the case without providing for the taking of additional evidence. *CarMax Auto Superstores v. South Carolina Dept. of Revenue*, 725 S.E.2d 711, 715 (S.C. App. 2012). Thus, under the controlling law in *Parker*, the remand is to be based on the existing record. The Court of Appeals is well aware of this "controlling law," having addressed it in *Sloan v. Greenville County*, 590 S.E.2d 338, 354-355 (S.C. App. 2003).⁷ Had the Court of Appeals intended that additional evidence be taken on remand, it would have specified such as it has done in other cases that it has remanded. *E.g., Sanders v. Sanders*, 722 S.E.2d 15, 20 (S.C. App. 2011) ("we reverse and remand this issue with specific instructions to allow additional evidence"). Accordingly, if there is to be a remand in this case, it should be on the existing record without any additional discovery or evidence.

⁷ In *Sloan*, the Court of Appeals found these rules were inapplicable, because the case did not involve taking new evidence after a remand, but it acknowledged that the taking of evidence after remand was controlled by this Court's decisions in *Piedmont* and *Parker*.

The Department argues that it should be allowed to conduct additional discovery and submit new evidence on remand, because the Court of Appeals inserted a new issue in the case: “[requiring] the Department to prove its alternative method of accounting was more reasonable than the taxpayer’s brings new demands of inquiry that were not previously relevant.” (Department Return at 13) (emphasis added).⁸ The Department offers no explanation of what new facts would need to be discovered or presented – the reason is simple – there are none.

The Court of Appeals held that the Department, as the “party seeking to override the legislatively determined apportionment method bears the burden of proving that method is not appropriate and an alternative method more accurately reflects the taxpayer’s business activity within the state.” *CarMax*, 725 S.E.2d at 715. Contrary to the Department’s argument, there is nothing new here – these issues are established by the alternative apportionment statute itself.⁹

The Department’s real complaint is the Court of Appeals’ ruling that the Department bears the burden of proof on these issues, and “although the Department disagrees with this conclusion” (Department Return at 13), the Department has not challenged it.¹⁰ In addition, the Department can hardly claim surprise that, as the party challenging the statutory method and advocating a statutory alternative, it bore the burden of proof on these issues. *A priori*, after showing the statutory method is “unfair,” the proponent of an alternative necessarily must also show that its alternative is more “fair” than the “unfair” statute. Moreover, as set forth in

⁸ As noted earlier, the apportionment method used by the Taxpayer was not “the Taxpayer’s” method – it was the method established by the General Assembly.

⁹ The South Carolina Income Tax Act specifically provides that an alternative apportionment method is available only upon the convergence of two facts: If the calculations under the standard allocation and apportionment statutes “do not *fairly* represent the *extent* of the taxpayer’s business activity in [South Carolina],” then a reasonable alternative method may be used. § 12-6-2320(A) (2000) (emphasis added). The purpose of any alternative method is to “*fairly* represent the taxpayer’s business activity in the State” and “to effectuate an *equitable* allocation and apportionment of the taxpayer’s income.” § 12-6-2320(A)(3), (A)(4) (2000) (emphasis added). Thus, the Department necessarily always knew the questions at issue.

¹⁰ As noted earlier, the Department has challenged the Court of Appeals’ “competing methods” ruling, but that challenge is based on a misreading of the court’s opinion. And if the Department is correct, then that ruling should be reversed. (See Arg. II, *supra*). Thus, there is no new issue in this case warranting any discovery or new evidence.

Argument I, *supra*, Taxpayer should be granted judgment as a matter of law, which moots all remand issues. Finally, and most importantly, the Department's real goal here is to bootstrap a "second bite at the apple" of proving the gross receipts apportionment statute is not "fair," something it utterly failed to do at trial. But as this Court has steadfastly held, a remand cannot be used to get "two bites at the apple" of proving one's case. *Parker*, 342 S.E.2d at 405, *quoted and applied in Piedmont Natural Gas*, 389 S.E.2d at 657.

The Department also argues that Taxpayer requested "a remand and a new finding of facts" in section II of the "Conclusion" in its Brief of Appellant, apparently contending that this request was tantamount to a request for the right to submit new evidence upon remand. (Department Return at 14). This is simply wrong. Taxpayer never mentioned the taking of new evidence upon remand in its brief. (App. Br. 44).

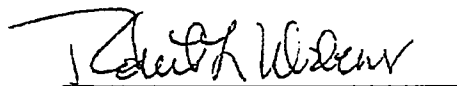
IV. Assuming Taxpayer is not entitled to judgment as a matter of law for the Department's failure to prove that § 12-6-2290 does not fairly represent Taxpayer's business activity in South Carolina, any remand should include an instruction that the ALC consider the undisputed fact that CarMax is a unitary business and apply this Court's opinions on the taxation of a unitary business.

It is undisputed that Taxpayer is a "unitary business." The Department did not present any contrary evidence, and the Department does not now dispute this. Taxpayer argues that this Court's cases hold that a separate accounting cannot be used in taxing a unitary business. If this is true, then Taxpayer should prevail – it is uncontested that Taxpayer is a unitary business – it also uncontested that the Department's alternative apportionment method is based on a separate accounting. If there is no absolute rule against using a separate accounting in taxing a unitary business, then the ALC should be instructed on remand (if there is to be one) that it must consider the fact that Taxpayer is a unitary business and apply this Court's analyses and rules on the propriety of applying a separate accounting to a unitary business.

CONCLUSION

The Department did not prove that the statutory apportionment method is "unfair" and, therefore, Taxpayer is entitled to judgment as a matter of law. The Court of Appeals did not hold that the proponent of an alternative apportionment method must prove its alternative is fairer than the universe of possible alternatives, but if it did, it was in error – the proponent of an alternative method need only prove that its alternative method is fairer than any alternatives advocated by the other party, assuming first that it has been proven that the statutory method is "unfair." Assuming Taxpayer is not entitled to judgment as a matter of law based on the Department's failure to prove the statutory apportionment method is "unfair," any remand should be based on the existing record. The Department is not entitled to a "second bite at the apple" of proving its case. Assuming Taxpayer is not entitled to judgment as a matter of law based on the Department's failure to prove the statutory apportionment method is "unfair," Taxpayer is nevertheless entitled to judgment if South Carolina law forbids the application of a "separate accounting" method to a unitary business.

Respectfully Submitted,



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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

Opinion No. 4953 (S.C. Ct. App. Filed Mar. 14, 2012)

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

v.

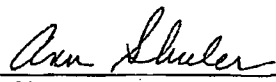
South Carolina Department of Revenue, ... Petitioner/Respondent.

CERTIFICATE OF SERVICE

I, Ann Shuler, an employee of the McNair Law Firm, certify that I have served the "Motion for Leave to File Amicus Curiae Brief of South Carolina State Chamber of Commerce in Support of Certiorari Petitions" and the "Amicus Curiae Brief of South Carolina State Chamber of Commerce in Support of Certiorari Petitions" by depositing copies in the United States Mail, postage prepaid, on November 16, 2012; addressed to the attorneys for the Petitioner/Respondent and Respondent/Petitioner, as follows:

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THE STATE OF SOUTH CAROLINA
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APPEAL FROM THE ADMINISTRATIVE LAW COURT
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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

	Page
TABLE OF AUTHORITIES	ii
I. THERE IS NO BURDEN OF PROOF ISSUE	4
II. THE COURT SHOULD ENTER JUDGMENT IN FAVOR OF CARMAX WEST VERSUS REMANDING THE CASE TO THE ALC WHERE THERE IS NO EVIDENCE THAT COULD SUPPORT THE DEPARTMENT 'S POSITION.	6
III. THE COURT SHOULD ENTER A FACTUAL FINDING THAT CARMAX WEST IS A UNITARY BUSINESS VERSUS REMANDING THE CASE TO THE ALC TO MAKE THAT DETERMINATION WHERE THE EVIDENCE AT TRIAL WAS UNCONTESTED ON THAT ISSUE	17

TABLE OF AUTHORITIES

Cases

<i>Amoco Prod. Co. v. Arnold</i> , 518 P.2d 453 (Kan. 1974)	11
<i>CBS, Inc. v. Comptroller</i> , 575 A.2d 324 (Md. 1990).....	14, 16
<i>Citizens Utils. Co. of Ill. v. Department of Revenue</i> , 488 N.E.2d 984 (1986)	24
<i>Colgate-Palmolive Co., Inc. v. Bower</i> , Ill. Cir. Ct. No. 01 L 50195, 2002 WL 31628400 (2002).....	11
<i>Donald M. Drake v. Dep't of Revenue</i> , 500 P.2d 1041 (Or. 1972).....	10
<i>Exxon Corp. v. S.C. Tax Comm'n</i> , 273 S.C. 594, 258 S.E.2d 93 (1979)	18
<i>HMN Fin., Inc. v. Comm'r of Rev.</i> , 782 N.W.2d 558 (Minn. 2010).....	12
<i>Lewis v. Lewis</i> , 392 S.C. 381, 709 S.C. 650 (2011).....	26
<i>Media General Communications v. S.C. Dept. of Revenue</i> , 388 S.C. 138, 694 S.E.2d 525 (2010)	5
<i>Metromedia, Inc. v. Dir., Div. of Taxation</i> , 478 A.2d 742 (N.J. 1984)	15
<i>NCR Corp. v. Comptroller of the Treasury</i> , 544 A.2d 764 (Md. 1988)	11
<i>Pacific Coca-Cola Bottling Co. v. Dep't of Revenue</i> , 773 P.2d 1290 (Or. 1989)	11
<i>Parker v. S.C. Public Serv. Comm'n</i> , 288 S.C. 304, 342 S.E.2d 403 (1986).....	25
<i>Piedmont Natural Gas Co., Inc. v. Hamm</i> , 301 S.C. 50, 389 S.E.2d 655 (1990)	25
<i>Roger Dean Enterprises Inc. v. State</i> , 387 So.2d 358 (Fla. 1980).....	11
<i>Sierra Club v. South Carolina Dep't of Environmental Control</i> , 387 S.C. 424, 693 S.E.2d 13 (2011)	7, 26
<i>Stan Musial & Biggies, Inc. v. State</i> , 363 So.2d 375 (Fla. Dist. Ct. App. 1978)	11

Statutes

S.C. Code Ann. § 1-23-10.....	14
S.C. Code Ann. § 1-23-610(B)	7
S.C. Code Ann. § 12-4-320.....	14
S.C. Code Ann. §12-6-2320(A).....	4, 6

Other Authorities

Hellerstein & Hellerstein, <u>State Taxation</u> , ¶ 8.03	19
Hellerstein & Hellerstein, <u>State Taxation</u> , ¶ 8.15[1].....	20
Hellerstein & Hellerstein, <u>State Taxation</u> , at ¶ 8.15[4].....	22
Hellerstein & Hellerstein, <u>State Taxation</u> , at ¶ 9.20(3)(a)	23
Keesling and Warren, <u>California's Uniform Division of Income for Tax Purposes Act</u> , 15 UCLA L. Rev. 156, 171 (1967).....	10
W. Pierce, <u>The Uniform Division of Income for State Tax Purposes</u> , 35 Taxes 747, 781 (1957)	8

Regulations

Multistate Tax Commission Regulations, MTC Reg. IV.18.(a)	8
Uniform Division of Income for Tax Purposes Act.....	Passim

INTEREST OF THE AMICUS

The Council on State Taxation ("COST") is a nonprofit trade association based in Washington, D.C. COST was formed in 1969 as an advisory committee to the Council on State Chambers of Commerce. Today COST has grown to an independent membership of nearly 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 do business in South Carolina and own and lease property in South Carolina.

South Carolina apportions the income of multistate corporate taxpayers by using a set of rules based upon the Uniform Division of Income for Tax Purposes Act ("UDITPA"). UDITPA has been adopted by a majority of other states as well, and the states that have adopted UDITPA often look to court decisions in their sister states when called upon 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 members. COST is concerned that the holding of the Administrative Law Court ("ALC") in this case will not only negatively impact how South Carolina administers income tax on COST members but also will negatively impact how other states administer their tax laws and that, if allowed to

stand, the decision in this case will inevitably lead to the very lack of uniformity and uncertainty that UDITPA was designed to prevent.

COST submits this *amicus curiae* brief to stress the overall importance of this case and to aid this Court in understanding how the decision of the ALC—allowing the South Carolina Department of Revenue (the "Department") to deviate from statutory rules in a very common situation—undermines the certainty that accompanies uniform multistate apportionment and equates to unstable and indiscriminate taxation by the State of South Carolina. The South Carolina legislature long ago adopted UDITPA in its statutes. It was designed to use a uniform measure to determine how much income from a taxpayer doing business in multiple states is apportioned and subject to tax in South Carolina. Those statutes apply in virtually every circumstance and with every taxpayer so that the multistate income can be uniformly and consistently divided, consistent with the other states that have adopted UDITPA. In a few circumstances, promulgated regulations can vary the statutory rules in those instances where a group of taxpayers or an entire industry has unique facts. It is only in the rarest and most unusual circumstances that the Department can justifiably vary from the standard apportionment methodology provided for in South Carolina's statutes and rules. The ALC decision below threatens to disrupt this long-standing South Carolina structure. In essence, the decision below arms the Department with the

power to deviate from the strict statutory scheme not just in rare and unusual circumstances, but even in situations where the facts are commonplace.

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.

ARGUMENT

Review of the ALC's decision by this Court is warranted in this case because of the potentially 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 single interstate taxpayer. The latitude the ALC granted the Department to deviate from the standard statutory apportionment formulae will have a significant impact on taxpayers across South Carolina. Of equal, if not greater, importance is the fact that that action of the Department threatens the consistency and uniformity that the South Carolina legislature has sought to achieve in the area of state taxation of interstate commerce.

Additionally, when appropriate, an appellate court should enter judgment or enter a factual finding where there is no evidence in the record upon which a lower court could rule in favor of one of the parties. In the alternative, if an

appellate court does remand such a case, then it should provide appropriate guidance or instructions to the ALC to avoid multiple appeals and trips back to the ALC. COST and its members have an interest in avoiding such inefficiencies, burdensome expenses and delayed resolutions to cases.

I. THERE IS NO BURDEN OF PROOF ISSUE

There is no longer a burden of proof issue in this case. The Court of Appeals properly held that the Department, as the proponent of an alternative method authorized by § 12-6-2320(A)), had the burden of proving that (1) the standard apportionment formula did not fairly represent the taxpayer's business activity in this state, and (2) the method chosen by the Department was reasonable. Although the Department at one time took a different position in the case, both parties now agree that this is the proper standard.

In its Petition for Writ of Certiorari, the Department attempts to create a burden of proof issue where none exists by arguing that the Court of Appeals erred in stating that the alternative formula chosen by the Department must be "not only appropriate, but more appropriate than any other competing methods." First, the Department argues that this language misstates the law in South Carolina. Additionally, the Department appears to argue that CarMax West had a duty to come forward with another competing method. Neither argument has credence or justifies this Court issuing a writ of certiorari.

The Court of Appeals appears to have quoted the language that the Department questions from *Media General Communications v. S.C. Dept. of Revenue*, 388 S.C. 138, 694 S.E.2d 525 (2010), a case in which both parties agreed that the standard method was not fair and agreed that the combined reporting method proposed by the taxpayer did fairly represent those activities. In that case, because the Department did not propose another method, the Court adopted the taxpayer's method. The Court did not address the burden of proof at all. Thus, Media General has no bearing on this case, which involves a taxpayer that is relying on the standard apportionment method and who is not proposing any other competing method. The only competing method in this case is the statutory method and that method is, therefore, the method that the Department must show fails to represent the taxpayer's activities in this state. To the extent that the Court of Appeals' language could be interpreted as requiring that the Department prove that its method was not only more appropriate than the statutory method but also more appropriate than any other conceivable method, it is harmless and irrelevant to the burden of proof question at hand where the taxpayer has relied on the statutory method and has not proposed an alternative method.

In addition, to the extent the Department is asserting that CarMax West had a duty to come forward with another competing method, the law provides no

support for this argument. Section 12-6-2320 allows a taxpayer to rely on the standard apportionment method. If the Department disagrees, then it must show that the standard method does not fairly represent the extent of that taxpayer's business activities in this State and that its alternative is reasonable. See S.C. Code Ann. §12-6-2320(A) There is simply no requirement that the taxpayer propose another competing method, and CarMax West had a clear right and, in fact, duty under the statute, to use the standard method, which it has done and seeks to defend.

**II. THE COURT SHOULD ENTER JUDGMENT IN FAVOR OF
CARMAX WEST VERSUS REMANDING THE CASE TO THE ALC
WHERE THERE IS NO EVIDENCE THAT COULD SUPPORT THE
DEPARTMENT 'S POSITION.**

COST and the taxpayers it represents have an interest in streamlining the litigation process, reducing inefficiencies and litigation costs, and avoiding duplicative or unnecessary litigation and appeals that delay final resolution. Where a lower court makes an error of law in its decision, an appellate court should usually remand the case to the lower court to allow it to apply the correct law to the facts of the case. However, an exception to this general rule should be made where, as in this case, there is no evidence in the record upon which the lower court could find in favor of one of the parties. In such a case, the appellate court should simply enter judgment and not remand the case to the lower court thus promoting efficiencies, reducing costs for all parties, including taxpayers,

and avoiding further delay to the final resolution. See S.C. Code Ann. § 1-23-610(B) (which provides that an appellate court may reverse a decision of the ALC if it is "clearly erroneous in view of the reliable, probative, and substantial evidence on the whole record."); *Sierra Club v. South Carolina Dep't of Environmental Control*, 387 S.C. 424, 431, 693 S.E.2d 13, 16 (2011).

As set forth in CarMax West's Petition in this matter, the Department presented no evidence of distortion in this case. The only "evidence" cited by the Department in support of distortion were two facts- that CarMax West had less taxable income than its related company, CarMax East, and that CarMax West's tax bill was lower under the standard formula than it would be under the Department's method. Neither of these assertions has any relevance to the questions at issue, i.e. does the standard method fairly represent the extent of CarMax West's activities in South Carolina and is the Department's alternate method a fair reflection of those activities.

A. Sound Tax Policy Supports Alternative Apportionment being Used in Limited Circumstances.

Sound tax policy supports the requirement that alternative apportionment be used in limited circumstances. The ALC Order correctly notes that the statutory authority of the Department to require an alternative method is triggered *only* if the standard formulas contained in Title 12, Chapter 6 fail to fairly represent the extent of the taxpayer's business activity in South Carolina.

However, the ALC Order then fails to apply the correct "fair representation" standard. South Carolina alternative apportionment law is modeled after the alternative formula contained in UDITPA. 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 take a similar position.

MTC Reg. IV.18.(a) provides:

[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 Department's ad hoc deviation from the statutory apportionment formula in this case is truly unprecedented. To Amicus's knowledge, this case represents the only time that a state tax administrator has ever used the alternative apportionment clause of a UDITPA-based formula to randomly sever a viable arm of a business in order to increase a state's tax liability. Such a radical departure from the way in which other states have routinely interpreted an identical provision should not be allowed to stand without this Court's scrutiny.

South Carolina adopted a modified version of the UDITPA and accompanying regulations in order to join other states in applying a standard statutory apportionment formula. The goal of UDITPA, and the South Carolina statutes modeled on it, is to provide consistent and uniform rules across the nation to ensure that each state taxes only an appropriate portion of a corporation's income in order to avoid duplicative taxation. Uniform rules are intended to address virtually every situation, and deviation from the rules should be used in the rarest of circumstances. As the primary technical drafter of UDITPA noted:

There are completely compelling reasons for giving the [alternative apportionment] provisions a narrow construction. Under a broad construction the purposes of obtaining uniformity through the adoption of the Uniform Act would be defeated. If a choice of methods is permitted, different administrators in different states inevitably will choose different methods. As a result, even if all the states imposing taxes on or measured by income

should adopt the Uniform Act, the chaotic condition heretofore existing would continue to exist.

Keesling and Warren, California's Uniform Division of Income for Tax Purposes Act, 15 UCLA L. Rev. 156, 171 (1967) (emphasis added). The ad hoc approach, if allowed to stand, will open the door to the "chaotic condition" that UDITPA seeks to ameliorate.

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 and in cases where the application of the specifically prescribed methods might be held unconstitutional." *Id.* While the distortion requirement has often been interpreted to be satisfied at a level of less than what is unconstitutional, the intent of the UDITPA drafters is clear—the provision should be used sparingly.

Other states that have invoked the alternative apportionment methodology have done so under much different circumstances than those at issue here. The use of alternative apportionment by either taxpayers or administrators in other states has typically been limited to very narrow circumstances. Some early equitable apportionment cases arose out of attempts by taxpayers or tax administrators to utilize alternative apportionment based solely on large disparities between tax liability under separate accounting and apportionment. *See, e.g., Donald M. Drake v. Dep't of Revenue*, 500 P.2d 1041 (Or. 1972)

(rejecting administrator's attempt to impose separate accounting on in-state portion of unitary business based on profits); *Amoco Prod. Co. v. Arnold*, 518 P.2d 453 (Kan. 1974). Alternative apportionment has also been invoked to exclude amounts from an out-of-state capital gain, an issue which would have been more appropriately addressed based on unitary business principles. *See, e.g., Stan Musial & Biggies, Inc. v. State*, 363 So.2d 375 (Fla. Dist. Ct. App. 1978); *Roger Dean Enterprises Inc. v. State*, 387 So.2d 358 (Fla. 1980) (holding that alternative apportionment is inapplicable to exclude gain).

Courts have hesitated to allow either taxpayers or administrators to invoke alternative apportionment whenever economists might disagree on the appropriateness of the standard apportionment formula. *See, e.g., Colgate-Palmolive Co., Inc. v. Bower*, Ill. Cir. Ct. No. 01 L 50195, 2002 WL 31628400 (2002) (denying Section 18 claim that a fourth factor representing contribution of international trademarks should be added to formula); *Pacific Coca-Cola Bottling Co. v. Dep't of Revenue*, 773 P.2d 1290 (Or. 1989) (denying factor adjustment for value of trade names, finding that value already reflected in costs of tangibles); *NCR Corp. v. Comptroller of the Treasury*, 544 A.2d 764 (Md. 1988) (denying factor relief claim for foreign-source income absent gross disparity in tax liability). The courts recognize that without any limitations based on exceptionality, relief petitions and litigation would certainly increase in frequency.

The case here is very similar to many of the other cases where the expanded use of alternative apportionment was justifiably curtailed. Simply stated, no circumstances warrant the use of alternative apportionment in this case. Neither side contends that application of the standard apportionment formula produced an unconstitutional result. Neither was there any substantive showing that the standard UDITPA formula failed to fairly represent the extent of CarMax's activities in South Carolina because of some unusual circumstances. No unusual circumstances existed. To the contrary, the standard applicable formula operated in this case precisely as it was intended to by the drafters of UDITPA and—more to the point—by the South Carolina Legislature.

The Department essentially determined that the taxpayer had different types of receipts and income—retail and intangibles—and that some of that income and receipts should not be reported on a South Carolina return. Every multistate taxpayer has different types of receipts and income and consequently could be subject to a similar ad hoc determination. As the Minnesota Supreme Court recently noted in a decision that prevented the Minnesota Tax Commissioner from deviating from its statutory tax rules: “[t]he Commissioner clearly dislikes the tax consequences that occur under the relevant statutes, but it is for the legislature, not the Commissioner, to change the law that creates such consequences.” *HMN Fin., Inc. v. Comm’r of Rev.*, 782 N.W.2d 558 (Minn. 2010).

B. Deviation From the Standard Formula Without Any Prior Guidance by the Department Violates the APA, Is Fundamentally Unfair and Runs Counter to Sound Tax Policy.

South Carolina's standard statutory and regulatory apportionment rules—like those in other states—are designed to uniformly address virtually every factual situation. However, as discussed above, the rules do allow for limited deviations from the standard formulae on a specific taxpayer basis, but only where there are unusual and nonrecurring fact patterns. The Department refused to follow the standard statutory apportionment formulae in this case, not because the facts were unusual and nonrecurring, but because the Department was dissatisfied with the amount of tax produced by the standard formulae. The Department cannot disregard its statutory obligation to provide advance guidance through rule making in order to increase tax revenue.

There is certainly nothing unusual about the structure of West. The Findings of Facts specifically note that West's structure "shares features with the structures of other multi-state taxpayers who divide their retail operations into 'East' and 'West' operations and similarly benefit from this structure in the form of tax savings" Findings of Fact No. 6. It is unpleasant for taxpayers who must rely on written guidance and interpretations to witness the Department acknowledge that a particular structure is commonplace while at the same time invoke a special rule aimed at unusual, taxpayer-specific circumstances.

The typical state administrative procedure act contains two separate sets of procedures—one for rulemaking and one for adjudication. While agencies delegated authority to issue rules and to decide individual cases normally have broad discretion as to the means by which they may make particular law, they are bound by their state act to follow scrupulously the procedures appurtenant to whatever means of lawmaking they actually choose in a particular instance.

The Department promulgates rules through regulations issued in accordance with the South Carolina's administrative procedures act. Code §1-23-10 *et seq.* and Code §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 Code §§1-23-10(4) and 12-4-320. The legislature obviously recognized that the Department would need to exercise a great deal of 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. 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.

In *CBS, Inc. v. Comptroller*, 575 A.2d 324 (Md. 1990), the Maryland Supreme Court, addressing a situation not that different from the one here, held that the tax administrator may enact certain tax policies only prospectively, and

then only by formal rulemaking. CBS dealt with the manner in which a taxpayer apportioned advertising receipts of national broadcasting companies. For a number of years, CBS computed its Maryland income tax pursuant to the three-factor formula. The taxpayer and the tax administrator stipulated that the taxpayer's method of apportionment "was reviewed during the audits of prior years . . . and no adjustment . . . was ever proposed." *Id.* at 325. Despite this 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. *Id.* The question presented was whether the tax administrator's new policy required formal rulemaking. The Court found that "the effect of the tax administrator's audit was to announce a substantially new generally applicable policy with respect to apportionment of the network advertising income of national broadcasting corporations." *Id.* at 330.

The Court 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*, 478 A.2d 742 (N.J. 1984), the Maryland Supreme 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*, 575 A.2d 328. The Court held that the tax administrator's new policy could not be effected through ad hoc adjudication, but only prospectively pursuant to the formal rulemaking procedures of the Maryland Administrative Procedure Act. As a result, the Appellant's position could not be applied retroactively.

The Maryland Supreme Court's reasoning in *CBS* seamlessly flows into the analysis to 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. 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 are aware of and have the ability to fully understand the Department's intent to sever parts of a company at the time a taxpayer files its return.

The importance of clear regulatory guidance that is available to all taxpayers prior to the time they file a return cannot be overstated. The ability to make reasonably accurate forecasts of state tax liability is an essential element of informing one's investors. Such 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 upon expected tax liabilities becomes impossible.

In sum, the Department presented no evidence to the ALC that would support a deviation from the standard formula and, therefore, the Court should simply enter judgment in favor of the taxpayer. A remand on this issue would only burden the taxpayer and the State of South Carolina with unnecessary expenses and delay a final resolution in this matter.

III. THE COURT SHOULD ENTER A FACTUAL FINDING THAT CARMAX WEST IS A UNITARY BUSINESS VERSUS REMANDING THE CASE TO THE ALC TO MAKE THAT DETERMINATION WHERE THE EVIDENCE AT TRIAL WAS UNCONTESTED ON THAT ISSUE.

Similar to I above, where the evidence regarding an issue is uncontested but the lower court simply failed to make a finding (in this case, because the Court did not think it relevant), the appellate court should simply enter a factual finding versus remanding the case to the ALC so that taxpayers do not bear unnecessary costs and have final resolution further delayed. Both the ALC and the Court of Appeals failed to rule that CarMax West operates a unitary business despite the evidence being uncontested on this issue at trial. *See App. pp. 1083-1086, Appellant's Brief, and p. 1158, Appellant's Reply Brief.* The Department introduced no evidence to show that CarMax West was not operating a unitary business, and, in fact, its auditor agreed that all CarMax entities were a unitary

business. *Id.* There is simply no reason to remand this case to the ALC on this issue when there is no evidence upon which a lower court could find that CarMax West did not operate a unitary business.

II. IF THE COURT DETERMINES THAT REMAND IS PROPER, THEN IT SHOULD PROVIDE INSTRUCTIONS OR GUIDANCE TO THE ALC AS DOING SO WILL AVOID MULTIPLE APPEALS.

In the alternative to I, II and III above, if this Court believes that a remand is necessary in this case, then the Court should instruct the ALC to consider whether CarMax West is a unitary business and, if so, consider whether the Department's effort at a form of separate accounting is appropriate for such a business. The ALC Order correctly notes that in order to deviate from the South Carolina income tax standards, the standard formula must fail to fairly represent the extent of the taxpayer's business activity in South Carolina and the requested alternative method must be reasonable. The Department's requested alternative method seeks to divide a unitary business and therefore may be viewed as a form of separate accounting. Thus, the ALC should be instructed to consider whether separate accounting is reasonable where the taxpayer operates a unitary business.

While separate accounting is a method expressly permitted by Section 12-6-2320(A)(1), it should not be used to separate the elements of a unitary business, and South Carolina law is clear on this point. *See Exxon Corp. v. S.C. Tax Comm'n*, 273 S.C. 594, 258 S.E.2d 93 (1979). Additionally, this Code Section

also expressly allows a taxpayer to petition for use of an alternative method, which the DOR is required to grant under the same standards as involved in this case. Accordingly, the policy question that will be before the ALC is whether it makes for good tax and public policy to allow taxpayers -- as well as the Department -- involved in a unitary business to petition for separate accounting.

Hellerstein & Hellerstein, *State Taxation*, at ¶ 8.03, pg. 8-38, describes separate accounting as follows:

Separate accounting is a technique of carving out of the taxpayer's overall business the activities taking place, the property employed, and the income derived from sources within a single state and by accounting analysis ascertaining the profits attributable to that portion of the business; Accordingly, separate accounting is based on the theory that the business of a multistate taxpayer can be divided into separate compartments so that its activities within the taxing state can be segregated from its activities elsewhere and accounted for separately.

After noting that "Over the years, separate accounting has been the focus for increased criticism," (pg. 8-40), the Treatise severely criticizes the separate accounting method for the following reasons:

Separate accounting, as a method of dividing the income of a unitary business among the states, suffers from three inherent defects. First, it is fearfully expensive, since adequate underlying data cannot be furnished without maintaining the books of account in a manner that will show the details of the taxpayer's business, operations, and transactions on a state-by-state basis. Moreover, it has been suggested that "a system of separate accounts for

branches or subsidiaries is, in the majority of cases, impracticable."

Second, the Achilles heel of separate accounting lies in the construction of the imputed prices at which goods are deemed purchased and sold between various branches or subsidiaries of the enterprise.

* * * *

The third inherent defect in separate accounting, as applied to a unitary business, goes to the merits of the method. As in *Alice in Wonderland*, it operates in a universe of unreality. For the essence of the separate accounting technique of dividing the income of a unitary business is to ignore the interdependence and integration of the business operations conducted in the various states, and to treat them, instead, as if they were separate, independent, and nonintegrated. (pgs. 8-41 and 8-43)

Taxpayers have frequently asserted separate accounting as a basis to invalidate standard income tax based assessments. Such challenges have been uniformly unsuccessful. Hellerstein states (§ 8.15[1] pgs. 8-240, -241, -243, -244, -245, -247) the following:

Taxpayers typically rely on separate accounting computations as the basis for their contention that the state's formula misapportions income to the taxing state, citing *Hans Rees' Sons, Inc. v. North Carolina*. [283 U.S. 123 (1931)]

* * *

As the ensuing discussion reveals, however, subsequent [United States Supreme Court] decisions have eroded—if not, altogether repudiated—the central proposition for which *Hans Rees* stands.

* * *

In subsequent decisions, the [Supreme] Court has reiterated the view that separate accounting evidence does not—as a matter of federal constitutional law—"impeach the validity or propriety" of the apportionment of the income of a unitary business.

* * *

Three years later in *Container* [Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159 (1983)], involving a constitutional challenge to California's worldwide combined reporting regime, the Court reiterated the view that the results of separate accounting evidence did not undermine the validity of the formulary apportionment of the income from a unitary business:

* * *

Despite the Court's apparent rejection of separate accounting evidence as theoretically irrelevant to the propriety of formulary apportionment of the income of a unitary business, the Court nevertheless felt compelled to respond to the taxpayer's claim that the separate accounting evidence demonstrated distortion, by revealing a disparity between the income attributed to the state by formula and the income attributed to the state by separate accounting. In rejecting the taxpayer's contention, the Court observed:

But we have seen no evidence demonstrating that the margin of error (systematic or not) inherent in the three-factor formula is greater than the margin of error (systematic or not) inherent in the sort of separate accounting urged upon us by appellant. Indeed, it would be difficult to come to such a conclusion on the basis of the figures in this case: for all of appellant's statistics showing allegedly enormous distortions caused by the three-factor formula reveal that the percentage increase in taxable income attributable to California between the methodology employed by appellant and the methodology employed by appellee comes to

approximately 14%, a far cry from the more than 250% difference which led us to strike down the state tax in *Hans Rees' Sons, Inc.*, and a figure certainly within the substantial margin of error inherent in any method of attributing income among the components of a unitary business.

* * * *

After considering the Court's decision in *Exxon* [Corp. v. Wisconsin Dept. of Revenue, 447 U.S. 207 (1980)], *Container*, and *Trinova*, [Corp. v. Michigan Dept. of Treasury, 498 U.S. 358 (1991)], *only the most sanguine taxpayer would harbor the hope that the Supreme Court may still be moved by separate accounting evidence to invalidate the application of a three-factor formula to the income (or other tax base) of a unitary business.* (Emphasis added.)

Hellerstein discusses several recent cases in which the taxpayer asserted that a separate accounting analysis moved distortion. In ¶ 8.15[4] (Supplement pgs. 8-71-72, Hellerstein states:

In *Pennzoil Co. v. Department of Revenue*, the Oregon courts considered the question of whether the inclusion in Pennzoil's apportionable tax base of the proceeds from one of the largest tort settlements in Corporate history—the \$3 billion payment that Pennzoil received from Texaco for settlement of a lawsuit for wrongful interference with Pennzoil's contract to acquire Getty Oil Company—gave rise to unconstitutional distortion. Pennzoil asserted that the inclusion of the settlement proceeds in the apportionable tax base, which, according to Pennzoil, increased its Oregon income by 1,877 percent, resulted in unconstitutional distortion. The Oregon Tax Court rejected this argument on several grounds.

* * *

Second, the Tax Court dismissed—again, quite

properly—the suggestion that Pennzoil's separate accounting evidence, which showed a loss in Oregon, demonstrated that the attribution of an extraordinary amount of income to the state was unconstitutionally distortive. In the absence of a demonstration that the source of the gain was not part of the taxpayer's unitary business—something that Pennzoil, in the Tax Court's view, was unable to establish, the law is well settled that separate accounting cannot impeach the validity of a reasonable apportionment.

In affirming the Tax Court's decision, the Oregon Supreme Court observed:

Our answer to Pennzoil's argument mirrors the Tax Court's. First, we disapprove of the separate accounting method that Pennzoil advocates. Indeed, the difficulty in applying a separate accounting method to a multistate business is the very reason for apportionment and the unitary business principle.

Lastly, Hellerstein (§ 9.20(3)(a), pg. 9-245-246) states:

[a] Separate Accounting as Basis for Equitable Apportionment

An Oregon construction company that worked on projects in California, Oregon, and Washington, sought to be taxed on a unitary basis, since the Oregon projects were profitable and the California projects showed losses. The Department of Revenue resisted and applied separate accounting to the company's income, relying on the UDITPA equitable apportionment provision.

The court, however, found no basis for the resort to special accounting, and took the position that the equitable apportionment provision should be narrowly construed, quoting from Keesling and Warren:

"There are completely compelling reasons for giving the relief provisions a narrow construction. Under a broad construction the purposes of obtaining uniformity through the adoption of the Uniform Act would be defeated. If a choice of methods is permitted, different administrators in different states inevitably will choose different methods. As a result, even if all the states imposing taxes on or measured by income should adopt the Uniform Act, the chaotic condition heretofore existing would continue to exist." We agree with the conclusion of the Tax Court that the use of any method other than apportionment should be exceptional and the party the taxpayer or the Department of Revenue—who seeks to invoke the applicability of ORS 314.670 has the burden of proof.

* * *

In most states, the taxpayer cannot establish a right under the equitable apportionment provision to substitute separate accounting for the formula merely by showing that separate accounting produces a lower tax. (Emphasis added.)

See also, Citizens Utils. Co. of Ill. v. Department of Revenue, 488 N.E.2d 984 (1986) (the court rejected the taxpayer's claim of unconstitutional distortion of income based on the allegation that the use of formula apportionment increased its tax liability 213% over the amount determined by separate accounting).

Instructions by this Court to the ALC regarding the need to consider unitary business law and related tax policy issues will ensure that the ALC

considers the relevant facts and law on remand, will promote judicial economy and will avoid unnecessary expenses and multiple proceedings and appeals.

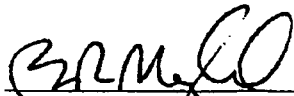
III. WHERE A CASE IS REMANDED DUE TO A LEGAL ERROR BY THE ALC, THE COURT SHOULD INSTRUCT THE ALC TO MAKE NEW FINDINGS BASED ON THE EVIDENCE IN THE RECORD AND SHOULD NOT ALLOW A FULL RE-TRIAL.

As previously stated, COST and the taxpayers it represents have an interest in reducing burdensome litigation expenses where possible and obviously the State of South Carolina shares that interest as it affects both parties equally. To that end, this Court should make it clear in its instructions to the ALC that the Court of Appeals' order for the ALC to reconsider all issues should be based on the facts in the record and is not an order for a new trial. Under South Carolina law, when a case is remanded back to the trial court, a party may not submit additional evidence unless the appellate court grants the party leave to do so. *Parker v. S.C. Public Serv. Comm'n*, 288 S.C. 304, 342 S.E.2d 403 (1986) (finding Supreme Court's remand to Public Service Commission "for such further *consideration* as may be proper in light of the views expressed herein" was an instruction for the Commission "merely to review the evidence which was admitted in the record" and did not allow the Commission to consider additional evidence, as no party should get two bites at the apple); *Piedmont Natural Gas Co., Inc. v. Hamm*, 301 S.C. 50, 389 S.E.2d 655 (1990) (holding that remand to Public Service Commission "to substantiate the record" was an order to review

the evidence already presented not to take additional evidence). As CarMax West has pointed out in its Petition, the Department agreed at trial that it should bear the burden of proof. *See* Appellant's Brief at App. p. 1078 (citing App. 464, lines 3-9). It should have presented any evidence it needed to meet this burden at trial. It would be unfair to now require the parties to bear the burden and expense of another trial. *Lewis v. Lewis*, 392 S.C. 381, 709 S.C. 650 (2011) (reversing Court of Appeals decision, which found that the value of the marital home was not supported by the record and which remanded the case with instructions that invited the lower court to accept additional evidence, and noting that "Given Respondent's incomplete presentation at trial, it would be fundamentally unfair to Petitioner to give Respondent a second bite at the apple"); *Sierra Club v. South Carolina Dep't of Environmental Control*, 387 S.C. 424, 693 S.E.2d 13 (2011) (remanding case to ALC with instructions to apply its factual findings to the proper regulations, which the ALC had not addressed in its order). Therefore, if this case is remanded, then the Court should instruct the ALC that its reconsideration of the issues while applying the correct burden of proof should be done based on the record and no new evidence or testimony shall be allowed.

CONCLUSION

COST respectfully urges this Court to grant CarMax's Petition for Writ of Certiorari and deny the Department's Petition for Writ of Certiorari. Review is appropriate for all the reasons detailed in CarMax's Petition, and, for the reasons explained in this brief, review is especially appropriate because the decision, if allowed to stand, will jeopardize and undermine the uniformity, fairness, and consistency of state taxation that South Carolina law was designed to offer to multi-state taxpayers and will result in significant and unnecessary expenses and delay for the taxpayer and the State of South Carolina.



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January 29, 2013

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

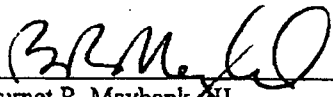
CarMax Auto Superstores West Coast, Inc.....Respondent/Petitioner

v.

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

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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APP_01395

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In The Supreme Court

APPEAL FROM THE ADMINISTRATIVE LAW COURT

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v.

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

PROOF OF SERVICE

I certify that I served the **Amicus Curiae Brief of Council on State Taxation ("COST") in Support of Petition for Writ** on the Petitioner and Respondent by depositing copies of it in the United States Mail, postage prepaid, on Jan 29, 2013 addressed to their attorneys of record as follows:

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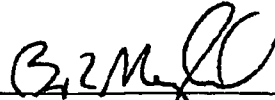
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January 29, 2013

The Supreme Court of South Carolina

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

v.

South Carolina Department of Revenue,
Petitioner/Respondent.

Appellate Case No. 2012-212203

ORDER

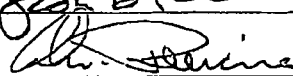
Petitioner/Respondent (Department of Revenue) and Respondent/Petitioner (CarMax) each seek a petition for a writ of certiorari to review the Court of Appeals' decision in *CarMax Auto Superstores West Coast, Inc. v. S.C. Dep't of Rev.*, 397 S.C. 604, 725 S.E.2d 711 (Ct. App. 2012). We grant the Department of Revenue's petition as to its Questions I and II, and deny the petition as to the Department's remaining questions. We also grant CarMax's petition as to its Questions II, III, and IV, and deny the petition as to the remaining questions.

Additionally, we order the parties to brief the following question:

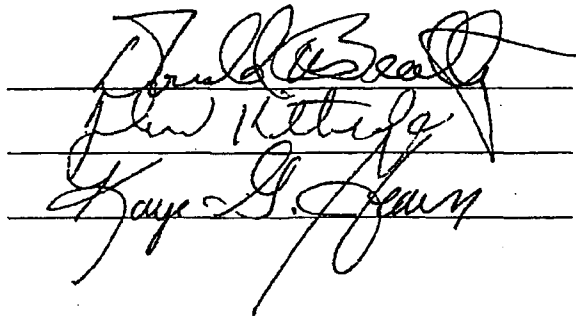
Is the Court of Appeals' decision in the instant case appealable in light of this Court's decisions in *Charlotte-Mecklenberg Hosp. Auth. v. S.C. Dep't of Health & Envtl Ctrl.*, 387 S.C. 365, 692 S.E.2d 894 (2012), and *Bone v. U.S. Food Serv.*, 404 S.C. 67, 744 S.E.2d 552 (2013)?

The parties shall proceed to serve and file the appendix and briefs as provided by Rule 242(i), SCACR.





C.J.
J.


J.
J.
J.

Columbia, South Carolina

August 29, 2013

cc:

The Honorable Jenny Abbot Kitchings

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