THE STATE OF SOUTH CAROLINA
In The Supreme Court

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S.C. Supreme Court

APPEAL FROM THE ADMINISTRATIVE LAW COURT

Ralph K. Anderson III, Administrative Law Judge

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

Duke Energy Corporation..... Petitioner,

v.

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

BRIEF OF PETITIONER

Burnet R. Maybank III
NEXSEN PRUET, LLC
1230 Main Street, Suite 700
P.O. Drawer 2426 (29202)
Columbia, SC 29201
(803) 771-8900

Eric S. Tresh, *Pro Hac Vice*
Maria M. Todorova, *Pro Hac Vice*
SUTHERLAND ASBILL & BRENNAN LLP
999 Peachtree Street, NE, Suite 2300
Atlanta, GA 30309
(404) 853-8000

Jeffrey A. Friedman, *Pro Hac Vice*
SUTHERLAND ASBILL & BRENNAN LLP
700 Sixth Street, NW, Suite 700
Washington, DC 20001
(202) 383-0718

Attorneys for Petitioner Duke Energy Corporation

Other Counsel of Record:

Tracey C. Green
John M.S. Hoefer
John W. Roberts
WILLOUGHBY & HOEFER, P.A.
Post Office Box 8416
Columbia, South Carolina 29202-8416
(803) 252-3300

Jonathon A. Gutting
Milton G. Kimpson
Harry A. Hancock

Attorneys for Respondent

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES iii

QUESTION PRESENTED 1

INTRODUCTION 1

STATEMENT OF THE CASE 5

I. Initial Procedural History 5

II. Decision of the Administrative Law Court 6

III. Opinion of the Court of Appeals 7

IV. Petition to this Court 9

STATEMENT OF FACTS 9

SUMMARY OF ARGUMENTS 11

ARGUMENTS 13

I. The Court of Appeals erred in holding that Duke Energy's receipts from sales of securities other than net receipts are not "receipts" and therefore excluded from its sales factor denominator. 13

1. The Court of Appeals erred in failing to apply the plain language of the standard statutory apportionment formula. 13

2. The Court of Appeals erred in concluding that receipts from Duke Energy's sales of securities were not "receipts" because they were not "money the business receives for its products or services." 17

3. The Court of Appeals erred by concluding that Duke Energy's receipts from sales of securities are not "receipts" but rather "the return of the principal" and "its own money." 19

4. To properly reflect Duke Energy's business activities in South Carolina, all of the receipts from Duke Energy's sales of securities must be included in the sales factor. 21

II. The Court of Appeals erred in affirming the Department's attempt to apply an end-run around alternative apportionment and this Court's recent precedent. 23

III. The Court of Appeals erred by considering arguments neither raised nor preserved by the Department. 26

IV. The Court of Appeals erred in usurping the power of the South Carolina Legislature by rendering the Legislature's 2007 legislative changes regarding the definitions of "sales" and gross receipts" meaningless....27

V. A predominant number of other states' courts have ruled that all receipts from sales of securities must be included in the sales apportionment factor....28

CONCLUSION....31

TABLE OF AUTHORITIES

CASES Page(s)

Alltel Commc'ns, Inc. v. S.C. Dep't of Revenue, 399 S.C. 313, 731 S.E.2d 869 (2012) 3, 14, 16

AT&T v. Dep't of Revenue, 15 Or. Tax 202, 2000 WL 1279835 (Or. T.C. 2000) 30

AT & T. v. State Tax Appeal Bd., 241 Mont. 440, 787 P.2d 754 (1990) 30

Beach v. Livingston, 248 S.C. 135, 149 S.E.2d 328 (1996) 14

CarMax Auto Superstores West Coast, Inc. v. S.C. Dep't of Revenue, 411 S.C. 79, 767 S.E.2d 195 (2014), *aff'g*, 397 S.C. 604, 725 S.E.2d 711 (2012) 3, 4, 12, 22-26

Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159 (1983) 21, 22

Covington Fabrics Corp. v. S.C. Tax Comm'n, 264 S.C. 59, 212 S.E.2d 574 (1975) 17, 18, 20-22, 24

Demas v. Convention Motor Inns, 268 S.C. 186, 232 S.E.2d 724 (1977) 15

Duke Energy Corp. v. S.C. Dep't of Revenue, 410 S.C. 415, 764 S.E.2d 712 (2014) 2, 8, 10, 18

Duke Power Co. v. S.C. Tax Comm'n, 292 S.C. 64, 354 S.E.2d 902 (1987) 15, 16, 17

Eastman Kodak Co. v. S.C. Tax Comm'n, 308 S.C. 415, 418 S.E.2d 542 (1992) 17, 18, 20-22, 24

General Mills v. Franchise Tax Bd., 172 Cal. App. 4th 1535, 92 Cal. Rptr. 3d 208 (Ct. App. 2009) 28, 29

General Motors Corp. v. Franchise Tax Bd., 39 Cal. 4th 773, 139 P.3d 1183 (2006) 19, 20

Illinois Tool Works, Inc. v. Lindley, 70 Ohio St. 2d 175, 436 N.E.2d 220 (1982) 30

Key Corporate Capital, Inc. v. Cnty. of Beaufort, 373 S.C. 55, 644 S.E.2d 675 (2007) 15

Lowenstein Corp. v. S.C. Tax Comm'n, 298 S.C. 93, 378 S.E.2d 272 (1989) 21

Mead Corp. v. Department of Revenue, OO CH 01854 (Ill. Cir. Ct. Feb. 5, 2002) 29

Media General Communications, Inc. v. S.C. Dep't of Rev., 388 S.C. 138, 694 S.E.2d 525 (2010) 16

Microsoft Corp. v. Franchise Tax Bd., 39 Cal. 4th 750, 139 P.3d 1169 (2006).....28

Pennzoil Co. v. Dep't of Revenue, 15 Or. Tax 101, 2000 WL 1025573 (Or. T.C. 2000).....30

Sherwin-Williams Co. v. Dep't of Revenue, 329 Or. 599, 996 P.2d 500 (2000).....29

S.C. Nat'l Bank v. S.C. Tax Comm'n, 297 S.C. 279, 376 S.E.2d 512 (1989).....16

St. Johnson Trucking Co. v. State, 118 N.H. 209, 385 A.2d 215 (1978).....24

United States Steel Corp. v. Wisconsin Dep't of Revenue, Dkt. I-6578 (Wis. Tax App. Comm'n May 9, 1985).....30

Western Elec. Co. v. Norberg, AA No. 81-391 (R.I. Dist. Ct. 6th Div., Mar. 30, 1983), *cert. denied*, 461 A.2d 679 (R.I. 1983).....29

CONSTITUTION AND STATUTES

S.C. Const. art I, § 8.....27

2007 S.C. Laws Act 110 § 51.A (enacted as S.C. Code Ann. § 12-6-2295(B).....14

S.C. Code Ann. § 12-6-2210.....24

S.C. Code Ann. § 12-6-2220.....1, 21

S.C. Code Ann. § 12-6-2230.....1

S.C. Code Ann. § 12-6-2240.....1, 21

S.C. Code Ann. § 12-6-2250.....11

S.C. Code Ann. § 12-6-2280 (for tax years after 1995).....11, 13, 18

S.C. Code Ann. § 12-6-2280(C).....13

S.C. Code Ann. § 12-6-2295.....14

S.C. Code Ann. § 12-6-2295 (B).....14

S.C. Code Ann. § 12-6-2295(B)(1).....15

S.C. Code Ann. § 12-6-2320.....22, 23

S.C. Code Ann. § 12-7-1170 (for tax years prior to 1996).....13

S.C. Code Ann. § 12-36-90.....17

S.C. Code Ann. § 12-37-930 17

Uniform Division of Income for Tax Purposes Act (UDITPA) 16

Or. Rev. Stat. § 314.665(6)(a) 29

R.I. Gen. Laws § 44-11-14 (a)(2)(v) (1995 & Supp. 1997) 30

RULINGS AND REGULATIONS

PD 87-77 (Va. Tax Comm'r Feb. 27, 1987) 30

PD 89-235 (Va. Tax Comm'r Sept. 6, 1989) 30

OTHER AUTHORITIES

Another California City Scrambling to Avoid Bankruptcy (September 27, 2012), available at http://www.foxnews.com/politics/2012/09/27/another-california-city-scrambling-to-avoid-bankruptcy/ 19

BLACK'S LAW DICTIONARY (10th ed. 2014) 14

City Council in Harrisburg Files Petition of Bankruptcy (October 12, 2011), available at http://www.nytimes.com/2011/10/13/us/harrisburg-pennsylvania-files-for-bankruptcy.html?_r=0 20

Detroit is broke; could bankruptcy lie ahead? (May 13, 2013), available at http://news.yahoo.com/detroit-broke-could-bankruptcy-lie-ahead-185859786.html 19

MERIAM-WEBSTER, http://www.merriam-webster.com/dictionary/total 14

QUESTION PRESENTED

1. Did the Court of Appeals err in narrowing the definition of "receipts" for South Carolina corporate income tax purposes and in holding that securities sold in Duke Energy's ordinary course of its business are not "receipts" for South Carolina corporate income tax purposes even though South Carolina statutes require that taxpayers include their "total gross receipts" or "total sales" in apportioning their income to South Carolina?

INTRODUCTION

This case is about whether Duke Energy Corporation ("Duke Energy") must include all of its receipts from sales of securities in the denominator of its sales apportionment factor when apportioning its South Carolina income.

During the tax years 1978 through 2001 ("Tax Years at Issue"),[1] multistate taxpayers engaged in manufacturing[2] were required to apportion their income using a statutory formula based on their sales, property, and payroll in South Carolina relative to their sales, property and payroll everywhere. The sales factor – the factor at issue in this case – was based on the ratio of "***total sales***" in South Carolina to the "***total sales***" made by a taxpayer everywhere. "Sales" included all receipts from sales of tangible property, intangible property, and services.

As part of managing its cash and working capital needs for its operations, Duke Energy purchased and sold securities in the regular course of its business. The South Carolina Department of Revenue (the "Department") agreed that the income from Duke Energy's sales of securities was business income for purposes of applying the South

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[1] Duke Energy's original refund claims related to the tax years 1978 through 2001. The ALC held that the refund claims for tax years 1978 through 1993 were untimely (the "Waiver Issue"). The Court of Appeals did not review the ALC's holding with regard to the Waiver Issue.

[2] The Court of Appeals concluded that Duke Energy was a manufacturer and therefore required to apportion its income using the three-factor formula. .

Carolina corporate income tax.[3] Therefore, Duke Energy included its sales of securities in the calculation of its "total sales" in accordance with the plain language of the South Carolina income tax apportionment factor.

The Department audited Duke Energy's amended South Carolina income tax returns for the years at issue in this case. Following the audit, the Department claimed that Duke Energy could not include all of the receipts from its sales of securities in the sales factor because "to do so lessens the South Carolina income subject to tax, and as a consequence unreasonably represents the amount of business done in South Carolina." (App. p. 5554.)

The Court of Appeals upheld the Department's determination holding that Duke Energy should only include the "net receipts" in the denominator of its sales factor. The court gave two reasons for its decision. First, the court stated that receipts from sales of securities, other than net receipts, were not "receipts" for purposes of computing Duke Energy's sales factor because they were "not money [Duke Energy] received from its products or services." Second, the court held that including all of Duke Energy's receipts from its sales of securities in the sales factor, as required under the standard apportionment formula, "would not reasonably represent the proportion of the trade or business carried on within this State." *Duke Energy Corp. v. S.C. Dep't of Revenue*, 410 S.C. 415, 425, 764 S.E.2d 712, 718 (2014); (App. p. 8443).

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[3] South Carolina law requires that all business income (income other than income not connected with a taxpayer's activities conducted in the regular course of its business) must be apportioned. S.C. Code Ann. §§ 12-6-2240, -2220, -2230.

The Court of Appeals decision is wrong and should be reversed for three reasons. First, the plain language of the statute requires taxpayers to include "total sales" in their sales apportionment factor. Not some sales, net sales, or net receipts, but "total sales."

Second, the Court of Appeals excluded some of Duke Energy's receipts from sales of securities from its sales factor denominator because including the total sales receipts reduced the amount of Duke Energy's income apportioned to South Carolina. The Court of Appeals should not disregard the plain meaning of the apportionment statute simply because it results in a taxpayer paying less tax. *See CarMax Auto Superstores West Coast, Inc. v. S.C. Dep't of Revenue*, 411 S.C. 79, 767 S.E.2d 195 (2014), *aff'g,* 397 S.C. 604, 611, 725 S.E.2d 711, 716 (2012). Indeed, it is black letter law in South Carolina that any doubt as to the meaning of a statute should be resolved in favor of the taxpayer. *Alltel Commc'ns, Inc. v. S.C. Dep't of Revenue*, 399 S.C. 313, 321, 731 S.E.2d 869, 873 (2012).

Third, the Court of Appeals incorrectly held that "total sales" did not mean all of Duke Energy's receipts from sales of securities because including the total sales would not accurately reflect Duke Energy's business activities in South Carolina. The Court of Appeals offered no explanation of why using the standard three-factor apportionment formula – which required the inclusion of all of Duke Energy's sales – did not accurately reflect Duke Energy's business activities in South Carolina. In addition, the Department proffered no evidence of Duke Energy's relative business activities in South Carolina or whether or not the amount of income Duke Energy apportioned to South Carolina under

the standard three-factor[4] apportionment formula reasonably represented its South Carolina business activities.

This Court has ruled that a party (a taxpayer or the Department) claiming that the standard statutory formula does not accurately reflect a taxpayer's South Carolina business activities must prove this fact and offer a reasonable alternative. *Id.* The Court of Appeals' analysis effectively allows the Department to circumvent this Court's determination in *CarMax* by changing the standard statutory apportionment method without proving that the standard method did not fairly reflect the taxpayer's income in the State. *CarMax Auto Superstores West Coast*, 411 S.C. 79, 767 S.E.2d 195.

If the Court of Appeals' decision is upheld, the Department would no longer be required to prove that the standard apportionment method did not reasonably represent a taxpayer's business activity in the State. Instead, the Department could simply propose an alternative reading of the operative statute and support its interpretation based on the amount a taxpayer's South Carolina apportionment and tax liability would increase or decrease. This approach would render *CarMax* a nullity.

Duke Energy therefore respectfully requests that this Court reverse the Court of Appeal's decision and find that "total sales" includes all of the receipts from Duke Energy's sales of securities.

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[4] *See* note 2, *supra*.

STATEMENT OF THE CASE

I. Initial Procedural History

This case arises from the Department's denial of Duke Energy's amended South Carolina corporate income tax returns seeking a refund of South Carolina corporate income taxes (collectively "refund claims") for the tax years 1978 through 2001 ("tax years at issue"). (App. pp. 4183-5531; App. p. 49; App. p. 2438, lines 14-21.)

Duke Energy's refund claims related to two issues. First, during the tax years at issue, Duke Energy purchased and sold securities. The securities were bought and sold in the ordinary course of Duke Energy's business as part of managing its cash and working capital needs. Duke Energy's South Carolina amended corporate income tax returns for the years at issue in this case included all of the receipts from its sales of securities in its sales factor. (App. pp. 8195-8197, § 5.A; App. p. 51.)

Second, Duke Energy claimed it was a service provider and thus was required to apportion its income using the single-factor apportionment method. (App. p. 2424, line 22-p. 2426, line 1; App. p. 2496, line 18-p. 2497, line 5; App. p. 2514, lines 8-18; App. p. 2520, line 25-p. 2521, line 10; App. p. 5808; App. p. 5922; App. pp. 7707-7708; App. pp. 7272-7273.)

The Department denied Duke Energy's refund claims and Duke Energy timely appealed. (App. p. 5532; App. pp. 5533-5542; App. p. 123; App. p. 2439, lines 17-23; App. p. 2442, line 14-p. 2443, line 11.) Subsequently, the Department denied Duke Energy's appeal. (App. pp. 5546-5556; App. p. 123; App. p. 2449, lines 13-18).

II. Decision of the Administrative Law Court

After the Department issued its final determination denying the refund claims, Duke Energy requested a contested case hearing before the Administrative Law Court ("ALC"). (App. pp. 5558-5581; App. p. 123; App. p. 2453, lines 10-11.)

Following Duke Energy's appeal to the ALC, the Department filed a Motion for Summary Judgment asking the ALC to rule that, as a matter of law: (1) Duke Energy's refund claims for the tax years 1978-1993 were untimely (the "Waiver Issue"); (2) Duke Energy was not permitted to include all proceeds from its sales of securities in the calculation of the denominator of its South Carolina corporate income tax apportionment formula (the "Gross Receipts Issue"); and (3) Duke Energy is a manufacturer of electricity and is not entitled to use the single-factor apportionment formula to apportion its income to South Carolina (the "Electricity Issue"). (App. pp. 166-370; App. pp. 49-50.)

Duke Energy opposed the Department's Motion for Summary Judgment ("Department's MSJ") on the grounds that genuine issues of material fact existed regarding the Waiver and Electricity Issues, and filed a Cross-Motion for Summary Judgment stating that, as a matter of law, Duke Energy was required to include the entire proceeds from sales of securities in the standard statutory apportionment formula. (App. pp. 371-824; App. p. 50.)

The ALC conducted a hearing on the parties' motions on June 26, 2012. (App. p. 50.) On June 29, 2012, the ALC informed the parties of its decision (1) to grant the Department's MSJ on the Waiver Issue; (2) to grant Duke Energy's Cross-Motion on the Gross Receipts Issue and therefore to rule that ***all of Duke Energy's sales of securities***

should be included in its South Carolina sales factor; and (3) to order an evidentiary hearing with regard to the Electricity Issue.[5]

A little over one month later, on August 9, 2012, without any further briefing or argument by the parties, the ALC changed his mind regarding the Gross Receipts Issue and issued an Order finding for the Department on that issue. (App. pp. 11-46.) The ALC held that only the net receipts should be included in the denominator of Duke Energy's apportionment formula because including all of the receipts from Duke Energy's sales would result in ***"distortion."*** (App. pp. 39-40.)[6] The question regarding distortion – a factual inquiry – was not before the ALC because the Department ***never*** argued distortion and the record contained ***no*** evidence regarding distortion.

The ALC held a hearing regarding the Electricity Issue on September 5 and 6, 2012, and on November 2, 2012, issued a Final Order and Decision finding for the Department. (App. pp. 93-119.)

III. Opinion of the Court of Appeals

Duke Energy appealed all of the ALC's orders to the Court of Appeals. The Court of Appeals heard argument on February 18, 2014. The Department did not defend the ALC's decision that Duke Energy's apportionment positions were "distortive" or did not reasonably represent Duke Energy's business in the State. Indeed the Department ***admitted*** that neither party had introduced evidence regarding distortion or regarding whether the standard apportionment formula reasonably reflected Duke Energy's South

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[5] As a result, the ALC asked the Department to draft a proposed order regarding the Waiver Issue and Duke Energy to draft a proposed order regarding the Gross Receipts and Electricity Issues.

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

Carolina business activities.[7] The Department also did not contest the fact that Duke Energy's sales of securities were a part of Duke Energy's regular trade or business.

On October 8, 2014, the Court of Appeals substantially affirmed the results of the ALC Order. *Duke Energy Corp. v. S.C. Dep't of Revenue*, 410 S.C. 415, 764 S.E.2d 712 (2014); (App. pp. 8435-8447). The Court of Appeals held that Duke Energy was a manufacturer for South Carolina income tax purposes and was thus required to apportion its income based on the three-factor formula. *Id.* at 422, 764 S.E.2d at 716; (App. p. 8443).

The Court of Appeals also held that Duke Energy's receipts from sales of securities were not part of its "total sales" or "total gross receipts" for corporate income tax purposes. Instead, the Court of Appeals concluded that Duke Energy should include only a portion of the receipts from its sales of securities – the net receipts – in its calculation of "total sales." The Court of Appeals reasoned that sales of securities, other than net receipts, were not "receipts" from Duke Energy's "products or services." *Id.* at 429, 764 S.E.2d at 719-20; (App. p. 8446.). The Court of Appeals also concluded that including all of the receipts from Duke Energy's sales of securities in its sales factor would "artificially reduce the base which reasonably represents the proportion of trade or business carried on within this State." *Id.* at 428, 764 S.E.2d at 719; (App. p 8446.) The Court of Appeals opinion offers no evidence to support this conclusion, and none exists in the record of this case. *Id.*

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[7] The reference can be heard at the audio recording of oral argument, beginning at 59:06 and ending at 59:40.

On October 21, 2014, Duke Energy filed a petition for rehearing (App. pp. 8448-8453), which was denied by an order of the Court of Appeals filed November 21, 2014. (App. pp. 8457-8458.)

IV. Petition to this Court

On December 21, 2014, Duke Energy timely submitted its petition and appendix. On January 20, 2015, the Department filed and served its return to the petition. Duke Energy filed and served its reply on February 2, 2015. On April 9, 2015, this Court granted in part and denied in part Duke Energy's petition.[8] The Court granted Duke Energy's petition as to the following question:

> Did the Court of Appeals err in narrowing the definition of "receipts" for South Carolina corporate income tax purposes and in holding that securities sold in Duke Energy's ordinary course of its business are not "receipts" for South Carolina corporate income tax purposes even though South Carolina statutes require that taxpayers include their "total gross receipts" or "total sales" in apportioning their income to South Carolina?

STATEMENT OF FACTS

Duke Energy is an electric utility based in Charlotte, North Carolina. (App. pp. 8211-12.) Duke Energy's primary business is the provision of electric service to its customers, including customers located in South Carolina. (App. p. 2424, line 22-p. 2426, line 1; App. p. 2496, line 18-p. 2497, line 5; App. p. 2514, lines 8-18; App. p. 2520, line 25-p. 2521, line 10; App. p. 5808; App. p. 5922; App. pp. 7707-7708; App. pp. 7272-7273.)

Duke Energy, like most large corporations doing business in the United States, had a treasury department located in Charlotte, North Carolina. The treasury department

[8] This Court denied Duke Energy's Petition with regard to the Electricity Issue.

was responsible for funding Duke Energy's daily liquidity. One of the ways that the treasury department fulfilled Duke Energy's daily liquidity needs was by purchasing and selling securities such as commercial paper, corporate bonds, U.S. Treasury bills and notes, U.S. money market preferred securities, and municipal bonds. *Duke Energy,* 410 S.C. at 427-28, 764 S.E.2d at 719; (App. p. 8445). The day-to-day management of these investments by the treasury department occurred at the company's headquarters in Charlotte, North Carolina. (App. pp. 2994, 8212-13.)

Duke Energy's treasury department engaged in these treasury activities to ensure the company had sufficient cash to cover its daily working capital needs and to ensure excess cash from its operations was appropriately invested. Specifically, the purchases and sales of securities generated income which provided funding for Duke Energy's operations in its ordinary course of business including, but not limited to purchasing fuel; funding payroll; acquiring and maintaining generation, transmission and distribution equipment; providing liquidity support for Duke Energy's borrowing programs that were necessary for the funding of environmental compliance projects and new generation, transmission and distribution facilities to serve its customers; forecasting and funding maturing debt issues and all significant corporate payments; executing and funding all electronic payments, including all wire transfers; funding and managing cash from significant transaction settlements; managing all short-term borrowing; and negotiating and establishing credit facilities. (S. Love Aff. ¶¶ 8, 9, 10, 11, 12, 17, App. pp. 8213-15.) In managing the cash needs, or surplus, of Duke Energy's business, the treasury department employees relied upon regularly compiled information which was transmitted

to the treasury department regarding the anticipated cash needs and anticipated receipts related to Duke Energy's other operations. (S. Love Aff. ¶ 17; App. p. 8215.)

Duke Energy's treasury department operation was an integral part of Duke Energy's business operations. There was a synergistic relationship between the treasury department and the balance of Duke Energy's business operations. (S. Love Aff. ¶¶ 8, 9, 11; App. p. 8213-14). As a result, the treasury department made significant contributions to Duke Energy's ability to earn income during the tax years at issue.

During the tax years at issue, Duke Energy received income arising from its sales of securities made during the regular course of its business. The Department agreed that Duke Energy's sales of securities were part of its regular business activities and the income was business income for South Carolina income tax purposes and, therefore, was subject to apportionment among the states in which Duke Energy conducted business activities. (App. p. 1030.)

SUMMARY OF ARGUMENTS

This Court should reverse the Court of Appeals' decision because South Carolina apportionment statutes plainly require taxpayers to include their "total sales" from business activities in South Carolina.

During the tax years at issue, South Carolina's standard apportionment calculated the proportion of a taxpayer's property, payroll, and sales attributed to South Carolina relative to the taxpayer's property, payroll, and sales everywhere.[9] The sales factor – the

[9] The Court of Appeals held that with respect to the Electricity Issue, Duke Energy was a manufacturer and during the Tax years at Issue, it was required to apportion its income based on the three-factor formula under S.C. Code Ann. § 12-6-2250. This Court denied Duke Energy's Petition regarding the Electricity Issue and as a result, the computation of the sales factor under S.C. Code Ann. § 12-6-2280 is at issue in this matter before this Court.

factor at issue in this case – was calculated by dividing the taxpayer's South Carolina ***total sales*** by the taxpayer's ***total sales*** everywhere in order to (along with the other two factors) reflect the proportion of the taxpayer's income earned within South Carolina. The term "sales" included, but was not limited to, rentals from tangible personal property, sales of intangible personal property, and receipts from services.

This Court only recently held that in determining what portion of a multi-state company's total income South Carolina is entitled to tax, the party (a taxpayer or the Department) seeking to deviate from the statutorily prescribed apportionment formula bears the burden of showing that both (1) ***as a matter of fact***, the standard apportionment method does not reasonably represent the taxpayer's business activities in the state, and (2) ***as a matter of fact***, a proposed reasonable alternative achieves such fair reflection. *CarMax*, 411 S.C. at 89, 767 S.E.2d at 200. The record in this case contains no evidence showing that including all of the receipts from Duke Energy's sales of securities unreasonably represents – or in the words of the Court of Appeals, "artificially reduce[s] the base which reasonably represents" – Duke Energy's business activities in South Carolina.

Notwithstanding this Court's directive in *CarMax* and the evidence (or lack thereof) in the record, the Court of Appeals effectively held that, ***as a matter of law***, Duke Energy's inclusion of the total receipts from sales of securities in the statutory standard apportionment method did not reasonably represent its business activities in South Carolina, and, ***as a matter of law***, the Department's proposed alternative method to exclude a portion of those receipts was reasonable.

In short, the Court of Appeals' holding is that, to properly reflect Duke Energy's business activities in South Carolina, one must ignore the plain words of the South Carolina standard statutory apportionment formula, must ignore this Court's recent precedent, and must ignore a portion of Duke Energy's business activities, ***as a matter of law***. However, because the plain language of the standard apportionment formula cannot be ignored and this Court's precedent is controlling, this Court should reverse the Court of Appeals' holding and find that Duke Energy's total receipts from sales of securities should be included in the computation of its sales apportionment factor.

ARGUMENTS

I. The Court of Appeals erred in holding that Duke Energy's receipts from sales of securities other than net receipts are not "receipts" and therefore excluded from its sales factor denominator.

1. The Court of Appeals erred in failing to apply the plain language of the standard statutory apportionment formula.

During the tax years at issue, the sales factor consisted of "[t]he ratio of sales made by such taxpayer during the income year which are attributable to this State to the **total sales** made by such taxpayer everywhere during the income year . . . ." S.C. Code Ann. § 12-6-2280 (for tax years after 1995); former S.C. Code Ann. § 12-7-1170 (for tax years prior to 1996). The term "sales" included, but was not limited to:

> (1) rentals from tangible personal property located in this State which are not separately allocated; and
> (2) sales of intangible personal property and receipts from services if the entire income-producing activity is within this State. If the income-producing activity is performed partly within and partly without this State, sales are attributable to this State to the extent the income-producing activity is performed within this State.

S.C. Code Ann. § 12-6-2280(C). The term "total" was not defined. Therefore, the plain meaning of the statute controls:

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

Beach v. Livingston, 248 S.C. 135, 139, 149 S.E.2d 328, 330 (1996) (citation omitted); *see also Alltel Commc'ns,* , 399 S.C. at 320, 731 S.E.2d at 873 (2012).

Applying this standard to the sales factor statute, "***total*** sales" means all, not some receipts or net receipts. There is nothing at all ambiguous in the phrase "total sales." This term means exactly what it says: ***total*** means ***all***: "comprising or constituting a whole: ENTIRE <the *total* amount>." MERIAM-WEBSTER, http://www.merriam-webster.com/dictionary/total (emphasis original); *see also* BLACK'S LAW DICTIONARY (10th ed. 2014) ("total ... 1. Whole; not divided; full; complete. 2. Utter; absolute.")

If there was any doubt as to whether "total sales" meant all receipts, the South Carolina Legislature removed it in 2006. In 2006, the South Carolina Legislature specifically addressed the very issue at dispute in this case by enacting sweeping changes to the South Carolina apportionment statutes. The Legislature enacted a new statutory provision that, effective for tax years after 2006, expressly defines the terms "sales" (for purposes of the three-factor formula) and "gross receipts" (for purposes of the single-factor formula). 2007 S.C. Laws Act 110 § 51.A (enacted as S.C. Code Ann. § 12-6-2295(B)).

The Legislature's amendment in 2006 carved out ***ten new categories of receipts to be excluded*** from "sales" and "gross receipts."[10] S.C. Code Ann. § 12-6-2295(B). Indeed, the plain language of the title to the 2006 amendment indicates that the

[10] Under S.C. Code Ann. § 12-6-2295, the definition of "sales" is identical to the definition of "gross receipts."

purpose of the enactment of S.C. Code Ann. § 12-6-2295 was to add a new definition of "sales" and "gross receipts" for apportionment purposes. *See Demas v. Convention Motor Inns,* 268 S.C. 186, 190, 232 S.E.2d 724, 726 (1977) (recognizing the propriety of discerning legislative intent from the title of an act).

These changes, for the first time, excluded receipts from sales of securities other than net receipts from the South Carolina sales apportionment factor. S.C. Code Ann. § 12-6-2295(B)(1) ("gross receipts" or "sales" exclude "repayment, maturity, or redemption of the principal of a loan, bond, or mutual fund or certificate of deposit or similar marketable instrument").

This change in law was material and drastic. The 2006 law change added a new section to the statute which excluded ten new categories of receipts from the definitions of "sales" and "gross receipts." When the Legislature amends a statute to include a ***material*** change, there is a ***presumption*** that the Legislature intended to change the existing law rather than to clarify its original intent. *Key Corporate Capital, Inc. v. Cnty. of Beaufort*, 373 S.C. 55, 60-61, 644 S.E.2d 675, 678 (2007). Excluding ten new categories of receipts from the definition of "sales" is material by any measure.

Indeed, the Department previously argued that more limited statutory amendments were changes in the law. For example, in *Duke Power Co. v. S.C. Tax Comm'n*, 292 S.C. 64, 66, 354 S.E.2d 902, 903 (1987), the Department argued that an amendment to the South Carolina license tax statute, which imposed the tax on "the entire gross receipts from business" and was later changed to "the gross receipts from services rendered from regulated business," limited the scope of the tax and was thus a change in the law. *Id.*; (Br. App't at 8-9). The South Carolina Supreme Court agreed

with the Department and held that the language of the pre-amendment statute "clearly states that the license fee on power companies, such as Duke, is based on entire gross receipts and not just receipts from customer charges." *Duke Power Co.*, 292 S.C. at 66, 354 S.E.2d at 903.[11] Not only did the Court of Appeals fail to address the import of the 2006 legislative amendment, but it also did not even acknowledge its existence.

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

Indeed, notwithstanding the plain meaning of the statute, South Carolina's sales factor provision is identical to the Uniform Division of Income for Tax Purposes Act's ("UDITPA") definition of the sales factor.[12] UDITPA § 15. UDITPA defines "sales" to encompass "***all gross receipts*** of the taxpayer not allocated [as nonbusiness income]" and provides that the definition of the term is "all inclusive." *Id.* § 1(g). The South Carolina

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[11] Duke Power Company changed its name to Duke Energy Corporation, the Appellant in this case.

[12] This Court previously has relied on UDITPA in interpreting South Carolina law. *See Media General Communications, Inc. v. S.C. Dep't of Rev.*, 388 S.C. 138, 146, 694 S.E.2d 525, 528 (2010).

Code itself contains 85 uses of "gross" for tax purposes, including gross receipts, gross income, gross wages, gross estate, and gross proceeds. (App. pp. 411-12, 678-727.). These statutes uniformly have been interpreted by the Department to mean "gross" and not "net."[13] Therefore, contrary to the Court of Appeals' conclusion, "total sales" cannot be interpreted as including less than all receipts and certainly not net receipts from sales of securities.

The phrase "total sales" cannot mean net receipts simply based on the ***allegation*** that including all of the receipts or sales would reduce the amount of tax owed or would not clearly reflect South Carolina income. If the Legislature wished to limit the scope of "total sales" to exclude sales of securities prior to 2006, it would have done so. Accordingly, the Court of Appeals' interpretation of the term "total sales" to mean less than total is inconsistent with the plain language of the standard sales factor statute.

2. The Court of Appeals erred in concluding that receipts from Duke Energy's sales of securities were not "receipts" because they were not "money the business receives for its products or services."

The standard apportionment formula provides a rough but constitutionally acceptable estimate of the business income attributable to South Carolina. *Eastman Kodak Co. v. S.C. Tax Comm'n,* 308 S.C. 415, 419, 418 S.E.2d 542, 544 (1992); *Covington Fabrics Corp. v. S.C. Tax Comm'n,* 264 S.C. 59, 66-67, 212 S.E.2d 574, 577-78 (1975).

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[13] For example, S.C. Code Ann. § 12-36-90 imposes the sales tax on "[g]ross proceeds of sales." S.C. Code Ann. § 12-37-930 imposes a special depreciation rule for certain "gross cost of assets" located in this state. "Gross wages" means all wages, and not the net amount an employee receives after deductions. *See also Duke Power Co.*, 292 S.C. at 66, 354 S.E.2d at 903 (1987) ("gross receipts" means all receipts from a sales transaction).

It is undisputed that Duke Energy's treasury function is an integral part of Duke Energy's principal business, and the income generated from sales of securities is business income. (App. p. 3002, lines 5-15; App. pp. 8213-8214, 8215 ¶¶ 11, 17.) Indeed, the Department even agreed that Duke Energy's sales of securities occurred in the regular course of its business and that the income Duke Energy earned from the sales of securities was business income. (App. p. 1030.) Nevertheless, the Court of Appeals found that Duke Energy's receipts from sales of securities other than the net receipts were not "receipts" because they were not money "for what [Duke Energy] ... does in its business," and "not money it received for its products or services." *Duke Energy*, 410 S.C. at 429, 764 S.E.2d at 719-20.

The court's fragmentation of Duke Energy's integrated business operations into net receipts and other receipts is inconsistent with the facts of this case and longstanding South Carolina law. *See Eastman Kodak Co.*, 308 S.C. at 419, 418 S.E.2d at 544 (1992) (the purpose of South Carolina's apportionment formula and the unitary business principle that underlies it is to provide a rough approximation of the South Carolina portion of a company's business income generated from business activities in multiple states); *Covington Fabrics Corp.*, 264 S.C. at 66-67, 212 S.E.2d at 577-78 (1975) (same). Both the net receipts and other receipts were generated from the same sales of securities, and both types of receipts were generated from Duke's principal business operations. Therefore, the Court of Appeals' reasoning departs from South Carolina law that requires receipts from all transactions producing business income to be included in the sales factor. S.C. Code Ann. § 12-6-2280.

3. The Court of Appeals erred by concluding that Duke Energy's receipts from sales of securities are not "receipts" but rather "the return of the principal" and "its own money."

The Court of Appeals' holding that Duke Energy's receipts from sales of securities other than the net receipts are not "receipts" for sales factor purposes is premised on the false assumption that those receipts represent "return of the principal" or "its own money – not money it received for its products or services."

First, nothing in the record supports the Court of Appeals' assumption and holding. Furthermore, the Court of Appeals' characterization of Duke Energy's sales of securities is simply incorrect. The term "receipt" is not a defined term. The Court of Appeals adopted *Webster's* definition of the term "receipt" as "something received" and reasoned that "[i]n the business context, 'receipt' means money the business receives from its products or services – for what it does in its business." (App. p. 8446.) Marketable securities are bought and sold. When a security is sold or redeemed, the entire amount is received from the relinquishment of a commodity. *See General Motors Corp. v. Franchise Tax Bd.*, 39 Cal. 4th 773, 786-87, 139 P.3d 1183, 1190-91 (2006). For example, if one purchases a municipal bond for $80 and subsequently sells it for $100, or one invests $80 in a partnership interest and then sells that partnership interest for $100, the entire $100 is received. Duke Energy purchased and sold securities in the regular course of its business, and the entire proceeds received from its sales of securities were receipts from "what it does in its business."

Furthermore, unlike a transaction that involves a return of principal, sales of marketable securities are highly dependent on the market environment and the amount of money received, if any, when a security is sold. Duke Energy was not protected from fluctuations in the value of the securities it had acquired, and the purchase/redemption

price was dependent on the market rates for the purchased securities. Indeed, only recently we have seen more than a few local governments declare bankruptcy and default on their bonds.[14]

As the California Supreme Court succinctly put it:

> To better understand this basic distinction and how it applies even in the case of debt instruments like bonds and Treasury bills, consider the case of a security (a $10,000 Treasury bill, say) bought on the market from a securities dealer, then redeemed with the issuer, the United States government. The price the purchaser/taxpayer receives on redemption, $10,000, is dependent on the value of the commodity it holds and independent of the price it paid to the broker. ***The taxpayer is not being repaid for money it lent; it had, in fact, paid nothing and lent nothing to the United States government. The entire amount received is properly treated as gross receipts.*** . . .

General Motors Corp., 39 Cal. 4th at 786-87, 139 P.3d at 1190-91 (emphasis added). Therefore, Duke Energy's sales of securities are just that – sales. There is no "return of principal" or return of "its own money."

Accordingly, because Duke Energy sold securities as part of its primary business, all of its proceeds from those sales fit the Court of Appeals' definition of a "receipt" and should therefore be included in the sales factor.

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[14] *See, e.g., Detroit is broke; could bankruptcy lie ahead?* (May 13, 2013), available at http://news.yahoo.com/detroit-broke-could-bankruptcy-lie-ahead-185859786.html; *Another California City Scrambling to Avoid Bankruptcy* (September 27, 2012), available at http://www.foxnews.com/politics/2012/09/27/another-california-city-scrambling-to-avoid-bankruptcy/ (stating that Central Valley would be the fourth California city to file for municipal bankruptcy this year); *City Council in Harrisburg Files Petition of Bankruptcy* (October 12, 2011), available at http://www.nytimes.com/2011/10/13/us/harrisburg-pennsylvania-files-for-bankruptcy.html?_r=0.

4. To properly reflect Duke Energy's business activities in South Carolina, all of the receipts from Duke Energy's sales of securities must be included in the sales factor.

The exclusion of a portion of Duke Energy's receipts from its sales of securities is inconsistent with the purpose of South Carolina's apportionment formula – to provide a rough approximation of the South Carolina portion of a company's business income that is generated from business activities in multiple states – and the unitary business principle that underlies its provisions. *Eastman Kodak Co.*, 308 S.C. at 419, 418 S.E.2d at 544 (1992); *Covington Fabrics Corp.*, 264 S.C. at 66-67, 212 S.E.2d at 577-78 (1975).

The United States Constitution precludes states from taxing value earned outside of their borders. *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 164 (1983). However, because multistate businesses are often integrated and operate without regard to state borders, they experience significant unquantifiable cross-border flows of value that cannot be identified or measured geographically. Both in theory and in practice, arriving at precise territorial allocations of value is therefore "often an elusive goal" for these "unitary" businesses. *Id.* at 164, 178.

Because it is impossible to determine the precise portion of a unitary business's income that is earned from business activities in South Carolina, South Carolina (to satisfy the requirements of the United States Constitution) – like many other states – relies on the unitary business principle. Rather than applying separate geographical accounting to determine what portion of the entire income of a unitary business is earned (and thus taxable) in South Carolina, the unitary business principle dictates that the entire ***business*** income – i.e., income connected with the business – of the unitary business (regardless of where it was earned) must be apportioned by way of a standard apportionment formula designed to approximate the taxpayer's business activities in each

state. S.C. Code Ann. § 12-6-2240; *Lowenstein Corp. v. S.C. Tax Comm'n*, 298 S.C. 93, 378 S.E.2d 272 (1989).[15]

It has long been recognized that the standard apportionment formula is intended as only a rough but constitutionally acceptable approximation of a taxpayer's business activity in South Carolina. *Eastman Kodak Co.,* 308 S.C. at 419, 418 S.E.2d at 544 (1992); *Covington Fabrics Corp,* 264 S.C. at 66-67, 212 S.E.2d at 577-78 (1975). To be sure, the U.S. Supreme Court has stated in the constitutional context that "[a]llocating income among various taxing jurisdictions bears some resemblance, as we have emphasized throughout this opinion, to slicing a shadow." *Container Corp.*, 463 U.S. at 192. As a result, application of the unitary principle and the standard apportionment formula eliminates a wasted attempt at artificially slicing up inseparable portions of a taxpayer's multistate, integrated, and codependent business operation. *Id.*

This Court also has recognized that measuring the exact amount of income attributable to a particular jurisdiction from a multistate business with precision is impossible and that South Carolina's standard apportionment formula is simply a way to produce a "rough approximation" of income. *Eastman Kodak Co.*, 308 S.C. at 419, 418 S.E.2d at 544 (1992); *Covington Fabrics Corp.*, 264 S.C. at 66-67, 212 S.E.2d at 577-78 (1975). Therefore, the rough approximation produced by the standard apportionment formula will be valid unless there is probative evidence that the income apportioned to South Carolina under the statute does not "fairly represent the extent of the taxpayer's business activity in this State ...." S.C. Code Ann. § 12-6-2320; *CarMax*, 411 S.C. at 88, 767 S.E.2d at 199.

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[15] ***Non-business*** income is directly allocated to the state. S.C. Code Ann. § 12-6-2220.

As discussed above, Duke Energy's treasury function is a critical driver of the company's income, is inseparable from Duke Energy's other business activities, and thus total receipts resulting from the activities of the treasury function must be included in the standard apportionment formula to roughly approximate the portion of Duke Energy's income derived from business activities in South Carolina. There is no evidence in the record showing that the inclusion of all of Duke Energy's business receipts – including the total receipts from its sales of securities – in the sales factor does not fairly represent its business activities in South Carolina. Therefore, in artificially separating some of the receipts from Duke Energy's sales of securities from the remainder of its business receipts, the trial court ignored the very purpose of South Carolina's system of apportionment, which is to aggregate all of a taxpayer's activities that synergistically contribute to the taxpayer's income and "roughly" apportion that income among the states.

II. The Court of Appeals erred in affirming the Department's attempt to apply an end-run around alternative apportionment and this Court's recent precedent.

The Court of Appeals' decision effectively affirmed the Department's attempt to end run around South Carolina's alternative apportionment statute and this Court's recent decision in *CarMax*.

South Carolina law provides that the Department or the taxpayer may use a reasonable alternative apportionment method if the standard statutory apportionment formula does not fairly represent a taxpayer's business activity in South Carolina. S.C. Code Ann. § 12-6-2320.

This Court only recently opined on the appropriate procedure for invoking the alternative apportionment provision. This Court held that a party deviating from the

standard apportionment formula bears the burdens of proving that (1) the statutory formula does not fairly represent the taxpayer's business activities in the state; and (2) an alternative apportionment method is reasonable. *CarMax*, 411 S.C. at 90, 767 S.E.2d at 200. To meet the first burden of the *CarMax* test, the proponent of the alternative method must present substantial evidence showing that the standard apportionment formula is unreasonable. *CarMax*, 411 S.C. at 89, 767 S.E.2d at 200 In *CarMax,* this Court held that the Department failed to satisfy its first burden because it "merely described what it did rather than cite any evidence justifying what it did. Rather, at trial, the Department relied on CarMax West to refute its use of an alternate formula ...." *Id.* (internal quotations omitted). This Court further noted that "[m]erely because the use of an alternative form of computation produces a higher business activity attributable to [the state], is not in and of itself a sufficient reason for deviating from the legislatively mandated formula." *Id.* (internal quotations omitted) (quoting *St. Johnson Trucking Co. v. State,* 118 N.H. 209, 212, 385 A.2d 215, 217 (1978).)

Consistent with and pursuant to the plain language of the standard apportionment formula sales factor provisions, Duke Energy included all receipts from the disposition of its securities in its sales factor. Therefore, the standard apportionment formula provides a "rough approximation" and a fair reflection of Duke Energy's income attributable to business activity in South Carolina. S.C. Code Ann. § 12-6-2210; *Eastman Kodak Co.*, 308 S.C. at 419, 418 S.E.2d at 544; *Covington Fabrics Corp.*, 264 S.C. at 66-67, 212 S.E.2d at 577-78.

The Court of Appeals concluded instead that Duke Energy's application of the standard apportionment formula "would artificially reduce the base which reasonably

represents the proportion of the trade or business carried on within this State," and thus Duke Energy cannot include the total receipts from sales of securities in its South Carolina sales factor. Because the Court of Appeals' holding is not predicated on any facts specific or unique to Duke Energy, the court essentially held that it would always be a misrepresentation of a taxpayer's business activities to include all receipts from sales of securities in the standard apportionment formula. Yet there is no evidence whatsoever in support of such a proposition. Furthermore, neither the Department nor the Court of Appeals has offered any explanation as to why including receipts from sales of securities in the sales factor denominator does not, or could not, roughly approximate Duke Energy's business activity in South Carolina, other than to acknowledge that the application of the standard apportionment formula produces a lesser South Carolina tax liability during the tax years at issue. Accordingly, the Court of Appeals' holding is completely at odds with this Court's directive in *CarMax*.

Therefore, this Court should reverse the Court of Appeals' decision because it will afford the Department with unrestrained authority to recreate taxpayer's apportionment results anytime it does not like the results of the standard apportionment formula. The Court of Appeals' proposed method would eviscerate uniformity and predictability in South Carolina's tax system and create a great deal of confusion for taxpayers because taxpayers would never know when the Department was going to target a particular activity and create a list of differences to exclude from the sales factor the gross receipts from that activity.

III. The Court of Appeals erred by considering arguments neither raised nor preserved by the Department.

Although the only question before the Court of Appeals with respect to the Gross Receipts Issue was whether, ***as a matter of law***, all receipts from sales of securities should be included in the standard statutory apportionment formula, the Court of Appeals *sua sponte* considered arguments that are neither raised nor preserved by the Department. Specifically, in determining whether, as a matter of law, Duke Energy is required to include all receipts from its sales of securities in its apportionment formula, the Court of Appeals considered the ***factual*** question of whether including all of Duke Energy's receipts in its South Carolina apportionment would – in the Court of Appeals' words – "artificially reduce the base which reasonably represents the proportion of the trade or business carried on within this State . . . by artificially inflating the denominator."

The Court of Appeals' holding is predicated on the presumption that "allowing Duke Energy to include its gross receipts from short-term investment instruments would artificially reduce the 'base which reasonably represents the proportion of the trade or business carried on within this State,' . . . by artificially inflating the denominator of the formula." (App. p. 8446.) Not only is this assumption premised on a factual question not before the Court of Appeals, but it is also not based on the evidence in the record.

The Court of Appeals' review was limited to the ALC's holding whether, as a matter of law, "gross receipts" and "total sales" include all proceeds from sales of securities for income apportionment purposes. This Court's recent precedent makes it abundantly clear that whether the inclusion of all proceeds from sales of securities would "artificially inflat[e] the denominator of the formula" (*Id.*) or "artificially reduce the base which reasonably represents the proportion of the trade or business carried on within the

State" (*id.*) is a factual question to be addressed only after the standard apportionment formula results are determined. *CarMax*, 411 S.C. at 89, 767 S.E.2d at 200.

The Court of Appeals' holding presumes that the inclusion of all receipts from Duke Energy's sales of securities does not fairly represent Duke Energy's business activities in South Carolina. The Court of Appeals, thus, imputed an *ipso facto* alternative apportionment mechanism into the standard apportionment provisions. The Court of Appeals must first apply South Carolina's apportionment provisions – including a calculation of "gross receipts" or "total sales." This Court only recently held that alternative apportionment – an issue not before the Court of Appeals – is determined only after the standard apportionment results are calculated. *See id.* Because the ALC decided the Gross Receipts Issue on motions for summary judgment (App. pp. 71-84), neither party has presented evidence regarding whether including all receipts from Duke Energy's sales of securities under the standard statutory formula is a reasonable representation of its business activities in the State. Accordingly, the Court of Appeals erred in considering questions not before it.

IV. The Court of Appeals erred in usurping the power of the South Carolina Legislature by rendering the Legislature's 2006 legislative changes regarding the definitions of "sales" and gross receipts" meaningless.

The Court of Appeals' decision effectively legislates from the bench in violation of the Separation of Powers Clause of the South Carolina Constitution, which provides that:

> In the government of this State, the legislative, executive, and judicial powers of the government shall be forever separate and distinct from each other, and no person or persons exercising the functions of one of said departments shall assume or discharge the duties of any other.

S.C. Const. art I, § 8.

As discussed above, prior to 2007, South Carolina law required the inclusion of "total gross receipts" or "total sales" in the South Carolina apportionment calculation. In 2006, the South Carolina Legislature changed the law to exclude several types of receipts including receipts from sales of securities. The 2006 law change was fundamental and substantially altered South Carolina apportionment law. Yet, the Court of Appeals did not address at all the import of this change. Instead, the court simply found that "total sales" could not mean what it says because including receipts from the sales of securities "would artificially reduce the 'base which reasonably represents the proportion of the trade or business carried on within this State.'" (App. p. 8446.)

However, that holding cannot be reconciled with the substantial changes to the definition of "sales". Indeed, the uncontroverted record in this case shows that the Department acknowledged that the treatment of several categories of receipts were impacted by the 2006 law change and thus, the actions of the legislature could not have been a mere clarification of the law as claimed by the Department. As a result, the Court of Appeals retroactively changed the law of its own accord for periods spanning more than a decade before the Legislature chose to act, clearly a power not given to the Courts, but only within the power of the State Legislature.

V. A predominant number of other states' courts have ruled that all receipts from sales of securities must be included in the sales apportionment factor.

The issue as to whether the entire receipts from sales of securities are includible in the sales apportionment factor is not new. Based on the more recent, state court decisions on this issue, the predominant view is that "sales" and "gross" mean "all," and not "net." For example, in a case dealing with the inclusion of receipts from sales of securities in the sales apportionment factor, the California Supreme Court stated:

> We agree with Microsoft that ... "[g]ross" implies the whole amount received, not just the amount received in excess of the purchase price. To only consider the net price difference as "gross receipts" is an awkward fit with the statutory language, at best.

Microsoft Corp. v. Franchise Tax Bd., 39 Cal. 4th 750, 759, 139 P.3d 1169, 1174 (2006). In the most recent case on point, the California Court of Appeal held that the full sales price of future sales contracts must be included in the sales factor. *General Mills v. Franchise Tax Bd.*, 172 Cal. App. 4th 1535, 92 Cal. Rptr. 3d 208 (Ct. App. 2009). The court stated:

> "Gross" implies the whole amount received, not just the amount received in excess of the purchase price. To only consider the net price difference as "gross receipts" is an awkward fit with the statutory language, at best. To the extent the language is ambiguous, we generally will prefer the interpretation favoring the taxpayer.

Id. at 1543, 92 Cal. Rptr. 3d at 214 (quoting *Microsoft Corp.*).

The California cases adopt the view espoused by other courts that "total sales" require the inclusion of <u>all</u> receipts, including the entire receipts from the sale of securities. For example, in *Sherwin-Williams Co. v. Dep't of Revenue,* 329 Or. 599, 996 P.2d 500 (2000), the Oregon Supreme Court affirmed the Oregon Tax Court's decision that the Department of Revenue erroneously included in the sales factor net income rather than gross receipts from the disposition of investment securities. Following the court's decision, the Oregon Legislature changed its law to exclude from gross receipts the sale of intangible assets including, but not limited to, securities, unless those receipts are derived from the taxpayer's primary business activity. Or. Rev. Stat. § 314.665(6)(a).

In *Mead Corp. v. Department of Revenue,* OO CH 01854 (Ill. Cir. Ct. Feb. 5, 2002), the Illinois Circuit Court upheld Mead's position that Illinois statutes required the inclusion of gross receipts from the sale of investments in the sales factor.

In Rhode Island, the district court concluded that the plain meaning of the sales factor statute required that the total receipts, including receipts from the disposition of intangibles, should be included in the sales factor. *Western Elec. Co. v. Norberg*, AA No. 81-391 (R.I. Dist. Ct. 6th Div., Mar. 30, 1983), *cert. denied*, 461 A.2d 679 (R.I. 1983). After the tax years at issue in that case, Rhode Island also amended its statute to provide that only the net income from the sale of securities or other financial obligations was to be included in the sales factor denominator. R.I. Gen. Laws § 44-11-14 (a)(2)(v) (1995 & Supp. 1997).

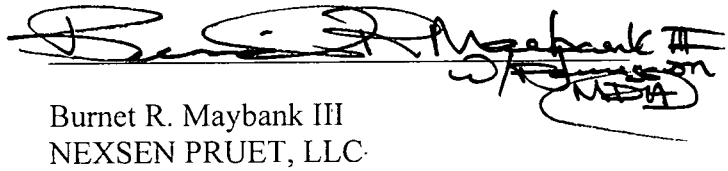
In *United States Steel Corp. v. Wisconsin Dep't of Revenue,* Dkt. I-6578 (Wis. Tax App. Comm'n May 9, 1985), the Wisconsin Tax Appeals Commission determined that the entire proceeds from the sale and redemption of short-term securities should be included in the sales factor. Wisconsin reacted to the court's decision by subsequently amending its statute to exclude interest, dividends, and receipts and the gain or loss from the disposition of securities from the sales factor. Other tribunals adjudicating similar controversies have likewise held that the gross receipts rather than the net income from the sale of intangibles should be included in the sales factor. *Illinois Tool Works, Inc. v. Lindley,* 70 Ohio St. 2d 175, 436 N.E.2d 220 (1982); PD 89-235 (Va. Tax Comm'r Sept. 6, 1989); PD 87-77 (Va. Tax Comm'r Feb. 27, 1987); *AT&T v. Dep't of Revenue*, 15 Or. Tax 202, 2000 WL 1279835 (Or. T.C. 2000); *Pennzoil Co. v. Dep't of Revenue*, 15 Or.

Tax 101, 2000 WL 1025573 (Or. T.C. 2000); *AT&T. v. State Tax Appeal Bd.*, 241 Mont. 440, 787 P.2d 754 (1990).[16]

Similar to California, Wisconsin, and Rhode Island, in 2006, the South Carolina Legislature changed the scope of the sales apportionment factor by materially changing the definition of the terms "sales" and "gross receipts" and expressly excluding receipts other than net receipts from sales of securities from the calculation of the sales factor. However, for periods prior to the 2006 legislative change (including the tax years at issue in this case), the South Carolina statutes were clear that the term "total sales" includes the entire receipts, including all receipts from sales of securities.

CONCLUSION

For the above-stated reasons, Duke Energy respectfully requests that this Court reverse the Court of Appeals' Opinion, hold that the total receipts from Duke Energy's sales of securities must be included in its sales apportionment factor, and remand this case for a consideration of the Waiver Issue.



Burnet R. Maybank III
NEXSEN PRUET, LLC
1230 Main Street, Suite 700
PO Drawer 2426 (29202)
Columbia, SC 29201
(803) 771-8900

[16] While there are a handful of cases from other jurisdictions that have ruled on this issue to the contrary, the modern view is that, in the absence of clear legislative guidance to the contrary, all receipts from sales of securities must be included in the sales apportionment factor.

Eric S. Tresh, *Pro Hac Vice*
Maria M. Todorova, *Pro Hac Vice*
SUTHERLAND ASBILL & BRENNAN LLP
999 Peachtree Street, NE, Suite 2300
Atlanta, GA 30309
(404) 853-8000

Jeffrey A. Friedman, *Pro Hac Vice*
SUTHERLAND ASBILL & BRENNAN LLP
700 Sixth St NW, Suite 700
Washington, DC 20001
(202) 383-0718

Attorneys for Petitioner Duke Energy Corporation

Columbia, South Carolina
June 1, 2015

THE STATE OF SOUTH CAROLINA
in The Supreme Court

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APPEAL FROM THE ADMINISTRATIVE LAW COURT

Ralph K. Anderson III, Administrative Law Judge

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

Duke Energy Corporation.....Petitioner,

v.

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

PROOF OF SERVICE

I certify that I have served Brief of Petitioner on counsel of record for the South Carolina Department of Revenue and to the Clerk of the Court of Appeals by depositing a copy of it in the United States Mail, postage prepaid, on June 1, 2015, addressed to:

Milton G. Kimpson
South Carolina Department of Revenue
P.O. Box 12265
Columbia, SC 29211

John M.S. Hoefer
Tracy C. Green
John W. Roberts
Willoughby & Hoefer, P.A.
P.O. Box 8416
Columbia, SC 29202

Jonathon Gutting, Esquire
P.O. Box 993
Charleston, SC 29402-0993

Harry A. Hancock, Esq.
New Jersey Treasury
229 Spring Street
Bordentown, New Jersey 08505

The Honorable Jenny Abbott Kitchings
Clerk of Court
South Carolina Court of Appeals
1015 Sumter Street
Columbia, SC 29201

Vanessa C. Mastroianni