

THE STATE OF SOUTH CAROLINA
In the Supreme Court

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APPEAL FROM THE ADMINISTRATIVE LAW COURT **Supreme Court**

Ralph K. Anderson, III, Chief Administrative Law Judge

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

Appellate Case No. 2014-002736

Duke Energy Corporation, Petitioner,

v.

South Carolina Department of Revenue, Respondent.

**The Department of Revenue's Response to the South Carolina
Manufacturers Alliance's Amicus Curiae Brief**

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Summary of Argument¹

Although an *amicus curiae* is, literally, a “friend of the court,” the *Amicus’s* brief in this case provides little insight into the issues actually before this Court and serves only to emphasize the flaws in Duke Energy’s argument. Nothing in the *Amicus’s* first two arguments warrants any substantial response beyond that already advanced in the briefs filed by the parties. The determination of whether Duke Energy can include all of its recycled investment principal in the apportionment formula for tax purposes does not hinge upon technical aspects of securities laws and regulations but on the nature of the transactions at issue. And although the plain meaning of the apportionment statutes excludes Duke Energy’s recovered principal—as it has routinely been described in this case, at least until now—the Department has had in place a long-standing administrative policy that, as recognized by Duke Energy’s own tax consultants, requires excluding the recovered principal from the apportionment formula. Just like Duke Energy did on its originally filed tax returns for more than 20 years.

¹ Although an *amicus* brief is “limited to the argument of the issues on appeal as presented by the parties,” Rule 213, SCACR, the *Amicus* restates the issue. The Department, however, does not agree with the *Amicus’s* “Question Presented” and, consistent with the Appellate Court Rules, incorporates the Department’s “Counter Statement of the Issues” set forth in its Brief. Interestingly, although this is the third time that the South Carolina Manufacturer’s Alliance has submitted an *amicus* brief in support of Duke Energy, it is the first time that it has addressed the issue now before the Court.

Argument

With respect to its first two arguments, the *Amicus* apparently believes it has added to the Court's analysis through its simplistic characterization of the Department's position as an opportunistic search for revenue. None of the *Amicus's* discussion provides even minimally helpful assistance in resolving the issues in this case.² The fact that the Administrative Law Court and the Court of Appeals fully agreed with the Department's position alone demonstrates that the denial of Duke Energy's refund claims was reasonable. The *Amicus* further appears to suggest that the Department issued an assessment to collect the amounts at issue even though, as the Court is well aware, the issues in this case arose from the filing of amended returns in which Duke Energy changed its long-standing exclusion of recovered investment principal from its apportionment formula. *See Duke Energy Corp. v. S.C. Dep't of Rev.*, 410 S.C. 415, 764 S.E.2d 712 (Ct. App. 2014). The real question in this case is whether, for the years that remain open,³ Duke Energy's recovery of excess cash invested in various short-term transactions should be excluded from the definition of sales for purposes of the apportionment factor as Duke Energy did in its originally-filed returns for 1978-1999. The *Amicus's* brief in this case adds nothing to

² Although Duke Energy's newfound filing position substantially reduces its South Carolina tax liability, other corporate taxpayers could recognize an increase in their liability. *See Dep't Br.* at 15 n.16.

³ *See Dep't Br.* at 33-36.

the discussions and extensive analysis about this issue set forth in the Department's brief or, for that matter, Duke Energy's briefs.

In its third argument, the *Amicus's* confusion extends into suggesting that the securities laws should drive the tax treatment of Duke Energy's short-term investment transactions. But the point of this case is the proper definition of sales in the apportionment formula in the context of the State's tax laws, not the application of technical provisions of the federal or state securities laws. *Cf., e.g., Gregory v. Helvering*, 293 U.S. 465, 470 (1935) ("To hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose.").⁴ It is undisputed that Duke Energy has never suffered a loss on any of these short-term investment transactions. The whole point of characterizing these transactions as not risky is to illustrate that these are not speculative investments but extensions of Duke Energy's working capital position—*i.e.*, cash and cash equivalents—that it strenuously seeks to preserve and maintain against all risk. [*See, e.g.,* App'x. at 3072 ("Cash is a critical asset of the Corporation. It is the policy of Duke Energy that all cash assets of the corporation be properly safeguarded and then managed to maximize value.")]. The minimal risk is fully illustrated by the testimony of Duke Energy's witness that it has

⁴ Notwithstanding *Amicus's* confusion on this point, the issue here is the treatment of the recovered principal for purposes of income tax apportionment. Neither the Department nor Duke Energy has argued that the recovered principal is subject to income tax. The *Amicus's* arguments regarding the actual income tax treatment of these transactions is confusing and unhelpful.

never suffered a loss on these transactions as well as its company investment guidelines, which establish a strategy designed to provide liquidity and to ensure that Duke Energy's "excess cash was appropriately invested, with a goal of minimizing cash in corporate bank accounts." [App'x. at 3007:22-3008:3 (Dep. of Sherwood Love); App'x. at 8216 (Aff. of Sherwood Love);] *see* Dep't Br. at 7-8. As such, the analogy of repeated deposits and withdrawals from an interest-bearing bank account is quite apposite.⁵

Simply put, *for tax apportionment purposes*, recovered investment principal is no different than the amount deposited and later withdrawn from an interest-bearing bank account. But if the withdrawal of the original amount deposited in a bank account is not a sale for apportionment purposes—which Duke Energy does not dispute—the return of principal from Duke Energy's various short-term investment transactions is not a sale either. This is especially so considering that both Duke Energy and the *Amicus* now concede that the return of principal from one type of Duke Energy's short-term investment transactions—repurchase agreements or "repos"—is not a sale and is excluded from the apportionment formula. *See*

⁵ If anything, the *Amicus's* bank account analysis demonstrates the similarities between Duke Energy's transactions and bank account transactions. *Amicus Br.* at 17-20; [*see also* App'x. at 3072 (stating purpose of Cash Management Group in part as "[p]rovid[ing] daily liquidity," "[s]afeguard[ing] cash assets," and "[p]rovid[ing] cost effective banking services").] In each case, the depositor or investor provides, with minimal risk, a certain amount to a third party, the bank or the issuer, and then later receives that original amount back in addition to some gain or interest. The depositor or investor is then taxed only on the amount of gain or interest and not the original amount deposited or invested—*i.e.*, the principal. And neither the amount deposited and withdrawn nor the amount invested and recovered are representative of the depositor or investor's business activities.

Dep't Br. at 29-30 (discussing *Gen. Motors Corp. v. Franchise Tax Bd.*, 139 P.3d 1183 (Cal. 2006), and related concession by Duke Energy); *Amicus* Br. at 20 (citing favorably California Supreme Court's decision in *General Motors* to exclude from the apportionment formula the recovered principal from "repos" because they have the "characteristics of a [secured] loan"). Because Duke Energy has never articulated any distinction among its various types of short-term investment transactions for apportionment purposes, the admitted exclusion of the recovered principal from repos from the formula supports the Department's position that the principal amount from all of these transactions should be excluded from the formula. *See* Dep't Br. at 27-30.

The *Amicus* takes issue with describing the original amount of working capital used in these short-term transactions as principal, even finding it "so absurd there is no accounting, economic, or financial treatise to refute it." *Amicus* Br. at 13-16. Whatever that statement means, prior to its brief to this Court and, for that matter, prior to the inception of this case, Duke Energy regularly characterized those original amounts as principal:

When short-term investment dollars are left at Merrill Lynch instead of being returned in full, please provide the following information:

	Date: <u>8-15-96</u>
<i>Principal</i> Maturing Today:	<u>14,982,900.00</u>
Interest on Maturities:	<u>17,100.00</u>
Total Maturing Today:	<u>15,000,000.00</u>
	Rolled: <u>15,000,000.00</u>
Amount Incoming:	<u>.....</u>

[App'x. at 3133 (emphasis added);] *see Duke Energy*, 410 S.C. at 427-28, 764 S.E.2d at 719 (discussing this illustrative transaction as part of its analysis). This Duke Energy internal document also states that the "Total Maturing Today" of \$15 million is the "Sum of *Principal* & Interest." [App'x. at 3133 (emphasis added).] And the recovered principal amounts, even when immediately "rolled" into another transaction, were always booked to the same internal account and any interest or gain recorded in a separate account. [App'x. at 3030:12-3031:9 (Love Dep.).]

In addition, Duke Energy's consultants also characterized the amounts as principal. Included in the Appendix and produced by Duke Energy in discovery are memoranda regarding this issue developed by Duke Energy's tax consultant prior to the filing of the amended returns, which state as follows in pertinent part:

Like many taxpayers, Duke Energy invests its liquid assets daily in a number of short-term securities (e.g. overnight repurchase agreements, certificates of deposit, etc.) throughout the year. As a result of these transactions, Duke has the opportunity in certain states to include the entire gross proceeds (including the *return of principal* from its overnight investments) in its sales factor denominators. The purpose of this memo is to analyze Duke Energy's ability to take that position in both North Carolina and South Carolina.

[App'x. at 3075, 3081, 3092 (emphasis added).] Further, as discussed in the Department's Brief at 27-30, Duke Energy's treasury department representative also used the term "principal" in describing the investment transactions at issue, [*see* App'x. at 3028:6-9 (Love Dep.).] and Duke Energy

even argued to the ALC: “The only issue before the Court was whether, as a matter of law, the *principal* realized from sales of securities was included in the standard apportionment formula.” [App’x. at 1040 (Duke Energy’s Mem. in Supp. of Mot. for Recons. at 5) (emphasis added).] In light of this history, the concerted effort to depart from the characterization of the recovered amounts as principal is just an attempt to avoid the fact that the substance of these transactions largely constitutes Duke Energy’s recovery of its own money that should be excluded from the apportionment formula.

The examples of potential filing positions that the *Amicus* suggests will arise from the Court of Appeals’ decision are unusual and evince a lack of understanding of the issue in this case and the tax apportionment process as a whole. *Amicus* Br. at 23-24.⁶ For instance, the *Amicus*’s argument that “interest” from a bank account or a loan will now be treated as “principal” because of the Court of Appeals’ opinion is unclear. There is no dispute that there is a difference between the amount deposited, loaned, or invested (*i.e.*, the principal) and the interest earned, which is shown by the fact that Duke Energy filed its original returns for over 20 years by including the interest and excluding the principal from its short-term investment transactions from its apportionment formula. The *Amicus* also seems to confuse the differences

⁶ The *Amicus*’s parade-of-horribles argument about tax consultants descending on this state “[a]rmed with a decision that ‘total’ means ‘net’” is not at all helpful. It also is not illuminating given that, based on memoranda produced in discovery, Duke Energy’s position on its amended returns apparently originated in or involved the Raleigh, North Carolina office of a worldwide tax accounting firm. [See App’x. at 3075-3101.]

between the treatment of an item for apportionment purposes versus for income tax purposes. *Amicus* Br. at 24 (“So it does not go into the numerator and no tax is paid on it.”). None of this argument assists in resolving the issue actually before the Court: whether the investment principal returned to Duke Energy following these short-term transactions should be excluded from the apportionment formula just as the company did on its originally-filed income tax returns.

The *Amicus*'s arguments also unhelpfully provide no clarity about and, in fact, confuse the issue of alternative apportionment. S.C. Code Ann. § 12-6-2320. The *Amicus* even erroneously posits that alternative apportionment was not invoked in this case, *see Amicus* Br. at 3, 23, 26, even though the Department has reserved its right to invoke alternative apportionment in this case should this Court reverse the Court of Appeals' decision.⁷ Regardless, the issue before this Court is whether the principal amount recovered from these short-term investment transactions is excluded from the standard apportionment formula. *See* Dep't Br. at 22-24. Only if that determination is rendered in favor of Duke Energy's newfound theory do the principles and the pertinent burden of proof of § 12-6-2320 become an issue in this case. The Department contends that it is unnecessary to reach

⁷ Although not asserting it as a basis for its motion for summary judgment, the Department reserved its right to invoke alternative apportionment if the ALC denied its motion for summary judgment. [App'x. at 858 (Summ. J. Reply Mem. at 44)]. The Department has continued to reserve its right to invoke alternative apportionment under § 12-6-2320 at every stage of this administrative litigation. *See* Dep't Br. at 24, n.23; [App'x. at 8336 (Brief of Resp. (Ct. App.) at 32 n.29)].

§ 12-6-2320 in this case because the only reasonable interpretation of the standard apportionment statute excludes the recovered principal from Duke Energy's short-term investment transactions from the standard apportionment formula. *Id.*

Finally, the *Amicus* hyperbolically characterizes the Department's admitted long-standing policy as "secret" and undocumented. *Amicus* Br. at 27-28. But the long-standing policy certainly was not secret because Duke Energy's own consultant recognized that it existed and required the exclusion of recovered investment principal from the apportionment formula.⁸ And, as recognized by the ALC, the Department has repeatedly pointed to its long-standing administrative policy on this issue. [App'x. at 200-06 (Dep't Mot. Summ. J. at 33-39), 303-04 (S.C. Tax Comm'n Decision I-D-309 (June 30, 1982) (deciding that sales of intangible property are included in the sales

⁸ This memorandum, on Price Waterhouse Coopers letterhead and produced in discovery by Duke Energy, provides in pertinent part:

Moreover, for taxpayers employing this standard three-factor, double-weighted sales apportionment formula, the South Carolina Department of Revenue has held that sales of tangible and intangible business connected property should be included to the extent that the sales results in a gain ("net gain"). S.C. Comm. Decision I-D-309 (S.C. Dept. of Rev., June 30, 1982).

...

The Department's final argument focuses on Commission Decision I-D-309, which is discussed in more detail above. That Decision, in brief, held that sales of tangible and intangible business property are included in the sales ratio only to the extent that the sale results in a gain to the taxpayer. *Although this has long been the administrative position of the Department, it was not confirmed until the [1982] decision in I-D-309.*

[App'x. at 3097, 3099 (emphasis added).]

factor only to the extent the sale resulted in a gain)); App'x at 306-07 (S.C. Tax Comm'n Decision 88-11 (Jan. 22, 1988) (deciding that it has been the policy of the Department since 1977 to include only the gain from the sale of foreign exchange contracts in the sales factor)).] Moreover, as the ALC specifically found, Duke Energy never disputed the existence of the Department's long-standing policy and it has not challenged on appeal the ALC's finding that the Department had a long-standing administrative policy.⁹ [See App'x. at 87 (Summ. J. Recons. Order at 3 ([T]he Department asserts that it has had a longstanding interpretation that principal was not included [in the apportionment formula], *an assertion that Duke Energy does not dispute.*) (emphasis added).] Because it is consistent with the plain language and purpose of the apportionment statutes—and has been expressly recognized and ratified by the General Assembly through the enactment of § 12-6-2295—the Department's interpretation is entitled to deference. Dep't Br. at 25-27 (citing *Kiawah Dev. Partners, II v. S.C. Dep't of Health & Env'tl. Control*, 411 S.C. 16, 766 S.E.2d 707 (2014)).

⁹ In fact, Duke Energy erroneously argued to the ALC not that the Department did not have a long-standing administrative policy but that the Department had "abandoned" its long-standing policy for purposes of this case, an argument the ALC flatly rejected. [See App'x. at 87 (Summ. J. Recons. Order at 3 n.2 ("The Court finds no such abandonment by the Department — indeed, quite the opposite."))]

Conclusion


For the reasons explained above and in the Department's brief to this Court, the decision of the Court of Appeals should be affirmed.

Respectfully submitted,

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This is to certify that I, an Administrative Assistant with the law firm Willoughby & Hoefler, P.A., have caused to be served this day one (1) copy of the **South Carolina Department of Revenue's Response to the South Carolina Manufacturers Alliance's Amicus Curiae Brief** by placing the same in the care and custody of the U.S. Postal Service addressed as follows:

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