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SC Court of Appeals

THE STATE OF SOUTH CAROLINA
In The Court of Appeals

APPEAL FROM ADMINISTRATIVE LAW COURT

Ralph King Anderson, III, Administrative Law Judge

Case No. 09-ALJ-17-0204-CC

Appellate Case No. 2012-208608

Rent-A-Center West, Inc., ... Appellant,

v.

South Carolina Department of Revenue Respondent.

**RECORD ON APPEAL
VOLUME II**

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**RECORD ON APPEAL
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Transcript of the Testimony of
RAC V. SCDOR - DAY TWO

Date: August 11, 2011

CREEL COURT REPORTING, INC.
Condensed Transcript and Word Index

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STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

1 Rent-A-Center West, Inc.,) Docket No.:
2) 09-ALJ-17-0204-CC
3 Petitioner,)
4)
5 v.)
6 South Carolina Department of)
7 Revenue,)
8 Respondent.)
9 Rent-A-Center Texas, L.P.,) Docket No.:
10) 09-ALJ-17-0206-CC
11 Petitioner,)
12 v.)
13 South Carolina Department of)
14 Revenue,)
15 Respondent.)

DAY TWO OF TWO

ADMINISTRATIVE HEARING

Thursday, August 11, 2011
9:00 a.m. - 5:11 p.m.

The hearing before the Honorable Ralph K.
Anderson, III, was taken at the Edgar A. Brown
Building, 1205 Pendleton Street, Suite 224, Columbia,
South Carolina, on the 11th day of August, 2011
before Andrea R. Taylor, Court Reporter and Notary
Public in and for the State of South Carolina.

EXHIBITS

1
2
3 Respondent's Exhibit Number One. 274
4 (SC Revenue Ruling #08-1)
5 Respondent's Exhibit Number Two. 274
6 (Designing a Combined Reporting Regime for a
7 State Corporate Income Tax: A Case Study
8 of Louisiana)
9
10 (The original exhibits were retained by the Court.)
11
12

STIPULATIONS

15 It is stipulated and agreed that this hearing
16 is being taken pursuant to the rules of the
17 Administrative Law Judge Division and the South
18 Carolina Rules of Civil Procedure.

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1 THE COURT: Good morning to all.
2 MR. VON LEHE: I wonder, as my usual situation,
3 could we have just a couple of minutes?
4 THE COURT: Yes.
5 MR. VON LEHE: Thank you very much.
6 THE COURT: Do y'all need me to step out?
7 MR. VON LEHE: No, no, Thank you, Your Honor. But,
8 you know, one question that will impact Mr.
9 Pomp's testimony will be whether or not his
10 report can be submitted and the question of
11 whether or not it pertains to tax policy or
12 interpretations of law. Of course, that
13 objection, you're aware of, has been made.
14 THE COURT: I think I would put it a little
15 different but - are you familiar with Vortex
16 Sports and Entertainment vs. Ware?
17 MR. VON LEHE: Your Honor, I have a feeling that I
18 should be, but to tell you the truth, I'm not.
19 THE COURT: Okay. 378 South Carolina 197. if you
20 want to look it up.
21 MR. VON LEHE: I do indeed.
22 THE COURT: 2008.
23 MR. VON LEHE: Vortex?
24 THE COURT: Vortex. I think I'm right on that.
25 Check me.

1 (Pages 1 to 4)

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1 MR. VON LEHE: 2008?
 2 THE COURT: Uh-huh (affirmative response). The
 3 bottom line is under Rule 702, Professor Pomp
 4 can testify as an expert involving issues of
 5 law that relate to the determination of fact.
 6 Rule 702 says if his testimony will assist the
 7 trier of fact to determine - to understand the
 8 evidence and determine the fact at issue. So
 9 it's got to either help me understand the
 10 evidence or determine a fact at issue. So
 11 either one of those, we're just going to be
 12 leading down the path. Am I right? Okay.
 13 Good. I was right on the cite. Occasionally
 14 every dog has his day. Do y'all want to see
 15 it?
 16 MR. VON LEHE: Your Honor, as you will recall, one
 17 of the things that we were going to do was that
 18 counsel was going to indicate that which he
 19 wanted redacted in the report.
 20 THE COURT: Yeah.
 21 MR. VON LEHE: He's done that, but we don't believe
 22 we can resolve that issue right now. We would
 23 prefer to have it resolved once Professor Pomp
 24 is on the witness stand answering questions.
 25 We can certainly submit to the Court that which

1 Q: Professor, please state your full name and your
 2 address.
 3 A: Richard D. Pomp, 65 Elizabeth Street, Hartford,
 4 Connecticut.
 5 Q: And where are you currently employed?
 6 A: I am the Alva, A-L-V-A, P. Loiselle L-O-I-S-E-
 7 L-L-E, Professor of Law at the University of
 8 Connecticut and an adjunct professor of law in
 9 the NYU LLM program of taxation.
 10 MR. VON LEHE: Your Honor, Professor Pomp's CV is in
 11 the trial exhibit book. I won't go over
 12 everything in it because we want to finish this
 13 case today, for one reason. But I would like
 14 to ask him to, first of all, we want to qualify
 15 him as an expert and we will ask the Court
 16 after he's presented the information upon which
 17 the Court can make that judgment, but we want
 18 to qualify him as an expert on tax policy
 19 associated with multi-state taxation.
 20 MR. RYAN: No objection to that, Your Honor.
 21 THE COURT: He's so qualified.
 22 MR. VON LEHE: Thank you, Your Honor.
 23 Q: Professor Pomp, you have been qualified as an
 24 expert. I would like, however, if you would
 25 give a very thumbnail sketch for the Court's

Page 6

Page 8

1 counsel has indicated he would like to have
 2 redacted because we have that in front of us.
 3 MR. RYAN: I'm okay with him doing it while he's on
 4 the stand, Your Honor. That's fine.
 5 THE COURT: Okay.
 6 MR. VON LEHE: So what we'll do is we submit the
 7 report with the redaction and -
 8 MS. GEER: Well, I don't think - I think what we
 9 want to do is see what's objectionable on the
 10 stand and then we can redact the report
 11 afterwards.
 12 MR. VON LEHE: With your permission, Your Honor,
 13 that's the way we'll handle it.
 14 THE COURT: Okay.
 15 MR. VON LEHE: I'll agree with learned -
 16 THE COURT: Learned counsel advising other learned
 17 counsel.
 18 MR. VON LEHE: It's not the first and I hope it
 19 won't be the last. Your Honor, we would
 20 definitely like to call Professor Rick Pomp to
 21 the stand.
 22 THE COURT: All right.
 23 PROFESSOR RICHARD D. POMP, having been duly sworn,
 24 testifies as follows:
 25 PROFESSOR POMP - DIRECT EXAMINATION BY MR. VON LEHE:

1 benefit of those things which relate, those
 2 things in your resume which relate to what
 3 you've been asked to give opinions on today.
 4 A: I guess, in part, the consultancies to
 5 various states like Alaska, California,
 6 Connecticut, Delaware, Illinois, Kansas,
 7 Louisiana, Montana, New Jersey, New York, North
 8 Dakota, South Carolina, not South Carolina,
 9 Tennessee, Texas, Utah and so forth. Those
 10 were on issues of tax policy. I've taught for
 11 nearly 40 years. Everything I teach involves
 12 tax policy. I sit on various advisory boards.
 13 I have a case book just entering its seventh
 14 edition now that's used in about 90 schools and
 15 accounting firms and tax administrations. I've
 16 been admitted as an expert on tax policy in
 17 about half the states in the country.
 18 Q: Now, you've been in this court before,
 19 Administrative Law Court in South Carolina?
 20 A: I have.
 21 Q: All right. And you said a moment ago, I may
 22 have misunderstood what you said, but you
 23 mentioned the states that you had consulted
 24 with, and perhaps that was for different
 25 projects or what have you, but I believe you

2 (Pages 5 to 8)

Page 9	Page 11
1 said not South Carolina. But in fact, what 2 about South Carolina, the state of South 3 Carolina Department of Revenue? 4 A: Yeah, I was thinking of the legislature, but I 5 have served as an expert witness for the Tax 6 Department of South Carolina on, I think, at 7 least two different occasions. 8 Q: All right. What about taxpayers in South 9 Carolina? 10 A: And I have appeared on at least, maybe three 11 occasion on behalf of taxpayers here in South 12 Carolina. 13 Q: All right. Professor Pomp, you have been 14 qualified, as you've heard, as an expert on tax 15 policy associated with multi-state taxation. I 16 want to ask you some questions. The first 17 question I wanted to ask you about is are you 18 familiar with the term nexus from a tax policy 19 standpoint? And please explain it from a tax 20 policy standpoint to the Court. 21 A: The term nexus refers to connections and 22 relationships. It's really a line drawing 23 problem. Where are we going to draw the line 24 in terms of some taxpayer's relationship to the 25 state so that it will justify the assertion of	1 just like in most states today. That Chinese 2 piece worker, in China, who benefits from sales 3 here in South Carolina, we wouldn't think of 4 allowing South Carolina to tax, even though 5 they are benefitting from the marketplace here. 6 The relationship is too attenuated. It's 7 simply too removed. And so we have this line 8 drawing problem. If I have people in South 9 Carolina, depending on what they're doing, that 10 probably will be nexus. If I own property in 11 South Carolina, that probably, at least 12 tangible or real, that probably will be nexus. 13 MR. RYAN: Objection, Your Honor. He's getting into 14 legal conclusion. 15 MR. VON LEHE: Please confine -- if I may, Your 16 Honor? 17 THE COURT: Yes. 18 MR. VON LEHE: If I may ask the witness, please 19 confine your answers to what should or not be 20 from a tax policy standpoint. 21 A: I was. 22 Q: Maybe I misunderstood. It may have been 23 misunderstood. 24 A: Please. 25 Q: No legal conclusions as to what is or isn't
Page 10	Page 12
1 taxation by the state. And it is a pragmatic 2 concept. It can incorporate notions of 3 economic development. It's sort of an amalgam. 4 But certain things have become clear over time. 5 One is there's a lot of people who benefit from 6 South Carolina who we don't view as having 7 nexus. And for example, suppose I went to 8 University of South Carolina Law School. It's 9 a subsidized law school by the state. Let's 10 suppose I had a scholarship from the state. I 11 graduate and I take a job in Atlanta. South 12 Carolina, on some level, would be perfectly 13 reasonable in wanting to tax me, at least in my 14 early years as a lawyer in Atlanta, on the 15 theory that they invested a lot of time and 16 money in my intellectual capital, and 17 therefore, they ought to get a return on that. 18 And as long as I never entered the state of 19 South Carolina after graduation, was a non- 20 resident, we would reject that. We would say 21 well, that's not sufficient nexus. Even 22 though, on one level, I certainly was the 23 beneficiary of a lot of benefits from South 24 Carolina. Second example, a lot of goods sold 25 in South Carolina I suspect are made in China,	1 At least not for South Carolina. 2 A: Let's just say the taxing state, because these 3 are general principles. In general, as a 4 matter of policy, if an out of state person has 5 people or property in the taxing state, that 6 generally will constitute nexus. But not 7 always. It depends what the people are doing. 8 If they're in the state, the taxing state, and 9 they are there to buy goods produced in the 10 taxing state, there are many states as a matter 11 of economic development that would say okay, we 12 don't want to view that as nexus. And that's 13 probably good sound tax policy. You don't want 14 to discourage economic development. So it 15 really is a line drawing problem, and it is 16 informed by pragmatic considerations, economic 17 development, and then history and tradition. 18 Q: Now, you mentioned this line drawing question 19 of policy and when it is a good idea or not a 20 good idea to draw these lines. Did you discuss 21 the existence of intangibles in these states? 22 Would you do that? 23 A: That intangibles may or may not constitute 24 nexus, depending on the type that they are and 25 what they are being used for. So that's

3 (Pages 9 to 12)

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Page 15

1 another area that could constitute nexus. It
 2 all depends.
 3 Q: But from a tax policy standpoint, is it good
 4 tax policy, perhaps you've already answered
 5 this, but is it good tax policy that there at
 6 least be some activities in a state?
 7 A: Yes. I mean, when you think of our notions of
 8 nexus, there is always some activity taking
 9 place in the taxing state. If I did not come
 10 into a taxing state as a lawyer, let's suppose
 11 I did all of my work back at my office in
 12 Connecticut and I emailed my findings in the
 13 form of an opinion letter to the client located
 14 in the taxing state, and I don't have a website
 15 that advertises my services and I don't solicit
 16 anyone in the taxing state as a potential
 17 client. The clients find me. And I never
 18 enter that taxing state other than sending in
 19 an email attachment, if you want to view that
 20 as entering the state, there's not a state that
 21 I am aware of that would say that creates nexus
 22 because I have done nothing in the taxing
 23 state. Having a customer in the taxing state
 24 is not enough. If it were, every major
 25 corporation in this country would have nexus

1 business, and I provide all my activities in
 2 Connecticut. Under the place of activity or
 3 the place of performance rule, the gross
 4 receipts from providing those services would be
 5 sourced to Connecticut. Under a market
 6 approach, if my client were in the taxing state
 7 and I nonetheless performed all my services in
 8 Connecticut, under a market approach, the gross
 9 receipts of my services would be sourced to
 10 where the client was.
 11 Q: And how is this matter of sourcing, how is it
 12 ordinarily determined?
 13 A: Well, in the first round, one would look at a
 14 statute to see how the legislature resolved it,
 15 and in the second round, one would look to case
 16 law to see how that statute was interpreted.
 17 Q: And when you say statute, are you referring to
 18 an allocation apportionment statute in a taxing
 19 state?
 20 A: It would be whatever the relevant statute was
 21 that dealt with how to source gross receipts
 22 from services.
 23 Q: I want to put up the demonstrative which I hope
 24 that the Court is not getting tired of seeing,
 25 but it's been up before.

Page 14

Page 16

1 with any state in which they sell their goods,
 2 but that certainly has never been any accepted
 3 concept of nexus.
 4 Q: All right, sir. I want to ask you some
 5 questions, sourcing questions and what good tax
 6 policy would recommend or dictate as far as
 7 sourcing income. First of all, what does the
 8 term sourcing gross receipts mean from a tax
 9 policy standpoint?
 10 A: Yes. Sourcing gets used in different context.
 11 So we have to be careful. Sourcing of gross
 12 receipts, we have to ask, well, gross receipts
 13 from what. So if we're talking services, gross
 14 receipts can be sourced either to the place of
 15 activity, the place of performance where those
 16 personal services were provided, or they can be
 17 sourced to the marketplace, or they can be
 18 sourced to the place where a payment was made
 19 from. So you have these two general approaches
 20 to how to source the gross receipts during the
 21 provision of a service.
 22 Q: And can you give an example as to sourcing with
 23 a service business?
 24 A: Yes. Let's suppose that I'm in a business, and
 25 you could take me as an example, the legal

1 MR. VON LEHE: Your Honor, we moved the easel. I
 2 didn't ask your permission, but we moved it so
 3 the witnesses could see it.
 4 Q: Now, Professor Pomp, would you please look at
 5 the demonstrative which I have placed on the
 6 board in front of you. You will see there two
 7 squares. One of them a yellow square, which
 8 indicates that it is the taxing state. And in
 9 that yellow square is an engineering firm.
 10 It's location is in the taxing state. The
 11 other square is out of state — other states or
 12 at least one out of state, and the customer is
 13 located there out of state. And the services
 14 in this particular example are being performed
 15 exclusively by the engineering firm in the
 16 taxing state and the customer is located
 17 exclusively out of state. And the sourcing
 18 alternatives would be, as listed on there, are
 19 place of activity view, where the services are
 20 performed; origin of payment view, where the
 21 customers are located and by the location from
 22 which payments are made. In looking at that
 23 demonstrative, could you apply the place of
 24 activity view and the origin of payment view?
 25 A: The place of activity view, which is where the

4 (Pages 13 to 16)

Page 17

Page 19

1 services are performed, we sourced the gross
 2 receipts from the services to the taxing state.
 3 The yellow one there. Under the origin of
 4 payment theory, the gross receipts would be
 5 sourced to the blue out of state.
 6 Q: And what if there were some activities in both
 7 states?
 8 A: You would source the -- under the place of
 9 activity view, you would determine how much of
 10 the activities took place in each of the
 11 states. One way to do that would be look at
 12 relative payroll. That would be one approach.
 13 Under the payment view, the origin of payment
 14 view, it wouldn't matter because that doesn't
 15 care where the activity were really performed.
 16 Q: I want to show you the corollary of this in
 17 which we switch things around a bit. And in
 18 this one, the taxing state is where the
 19 customer is located. The management of
 20 services are performed out of state. Please
 21 continue your description from a tax policy
 22 standpoint concerning that fact or
 23 circumstance.
 24 A: Well, under the place of activity rule, we
 25 would source the gross receipts to Texas, under

1 pie; and then finally, whether income should be
 2 taxed on a gross or a net basis.
 3 Q: All right, sir. But first, before going into
 4 that. You state that you viewed the agency
 5 determination. And what do you say about the
 6 agency determination?
 7 A: I found six, what I would view as really
 8 fundamental misconceptions in the agency
 9 determination.
 10 Q: Were you present yesterday for the testimony of
 11 Mr. Tollack or Ms. Wolverson and for Mr. Wells?
 12 A: I was.
 13 Q: And was or was not their testimony factually
 14 consistent with what you have identified as
 15 these fundamental errors in the agency
 16 determination?
 17 A: All the testimony I heard is consistent.
 18 Q: Please discuss these referenced errors. What
 19 are they?
 20 A: The first one, Your Honor, is on page 4 where
 21 the agency determination talks about this
 22 income shifting, that 95.5 percent of any
 23 profit is shifted to the taxpayer. And that's
 24 profit of RAC East. And that is based on the
 25 fact that the transfer pricing study says that

Page 18

Page 20

1 your example, the out of state, because that's
 2 where the services were provided under your
 3 hypothetical. It would be the same rule. It's
 4 a principle. It doesn't change whether it's
 5 taxing state or out of state. Principles are
 6 neutral. So the gross receipts would be
 7 sourced to where the services were performed.
 8 Under the origin of payment view, we would now
 9 have a payment coming from the yellow taxing
 10 state, and so that would be viewed as the
 11 source.
 12 Q: All right, sir. Now, I have in my hand a copy
 13 of your opinion, which is Exhibit One, Tab 17.
 14 Now, I want to ask you some questions about
 15 this opinion. You stated that you addressed
 16 four tax policy questions.
 17 A: That is correct.
 18 Q: And what are those tax policy questions?
 19 A: I talk about the policy considerations of
 20 nexus, what income should be apportioned, how
 21 income should be apportioned. So it's what
 22 income should be apportioned. I used the
 23 metaphor that's the size of a pizza pie, how
 24 should that income be apportioned, and I use
 25 the metaphor of using the slice of that pizza

1 RAC Texas receives an amount equal to the net
 2 profit of RAC East in excess of 4.5 percent of
 3 operating expenses. And the first time you
 4 read it, you sort of say well, 95.5 plus 4.5
 5 that equals 100 percent. Sounds right to me.
 6 Until you realize the fallacy in that. And so
 7 I have an example on page 4 that illustrates
 8 the fallacy in that, a nice, just simple
 9 hypothetical to keep the math easy. RAC East
 10 has operating expenses of \$100. So there's the
 11 operating expenses pursuant to however it's
 12 defined in the transfer pricing agreement. And
 13 I assume net profits of five dollars. And now,
 14 let's calculate the fee that RAC Texas would
 15 receive. Well, as we heard yesterday, the
 16 company is guaranteed 4.5 percent of its
 17 operating expenses as its profits. So 4.5
 18 percent times 100 is going to be \$4.50. Texas
 19 gets the difference between the five dollars of
 20 net profit and the -- excuse me, and the \$4.50,
 21 and that turns out to be 50 cents of profits.
 22 And when you express 50 cents as a percentage
 23 of the five dollars, you get 10 percent, not
 24 95.5 percent. That's a -- really a very
 25 different impression one comes away with. It's

5 (Pages 17 to 20)

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1 a far cry from asserting that 95.5 percent of 2 profit is shifted to Texas. It's just not 3 true. 4 Q: So you have pointed that out and discussed that 5 particular issue. Anything else you would -- 6 A: Yes -- 7 Q: -- like to say about that? 8 A: On that one, no. 9 Q: Right. What other issues did you discuss from 10 the agency determination? 11 A: Again, back to page 4, I read where Texas owns 12 a license to a computer system. This point of 13 sale computers. And so I asked to see the 14 license agreement. And it is a license 15 agreement between High Tough and the licensee. 16 It is not a license agreement between RAC Texas 17 and the licensee. So RAC Texas does not own 18 the license to the computer system. From what 19 I could see, RAC Texas has no intangible 20 property that it owns in South Carolina. So I 21 thought that was a pretty serious mis- 22 impression. 23 Q: All right, sir. What's next? The third one. 24 A: There's a third one also on page 4, Your Honor, 25 where the Department asserts that the	1 course, consults with what is the equivalent of 2 an outside law firm here and either gets the 3 green light or the red light. And if that 4 manager gets the green light, then the manager 5 goes ahead and fires the employee. But I 6 didn't see anywhere in the process where Texas 7 was in South Carolina either interviewing 8 people or firing people or anything else. That 9 all those activities of the hiring and the 10 firing, they take place in South Carolina, that 11 employee is on the payroll of East, that it is 12 not an employee of Texas. And so really, the 13 HR Department, which does get involved in the 14 hiring and firing and the whole employment 15 process, which is what you'd expect, performs 16 all of those activities in Texas. 17 Q: What does the agency determination say about 18 the leasing of property in South Carolina? 19 A: And that's over on page 5, Your Honor. The 20 determination says leasing of South Carolina 21 property occurs within South Carolina. Well, 22 not by Texas, however. Texas, again, acts like 23 outside counsel. They have the expertise in 24 drafting rental agreements, leasing agreements 25 and negotiating these agreements. So it's no
Page 22	Page 24
1 activities being taxed occur within South 2 Carolina. And based on my due diligence and 3 interviews and conversations, and again, 4 supported by the testimony yesterday, Texas 5 performs no activities in South Carolina. It 6 has no people; it has no property in South 7 Carolina. All of its management activities 8 that the Department is seeking to tax, the fee 9 that it receives for its management activities 10 occur in Texas. 11 Q: What about employees? 12 A: Well, you heard a lot of testimony yesterday 13 about how the hiring and the firing process 14 works. RAC Texas is essentially the equivalent 15 of outside counsel. That you have a store 16 manager, an issue develops with an employee, 17 unsatisfactory employee and they want to know 18 if they can fire that person. Well, one has to 19 be very careful, especially in this environment 20 about all sorts of claims being alleged for 21 improper firing. So this is part of the 22 function that Texas performs. They have the 23 expertise. They have developed the expertise 24 in their HR Department as part of their running 25 their retail stores. And so the manager, of	1 different than me calling up a law firm that 2 has more expertise than I do in a lease and 3 saying hey, will you review this and sign off 4 on it and see if, you know, it's fair or 5 whatnot? And then in the end, I'm the one who 6 enters into the lease. And that's exactly what 7 occurs here, that RAC Texas may indeed review 8 the lease and may negotiate terms or maybe it 9 has standard leasing terms that are non- 10 negotiable, but in any event, the lease is 11 entered into by RAC East. They are the legal 12 entity that signs the lease. So I thought to 13 view RAC Texas as if it leased real property in 14 South Carolina, again, misunderstood the facts. 15 Q: And what does the agency determination say 16 about advertising? 17 A: The determination describes RAC Texas as 18 conducting advertising for South Carolina 19 stores, and that occurs within South Carolina. 20 But again, based on my due diligence and 21 consistent with yesterday's testimony, RAC 22 Texas' advertising activities occur in Texas, 23 not in South Carolina. So those were the six 24 major misconceptions or errors or mis- 25 impressions that I identified.

6 (Pages 21 to 24)

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1 Q: All right. In your report --
 2 THE COURT: Wait a minute. Yeah, I've only got
 3 five. My law clerk just whispered she's only
 4 got five. My math --
 5 MR. VON LEHE: May I go down my list quickly?
 6 THE COURT: Okay.
 7 MR. VON LEHE: First, and this is my recollection,
 8 counsel, or please let me know. First he
 9 talked about the Management Services Agreement
 10 and how the computation was made.
 11 THE COURT: Income shifting.
 12 MR. VON LEHE: Yes. Secondly, he talked about the
 13 computer software.
 14 THE COURT: License to the computer system.
 15 MR. VON LEHE: Third, he talked about the activities
 16 of RAC Texas.
 17 THE COURT: Yeah.
 18 MR. VON LEHE: Fourth, he talked about employees.
 19 THE COURT: Okay. That's what I missed.
 20 MR. VON LEHE: Facts concerning employees in South
 21 Carolina.
 22 THE COURT: Okay.
 23 MR. VON LEHE: And then fifth was leasing and sixth
 24 was advertising.
 25 THE COURT: All right. Thank you.

1 management fee. Under section 162 of the
 2 Internal Revenue Code, it would be an ordinary
 3 and necessary deduction.
 4 MR. RYAN: Objection, Your Honor, legal conclusion.
 5 MR. VON LEHE: Your Honor, in this regard, even
 6 though he is discussing a provision of the
 7 Internal Revenue Code, he's not commenting on
 8 South Carolina law. In other words, it's a
 9 different set of laws by at least a different
 10 jurisdiction. We've adopted them by reference,
 11 but nevertheless, his statement is -- we will
 12 confine that statement if it makes it more
 13 palatable.
 14 THE COURT: Well, relate it to where is assisting
 15 the trier of fact in understanding the evidence
 16 or determining a fact at issue.
 17 MR. VON LEHE: Your Honor, he will be assisting the
 18 trier of fact by the fact that there is a
 19 constraint on deductions which is provided by
 20 Section 162 of the Internal Revenue Code, that
 21 there may be ordinary and necessary deductions.
 22 The trier of fact, in looking at this deduction
 23 which was taken, this would then assist the
 24 trier of fact in deciding whether or not this
 25 was a reasonably necessary expenditure.

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1 Q: Now, your report, Professor Pomp. You have a
 2 copy. What this case is not about --
 3 A: I do.
 4 Q: From a tax policy standpoint, please tell us
 5 what you mean by that.
 6 A: Well, from a policy perspective, all
 7 intercorporate prices should be at an arms
 8 length basis because RAC East is going to be
 9 taking a deduction and that deduction should be
 10 appropriate. And every tax department has the
 11 power, as it should, to adjust intercorporate
 12 prices if they don't reflect an arms length
 13 standard. There was nothing in the
 14 determination that challenged the amount of the
 15 fee. There is sort of this innuendo that well,
 16 it's 95.5 percent of the profits, which of
 17 course was a wrong statement, but they never
 18 challenged the amount. They just sort of took
 19 -- they cut at it by innuendo. So I don't see
 20 where anyone is challenging the amount and,
 21 again, there is a transfer pricing study that
 22 was done to support that amount. Second, every
 23 taxpayer should be allowed to deduct ordinary
 24 and necessary expenses of generating income.
 25 And RAC East has an expense here for the

1 MR. RYAN: He has no knowledge about these actual
 2 expenses or what they did. He's just giving
 3 his opinion that they're ordinary and
 4 necessary, which is applying the law and
 5 telling you this is how the law should read.
 6 That's a legal conclusion.
 7 MR. VON LEHE: This is theoretical only, Your Honor.
 8 He's not going to testify as to whether this
 9 was accurate or was not accurate. He's just
 10 saying this would be a test that would be
 11 applied.
 12 THE COURT: Ask the question again that started down
 13 this path so I can be clear where to go.
 14 Q: Yes. From a tax policy perspective, this is
 15 the question that I would ask. From a tax
 16 policy perspective, did the South Carolina
 17 Department of Revenue make any effort to
 18 disallow this deduction?
 19 A: They did not.
 20 MR. VON LEHE: That's sufficient, Your Honor, for
 21 our purposes.
 22 THE COURT: Okay.
 23 Q: What does the agency determination say about
 24 taxing RAC Texas --
 25 MR. RYAN: Objection, Your Honor, the document

7 (Pages 25 to 28)

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1 speaks for itself.
 2 MR. VON LEHE: Your Honor, I'm going to ask him to
 3 proceed with his analysis then of the document.
 4 THE COURT: Go ahead.
 5 Q: Would you proceed with your analysis of the
 6 document.
 7 A: And by the document you mean?
 8 Q: I beg your pardon. I mean of the agency
 9 determination.
 10 A: Yes. There's a third thing that was not
 11 challenged by the Department or not offered as
 12 an explanation in support of their assessment.
 13 There is no mention of RAC Texas being related
 14 to RAC East as being determinative or
 15 informative or probative or having any weight
 16 whatsoever. So there's nothing that relies on
 17 the fact that Texas and East are related
 18 parties.
 19 Q: All right. I'm going to ask you to go back now
 20 to what you say are the tax policy issues
 21 involved with this matter. And I'm going to
 22 ask you what you perceive to be important tax
 23 policy considerations in the case. Just begin
 24 by way of reference of Section B of the report.
 25 A: Well, the first issue of critical importance is

1 tax policy perspective.
 2 A: I found them on the website of the Department
 3 under a heading called Policy and Law. That
 4 after the Geoffrey case came down here in South
 5 Carolina in the early '90s, and that was the
 6 case, I will describe it, that was a case in
 7 which a Delaware holding company licensed
 8 trademarks for use by a related entity here in
 9 South Carolina. And they received a royalty
 10 for doing so. And the Supreme Court of South
 11 Carolina held that because there was intangible
 12 property being used in the state, the state
 13 could tax those royalties. And it was a fairly
 14 short opinion, and it gave rise to a lot of
 15 discussion around the country. It may be one
 16 of the most famous opinions in the field of
 17 state taxation. Widely discussed, widely
 18 debated and a whole literature about it. The
 19 Department received many, many inquiries from
 20 taxpayers about what does this decision mean.
 21 And in the preamble to the Revenue Ruling 98-3,
 22 it says, the purpose of this revenue ruling is
 23 to address the common questions that have
 24 arisen concerning the implications of Geoffrey.
 25 Because it is my understanding the Department

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1 whether there is nexus in this case. As I
 2 started off, this is a question of line
 3 drawing. It's about relationships. All states
 4 confront this. Every state has some statute
 5 that talks about doing business. That's sort
 6 of the shorthand for nexus. You are doing
 7 business in this state if, sometimes there's
 8 details that are set forth. Sometimes it is
 9 open ended. But every state has to struggle
 10 with what constitutes nexus. What are the
 11 activities in the state. And so, from a policy
 12 perspective, if there are no activities in the
 13 state, and if there are no people and there's
 14 no property, then from a policy perspective,
 15 one would assume the line is drawn in favor of
 16 there being no nexus.
 17 Q: And do you mention in your report and have you
 18 reviewed two publications of the Department of
 19 Revenue, which are Revenue Ruling 98-3 and
 20 Revenue Ruling 08-1?
 21 A: I have.
 22 Q: And would you discuss them.
 23 A: The -
 24 Q: From a tax policy perspective. These are
 25 policy documents. Please discuss them from a

1 is getting lots of inquiries about what does
 2 the case mean. And so Revenue Ruling 98-3 sets
 3 forth a series of examples that, from a policy
 4 perspective, are attempting to draw a line
 5 between what activities will be viewed as
 6 constituting nexus and which ones won't. And
 7 these are very, very illustrative. They have
 8 become widely known. They answer a lot of
 9 questions. And I'll just draw your attention
 10 to the highlights of them. In each one of
 11 these cases, the out of state person can be
 12 viewed as having property, intangible property
 13 in the state, and in a couple of very telling
 14 examples, the out of state person actually has
 15 people in the state. And in all of these
 16 examples, the tax department has concluded that
 17 nexus will not exist. And if you look at the
 18 first one, a New York best selling author's
 19 books are sold nationwide, including in South
 20 Carolina. Well, there's the use of a copyright
 21 in South Carolina. And if that's all that's
 22 going on, then there will not be nexus. And
 23 this would protect me from having to file a
 24 return on the sale of my casebooks here in
 25 South Carolina. The next two involve, in one

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1 case a basketball player's picture on cereal
2 boxes, t-shirts, television ads that appear
3 here. Those are either copyrighted or
4 trademarked, and so there's intangible property
5 in the state. The next one is a country
6 singer's music being played on South Carolina
7 radio stations. But the ones that are really,
8 I think show you how notions of nexus can also
9 incorporate economic development
10 considerations, if you look at page 8. One,
11 two, three, four, five paragraphs down, here's
12 a North Carolina company sending employees, in
13 this case legal staff and witnesses. You look
14 around the courtroom, legal staff and witnesses
15 to South Carolina to assist its independent
16 legal counsel to -- I guess there's a to
17 missing, to defend a lawsuit. And use of the
18 South Carolina court system does not make the
19 North Carolina company taxable. So clearly
20 benefiting from the legal infrastructure here
21 in South Carolina, but that's not enough. And
22 the next one is also quite telling, Your Honor.
23 Here, there's employees. We don't know how
24 many. Presumably that's irrelevant. And we
25 don't know for how long. Presumably that's

1 should be drawn in favor of nexus when a
2 taxpayer has no activities in the state and
3 does nothing in the state other than just has
4 a customer in the state. So I would think the
5 policy is in conflict between the determination
6 letter and the assessment and the position of
7 the Department as set forth in these two
8 rulings.

9 Q: Would you turn to section C of your report,
10 please, income from within the state.

11 A: Yes.

12 Q: First, I want to ask you a very general
13 question, which is certainly not meant to be an
14 insulting one, but you're familiar with the
15 Uniform Division of Income for Tax Purposes
16 Act?

17 A: I am.

18 Q: And it has an abbreviation?

19 A: Yes. And people in this field, its know as
20 UDITPA, U-D-I-T-P-A.

21 Q: And what has been your association with this
22 Act?

23 A: Well, I have taught the Act for nearly 40 years
24 because it is a uniform act and it has been
25 adopted, either in whole or in part, by almost

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1 irrelevant. To purchase raw materials and
2 inventory. And that is held not to be nexus,
3 create nexus. Because we obviously don't want
4 to discourage people from coming to a state to
5 purchase materials, inventory and use local
6 goods and services. So it is a very important
7 ruling because it gives up a lot of what was
8 won in Geoffrey. It's almost an embarrassment
9 of riches, the Geoffrey case, and the
10 Department, I think quite wisely, has curtailed
11 what otherwise might be viewed as its powers
12 under Geoffrey. And then a few years ago, the
13 Department issued Revenue Ruling 08-1, which
14 repeats a number of the examples above, buy it
15 doesn't really change anything fundamentally,
16 so.

17 Q: But from a tax policy standpoint, from the tax
18 policy enunciated in that ruling, how do these
19 rulings relate to the Department of Revenue's
20 efforts to tax RAC Texas in this case?

21 A: Well, when I stand back and I look at the
22 policy that's embodied here where there's no
23 nexus notwithstanding activities in the state,
24 people and property in the state, it is hard,
25 from a policy perspective, to see why a line

1 every state in the country. So it has helped
2 sort of drive the way, the approach, the
3 taxation of multi-jurisdictional corporations.
4 It has had an enormous impact, even in states
5 that have not formally adopted it.

6 Q: And what does this Act have to do with tax
7 policy?

8 A: Well, this Act, as any model act is going to
9 do, is going to incorporate, at least at the
10 time of its adoption, what people thought good
11 sound tax policy was. And so in principle, it
12 should be emulated, copied and adopted
13 throughout the country. I mean if you have a
14 model act and you want it widely adopted, it
15 ought to incorporate good principles or it's
16 not going to be adopted.

17 Q: And in Exhibit Tab 14, please turn to tab 14 in
18 the exhibit book.

19 A: I have it.

20 Q: Please identify that tab.

21 A: This is the Uniform Division of Income for Tax
22 Purposes Act.

23 Q: Okay. And now does the -- please look at
24 section 17 of the Act.

25 A: Yes.

9 (Pages 33 to 36)

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1 Q: What does that section of the Act relate to?
 2 A: This relates to how to assign the gross
 3 receipts from the provision of sales other than
 4 sales of tangible personal property.
 5 Q: Would that include services?
 6 A: And that would include services. And maybe we
 7 should stand back just one step, the Uniform
 8 Act applies an apportionment formula to the
 9 business income of a corporation. And so we
 10 were talking about how to apportion the
 11 business income of a corporation. And the Act
 12 uses an approach of three factors; property,
 13 payroll and sales. And now we're talking about
 14 the sales factor. The sales factor has a
 15 numerator, sales in the taxing state, and it
 16 has -
 17 THE COURT: You said the Act said what? Used what
 18 three factors?
 19 PROFESSOR POMP: I think the easiest way is maybe to
 20 draw it, Your Honor. The Act applies an
 21 apportionment formula to the business income of
 22 a corporation. So we view this as the pizza,
 23 and now we're going to have a formula for
 24 determining the slice of the pizza that the
 25 taxing state is going to be able to tax. And

1 approach of UDITPA. Section 17 focuses on the
 2 sales formula, the sales factor. So how do we
 3 determine the sales in the taxing state when we
 4 have services being provided? This case is
 5 really, in part, about the numerator. How do
 6 we determine what the gross receipts are?
 7 Because UDITPA defines sales as gross receipts.
 8 How do we define what the gross receipts are in
 9 the taxing state when we have services being
 10 provided? And that's what section 17 answers.
 11 Now -
 12 Q: How does this provision relate to the
 13 activities rule that you described earlier and
 14 the origin rule which you described earlier?
 15 A: Section 17 adopts a form of the activities
 16 rule. Sales, and let me shorthand reading
 17 section 17, the other than sales of tangible
 18 personal property, I'll shorthand that as
 19 services. Sales of services are in the state,
 20 that's the numerator of that fraction, if the
 21 income producing activity is performed in this
 22 state. So if the income producing activity is
 23 performed in this state, then the gross
 24 receipts from that activity, the provision of
 25 the service will be put in the numerator of

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1 that formula, as set forth in UDITPA, consists
 2 of property, payroll and sales. Property,
 3 payroll and sales. Payroll and sales. And it
 4 takes an average of each of these factors. So
 5 it takes the property factor, the payroll
 6 factor and the sales factor, adds them together
 7 and divides by three. And I'll now sort of
 8 explode the sales factor because that's the
 9 only factor relevant in this case. So what
 10 does the sales factor look like? It is sales
 11 in the taxing state in the numerator divided by
 12 sales throughout the US. So we are trying to
 13 get a relative measure of the sales occurring
 14 in the taxing state as a percentage of the
 15 corporation's total sales. So, you know, if
 16 this were, let's say, five percent and this
 17 were - I've got to do it so I can do the math,
 18 this were five percent and this were two
 19 percent, we would do two plus five is seven
 20 plus five is 12, divided by three, that would
 21 give us an apportionment formula of four
 22 percent. We would then multiply the business
 23 income of the corporation times four percent,
 24 and the result would be this slice of the pizza
 25 that South Carolina could tax. That is the

1 that fraction. But if the income producing
 2 activity is performed both in and outside the
 3 state, then we see where a greater proportion
 4 of the income producing activity is performed.
 5 And that is the state whose numerator will get
 6 the gross receipts. But from a broader
 7 perspective, this is looking to where the
 8 activities take place. So this rejects a
 9 market approach, it rejects an origin of the
 10 payment approach, and it adopts a place of
 11 performance or a place of activity approach.
 12 Q: And in making that decision about where the
 13 activities take place, assuming as you said
 14 it's an activities rule, in making that
 15 decision, how does section 17 direct someone to
 16 do that?
 17 A: It looks to cost of performance, which in many
 18 cases the major cost will of course be the
 19 payroll.
 20 Q: And would that - does that relate to a service
 21 business?
 22 A: And section 17 relates to a service business.
 23 It is sale other than tangible personal
 24 property. And that would be services.
 25 Q: And would, and if so how, would payroll relate

10 (Pages 37 to 40)

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1 to a service business?
 2 A: Well, one of the primary costs of providing a
 3 service is the payroll of the persons providing
 4 that service.
 5 Q: How does the Department determination -- in the
 6 Department determination, does it discuss the
 7 activities test?
 8 A: Yes, it does. And it's one of the parts of the
 9 determination that I am in full agreement with.
 10 It states, and I agree with this, that location
 11 where an activity occurs determines what
 12 jurisdiction can assert tax on that activity.
 13 I think that is an entirely proper approach
 14 from any policy perspective.
 15 Q: And what about the application of that rule?
 16 A: Well, the application of that rule to RAC Texas
 17 would conclude that the activities --
 18 MR. RYAN: Calls for a legal conclusion, Your Honor,
 19 applying of the rule.
 20 THE COURT: I sustain that.
 21 MR. VON LEHE: Well, I was going to say, Your Honor,
 22 the question is not meant to ask for a legal
 23 conclusion. It's simply meant to ask where the
 24 activities, if you could take the activities of
 25 RAC Texas, which I think he's already commented

1 factually where should they assign the receipts
 2 --
 3 MR. VON LEHE: Yes.
 4 THE COURT: -- Then that's calling for a factual
 5 determination.
 6 MR. VON LEHE: I believe that --
 7 THE COURT: But it's utilizing a legal principle to
 8 determine that factual determination.
 9 MR. VON LEHE: I think it would help the trier of
 10 fact, Your Honor, which of course is you in the
 11 language you gave me this morning, to
 12 understand the evidence or the fact at issue.
 13 THE COURT: Mr. Ryan?
 14 MR. RYAN: I think Your Honor can read the
 15 determination and understand it quite well on
 16 his own. I don't think he needs to explain
 17 what the determination says. What he's trying
 18 to get him to say is what he thinks should
 19 apply and how it should be applied as a legal
 20 conclusion. It's not guiding you on what the
 21 facts are.
 22 MR. VON LEHE: I'm going to ask again, if you apply
 23 the activities rule as the agency determination
 24 says it does, where would these receipts be
 25 sourced? I'm mentioning nothing about South

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1 on, where would the rule apply, where would the
 2 rule source the receipt. It's not really a
 3 legal conclusion. We haven't even discussed
 4 any South Carolina law yet. I certainly plan
 5 to do that before the day is over. Just what's
 6 in that agency determination, what does it say,
 7 and what does it do?
 8 THE COURT: All right. Any response to that?
 9 MR. RYAN: What the agency determination says, this
 10 document speaks for itself. He was asked to
 11 apply a rule. I believe that's applying -- I
 12 mean, that's a legal conclusion.
 13 MR. VON LEHE: I'm asking him to apply what the
 14 agency determination says it's applying.
 15 THE COURT: Well, both of y'all are saying two
 16 different things. Ask the question again.
 17 Q: My question to Professor Pomp is, based on that
 18 statement in the agency determination, where
 19 should it have assigned the receipts?
 20 MR. RYAN: Objection. That's a legal conclusion.
 21 MR. VON LEHE: Your Honor, again, it's not a legal
 22 conclusion. And if it were, Your Honor, I
 23 would certainly submit that it would --
 24 THE COURT: This is one of those where we're kind of
 25 getting in a gray area, but if you're asking

1 Carolina law. I'm simply asking the question.
 2 It's written in agency determination, it makes
 3 this statement. And based on that statement --
 4 THE COURT: You're getting close, but I overrule the
 5 objection on the last way you asked the
 6 question.
 7 Q: Based on the statement in the agency
 8 determination, where would the activities rule
 9 source these receipts?
 10 A: Texas.
 11 Q: All right. Thank you. You say that for what
 12 reason?
 13 A: That that is where the activities that are
 14 involved in the management, generating the
 15 management fee, occur. All those activities
 16 occur in Texas.
 17 Q: All right. I want to ask you some questions
 18 that are in section D of your report.
 19 Alternative apportionment formula applied by
 20 the Department of Revenue.
 21 A: Yes.
 22 Q: Did you read the audit report?
 23 A: I did.
 24 Q: And did you read the agency determination? I
 25 believe you just said you had.

11 (Pages 41 to 44)

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1 A: I have.
 2 Q: All right. Based on the agency determination
 3 in the audit report, what did the Department of
 4 Revenue do in the case of RAC Texas? What have
 5 they done?
 6 A: They have disregarded the statute and adopted
 7 an alternative methodology. The statute
 8 provides for an alternative methodology, so
 9 they disregarded the apportionment formula.
 10 And the way I would have thought from a policy
 11 perspective when you think of apportionment the
 12 way it should be applied, they disregarded that
 13 and they went to a separate accounting. That
 14 is what it is known in the field as separate
 15 accounting.
 16 Q: All right, sir. That's what the report and
 17 agency determination say they have done; is
 18 that correct?
 19 A: That is correct.
 20 Q: All right. Now, I want to ask you some general
 21 questions. You've already explained it so
 22 perhaps I don't want to go back over what might
 23 be called plowed ground here. But in general,
 24 you've explained how an apportionment formula
 25 works. You just did that. Is that correct?

1 Suppose in this state you have a store and it
 2 is a high volume store. High volume. And
 3 we'll make it break even, just break even.
 4 Same goods are being sold here. Low volume.
 5 High profit. Now, under separate accounting,
 6 a state would simply tax the profits as shown
 7 on the books of that store. And people said
 8 well, wait a minute, doesn't this store do
 9 something to contribute to those profits? Why
 10 don't you just shut down the store if it is at
 11 a breakeven point? Well, they don't shut down
 12 the breakeven store. Why not? Because that
 13 high volume allows the corporation to buy its
 14 inventory cheaper than otherwise. So this high
 15 volume is actually contributing to the profits
 16 of this store by lowering its inventory costs.
 17 And so early on people realized, you know what,
 18 were you have this kind of interdependency,
 19 this kind of spillover and flows of value, you
 20 can't really just view in isolation what's
 21 going on in this state. You have to take into
 22 account the entire profits of the business, and
 23 then somehow using a formula, figure out what
 24 should be taxed by this state. And whole
 25 series of problems with separate accounting

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1 A: Correct.
 2 Q: And I want you to give us a general -- a
 3 general description of a unitary business and
 4 apportionment methods.
 5 A: We could certainly start kind of historically,
 6 how did this all happen, Your Honor, and turn
 7 the clock back to the early part of the 20th
 8 century and you have the rise of multi-
 9 jurisdictional corporations and immediately a
 10 state had to figure out what are we going to do
 11 about it. We want to be able to tax them.
 12 They're in our state, and so what should the
 13 rules be. So we'll just take two states to
 14 keep it simple. You have a corporation doing
 15 activities in one state, activities in a second
 16 state, and what do we do about it? And one of
 17 the first methods used, one of the oldest is
 18 known as separate accounting. All right. You
 19 know what, we ought to just look at what's
 20 going on in our state, put a little black box
 21 around it and try to get a feel on what its
 22 profits are. Sounds sensible. And then a
 23 number of problems develop which led to the
 24 rejection of separate accounting quite early
 25 on. And I'll give sort of the classic example.

1 doesn't capture. Suppose this store is having
 2 some kind of problem and doesn't know how to
 3 solve it and they call up the manager in this
 4 other state and they say, you ever had this
 5 problem, and the manager says oh, yeah, you're
 6 having that problem. We had that problem. It
 7 took us eight months to solve it. Really?
 8 What did you do? Here's what you do. And in
 9 that ten minute phone call, this store solves
 10 a problem that otherwise would have caused lost
 11 profits perhaps as they spent eight months
 12 trying to reinvent the wheel. It's that kind
 13 of flow of value that separate accounting
 14 doesn't capture. And so you have these
 15 theoretical problems with separate accounting.
 16 Then you had the business community actually in
 17 opposition because they don't keep their books
 18 on a separate accounting basis. And in many
 19 cases, it's impossible to do it. And so
 20 separate accounting really fell by the wayside.
 21 It is still available as a alternative, but is
 22 certainly not the alternative of choice.
 23 THE COURT: So, from an economic standpoint, separate
 24 accounting doesn't take in the benefits of
 25 economy of scale?

12 (Pages 45 to 48)

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1 PROFESSOR POMP: Exactly right. One of many
2 benefits that it does not take into account.
3 A: So if we view the business as the pizza,
4 formulary apportionment tries to determine the
5 slice of the pizza. Separate accounting comes
6 along and says okay, no, just give us the
7 pepperoni. We just want to tax the pepperoni.
8 We don't want to know from the rest of the
9 pizza, the cheese, the tomatoes, the crust,
10 anything else. We're just coming in there,
11 give us the high profit item and we don't want
12 to be bothered in looking at the entire pizza.
13 That's what separate accounting does, and of
14 course, it overlooks a lot of things in the
15 modern economy especially where you have all
16 these spillovers and interdependencies. So it
17 is not viewed as being appropriate where you
18 have a unitary business. And essentially, I
19 view Texas as a unitary business, that the
20 component parts are too closely connected and
21 necessary to each other to merit any kind of
22 division. That these are management services
23 that support the retail operation. They are an
24 organic part of running the retail stores And
25 you can't sort of separate the two into two

1 entire Rent-A-Center, Inc. sales force. Rent-
2 A-Center, Inc. operates stores in all 50 states
3 and the District of Columbia. The fact that
4 the taxpayers' stores in Texas account for 10
5 percent of the sales force in all states
6 demonstrates the enormity of the gross receipts
7 from the Texas stores." But that's exactly the
8 way formulary apportionment works. If there
9 are, let's suppose this business expands in
10 Texas. Two things are going to happen
11 simultaneously, Your Honor, assuming those
12 stores are profitable, the pizza pie increases
13 in size because you're going to have more
14 profits now. Simultaneously with that, the
15 taxing state's slice is going to get smaller
16 Because the gross receipts in the denominator,
17 which are gross receipts from everywhere, are
18 going to get larger. The gross receipts in the
19 taxing state won't change because the company
20 has expanded outside the state. So, again,
21 maybe - I'm going to draw this, but let me
22 start off with a business and a slice, and now
23 the definition of that slice would be the gross
24 receipts - the gross receipts in the taxing
25 state divided by gross receipts over the US.

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1 independent discrete businesses. They are
2 linked together. They are component parts. It
3 is almost a quintessential unitary business.
4 And therefore, in my mind, from a policy
5 perspective, if you were to say well, how
6 should be taxing a unitary business, the answer
7 is with an apportionment formula. Now, you can
8 pick and choose what apportionment formula you
9 want. The states have different approaches,
10 but you don't reject formulary apportionment
11 because you don't like the results of it.
12 Sometimes a state gains from formulary
13 apportionment, sometimes it doesn't. But it's
14 a principle position. And you don't change
15 principles just because you don't like the
16 result in a particular case.
17 Q: What is your understanding of why the
18 Department of Revenue has refused to apply the
19 apportionment formula to RAC Texas? Why did
20 they choose an alternative, according to what
21 you've read?
22 A: Well, they have a list of reasons. One is
23 found on - I quote on page 14 of my report,
24 Your Honor. "That the retail stores operated
25 by the taxpayer account for ten percent of the

1 The business expands out here outside the
2 taxing state. And the stores are profitable.
3 Well, we now have a bigger pizza pie because
4 that's the profits of the business. Well, the
5 profits of the business have increased. The
6 slice, gross receipts in the taxing state won't
7 have changed because they expanded outside.
8 The denominator will get larger. The slice
9 will get smaller. Whether this means more
10 income gets apportioned or less income is an
11 empirical question. We can't talk about that
12 in theory. We don't know. Both happen
13 simultaneously, bigger pizza, smaller slice.
14 But that's the way apportionment is supposed to
15 work. That's not a defect. That's not
16 anything unusual, out of the ordinary. That is
17 exactly the apportionment theory applied to a
18 unitary business. So when I read that, I said
19 wow, that's sort of disregards the way
20 apportionment is supposed to be working. And
21 the determination says well, that will dilute
22 the gross receipts received from South Carolina
23 and misrepresent Texas' actual economic
24 activity in the state. And I would say no,
25 it's capturing under apportionment theory

13 (Pages 49 to 52)

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1 exactly South Carolina's slice. You may not
2 like it, but that's the whole theory of
3 apportionment. You know, you may win in some
4 cases, you may lose in others.

5 Q: Professor, you mentioned the result of
6 including the gross receipts from those stores
7 in the denominator of the apportionment
8 formula. Did you also mention the result from
9 excluding the receipts from those stores?

10 A: That if you exclude the result of the gross
11 receipts from the stores, you are violating one
12 of the tenets of apportionment. Now,
13 apportionment takes into account all of the
14 gross receipts. And by the way, it would be
15 not only the stores, but the management fee.
16 I mean it's the entire gross receipts of the
17 unitary business.

18 Q: All right. His Honor asked you a moment ago a
19 question about separate accounting and I think
20 it was -- or what you alleged to be the
21 weakness of separate accounting in this case.
22 Please comment on that. Are there other things
23 which separate accounting does or does not
24 capture?

25 A: Well, it certainly doesn't capture any of the

1 and you see whether it is successful as you
2 expand, as you try it in different situations.

3 Q: All right. I'm going to ask you a question
4 related to the method the Department of Revenue
5 has used. First of all, please say again how
6 the Department of Revenue derived the amount of
7 management fees that it decided to tax.

8 A: Well, this is another problem in what the
9 Department did. The Department wants to tax
10 only the management fees from the stores in
11 South Carolina. There is RAC East. It owns
12 stores both in South Carolina and elsewhere.
13 And it wants to tax only the management fee
14 paid by the stores, or attributable to the
15 stores. The problem is that the management fee
16 is based on operating expenses and profits.
17 And that information is not readily available.
18 And so what they did was they said okay, well,
19 as a shorthand, let's take the total management
20 fee paid by RAC East, so the total management
21 fee. And we will multiply that times the South
22 Carolina sales factor. They had that from the
23 return filed by RAC East. RAC East filed a
24 return and is a taxpayer.

25 Q: And what is the South Carolina sales factor?

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1 synergies. It doesn't capture the fact that
2 the management fee can't be viewed in isolation
3 because that management fee is so linked to the
4 retail stores that one can't be carved out from
5 the other in any meaningful sense.

6 Q: And how do you see this management fee as being
7 linked to the retail stores in RAC Texas?

8 A: These are the management services that support
9 the retail operation. They consist of skills
10 like how to negotiate a lease; what are the
11 good demographics for siting a store? How do
12 we price our goods? You know, what is the
13 market, what can the market bear? It's all of
14 that information and knowledge, where have you
15 acquired that from? From the retail stores.
16 We heard yesterday's testimony, Texas is
17 somewhat of a test market. We're going to
18 learn from what works in Texas and see if we
19 can take it to other states. So it's sort of
20 a feedback loop. You're learning from the
21 stores. You're applying that. You see if it
22 works, doesn't work. You apply it again. The
23 two are just linked. Your experience in the
24 stores are what gives you the expertise, the
25 insight, the know-how, and then you apply that

1 What do you mean by that?

2 A: And that is South Carolina gross receipts over
3 US gross receipts.

4 Q: You're talking about rentals in the store; is
5 that what that is?

6 A: Rentals in the stores, sales in the stores.
7 Those would be your two major components of
8 gross receipts with rentals being greater than
9 the sales. So they took the total management
10 fee paid by RAC East, because it is RAC East
11 that pays the management fee. That's the
12 corporate entity that pays the fee. And they
13 had to get from that fee down to the store
14 level and they shorthanded it. They said okay,
15 we'll use the sales at the stores in the
16 numerator, we'll take the entire gross receipts
17 of RAC East, its stores there, and we'll apply
18 that fraction to the total management fee. And
19 the problem with that is the fee, the
20 management fee is not paid on the basis of
21 gross receipts. So you're using gross receipts
22 to come up with a fee which has nothing to do
23 with how that fee is paid. So it's a shorthand
24 that really doesn't capture what it is you want
25 to capture, because as we hears yesterday, the

14 (Pages 53 to 56)

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1 profits of the stores vary and you can't use
 2 sales as a proxy for profits.
 3 Q: And what are they trying to capture? What are
 4 they trying to capture?
 5 A: They are trying to capture the management fee
 6 paid by South Carolina stores on the theory
 7 that that management fee was attributable to
 8 activities performed in Texas, which of course,
 9 I don't see either. So you sort of start off
 10 with okay, you're here in South Carolina and
 11 therefore we can tax you. We're going to apply
 12 separate accounting, and then we're going to
 13 have this yet another defective way about going
 14 about it, some approximation for the management
 15 fee. And then of course it is being taxed on
 16 a gross basis. It is the gross management fee.
 17 No offsetting deductions attributable to the
 18 generation of that management fee.
 19 Q: You had said, I believe a few minutes ago, that
 20 you don't believe these businesses ought to be
 21 separated. That you shouldn't separate
 22 management fees from store operations.
 23 A: That is correct.
 24 Q: Now, but for a moment, let's assume that you
 25 can just for a moment. Just assume that you

1 attributable to stores in South Carolina.
 2 That's the first problem. And the second
 3 problem is it is taxing on a gross basis. And
 4 we are talking about a corporate income tax
 5 here. And the essence of an income tax, unlike
 6 the sales tax, for example, or gross receipts
 7 tax is that you're looking for profit. You're
 8 looking for your revenue less your costs. And
 9 there's always, or typically costs associated
 10 with generating revenue. And that's why every
 11 income tax gives a deduction for the cost of
 12 doing business. If you did not, you would not
 13 have an income tax. And this -- well, what was
 14 done anyway does not allow for any kind of
 15 deduction of expenses of generating the
 16 management fee.
 17 Q: So I understand what you're saying, the fact
 18 that this is a gross receipts --
 19 MR. RYAN: Objection, Your Honor. He's leading.
 20 MR. VON LEHE: I just want to get a confirmation,
 21 Your Honor, as to what the witness is saying.
 22 THE COURT: You were leading. I sustain that.
 23 Q: Please tell the Court what you see as the
 24 problem with the gross receipts nature of this
 25 tax, if you see one.

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1 can, we can separate that management fee out
 2 from the RAC Texas stores. Make that
 3 assumption, please. Now, even under that
 4 assumption from a tax policy standpoint, how do
 5 you evaluate this effort of taxation? This so
 6 called separate accounting.
 7 A: Well, because of this problem, it's not even a
 8 rigorous application of separate accounting.
 9 And then you have the problem with the
 10 expenses.
 11 Q: Is there any way from a tax policy standpoint
 12 that you can think of in which this will
 13 accurately support a tax against RAC Texas?
 14 THE COURT: What is this?
 15 Q: This method the Department of Revenue used.
 16 A: If RAC Texas is a unitary business, as I
 17 believe it is, then there's no way taking the
 18 pepperoni can accurately reflect its activities
 19 in South Carolina.
 20 Q: Assume it's not a unitary business for a moment
 21 and assume that we could tax this management
 22 fee separately by this method that's been used.
 23 A: Well, I -- I have a serious problem with it.
 24 Two serious problems with it. One is that it
 25 doesn't measure the real management fee

1 A: The problem with taxing gross receipts under an
 2 income tax is you no longer have an income tax.
 3 Because the essence of an income tax is profit,
 4 and in measuring profit, you are entitled to
 5 reduce your revenue by the cost of generating
 6 that revenue. And if you ignore the cost of
 7 generating revenue, you no longer have an
 8 income tax. You have some other animal,
 9 whether it's a sales tax or gross receipts tax.
 10 But you don't have an income tax.
 11 Q: From a tax policy perspective, if there is a
 12 difficulty, if there is a difficulty, what is
 13 the difficulty in pulling expenses out of a
 14 unitary business to match up against some
 15 income stream?
 16 A: Well, the difficulty is when a business is
 17 unitary, it makes no sense to talk about what
 18 are the expenses that may have generated the
 19 components of that unitary business. For all
 20 the reasons why we view the unitary business as
 21 this organic whole and we take its revenues as
 22 the unitary business and we subtract the
 23 expenses of the unitary business, and then we
 24 come up with a net income which is the amount
 25 we then apportion, there is no attempt made in

15 (Pages 57 to 60)

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1 a unitary business apportionment system to
 2 segregate out expenses that might be
 3 attributable to one component of income versus
 4 another. That if you are taxing the unitary
 5 business income, you are giving a deduction for
 6 all of the expenses of generating that unitary
 7 business income.
 8 Q: In your report, Professor, you mentioned a
 9 couple of examples. I believe your report
 10 mentions salaries. I think you also mentioned
 11 inventory purchasing.
 12 A: Yes.
 13 Q: Can you comment on those?
 14 A: Yes. I mean -- and you heard some testimony
 15 yesterday. When the person sitting there in
 16 Texas negotiates some kind of deal for
 17 purchasing inventory cheaply, that cheap
 18 inventory is going to benefit all of the
 19 stores. And there is no way as a theoretical
 20 matter that you can assign the -- let's say the
 21 time spent on that phone. There are ways cost
 22 accountants could do it presumably. But there
 23 is no way consistent with unitary theory.
 24 Unitary theory doesn't even ask you to do it.
 25 That when that person hangs up the phone after

1 separate accounting or with any other kind of
 2 accounting evidence. You have the right to do
 3 it, but the courts have set a very high bar.
 4 Q: All right. Now, I want to turn your attention
 5 to RAC West. You wrote a report about RAC
 6 West, I believe, did you not?
 7 A: I did. What tab is that?
 8 Q: Sixteen.
 9 A: Okay. All right.
 10 Q: Again, whatever you say about this report,
 11 Professor, try to confine your comments to tax
 12 policy rather than any legal conclusions. I
 13 wanted to ask you about RAC West. What were
 14 you asked to do concerning RAC West?
 15 A: On page 3, under question asked, I was asked to
 16 opine from a tax policy perspective about the
 17 appropriateness of the Department's actions in
 18 disregarding the statutory formula
 19 apportionment and substituting separate
 20 accounting.
 21 Q: And please tell us what you understand about
 22 RAC West's structure and operations, both
 23 within and without South Carolina.
 24 A: RAC West operates retail stores and RAC West
 25 owns intellectual property which it licenses.

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1 two hours, they have generated the management
 2 fee and they have generated cheaper inventory
 3 at the retail stores. They have helped
 4 generate unitary income of the unitary
 5 business, and their salary, the time they spent
 6 on the phone is going to be a deduction against
 7 unitary income. And we don't ask under an
 8 apportionment unitary business system how much
 9 of their time is associated to the management
 10 fee, how much is associated to the retail
 11 stores. That's one of the beauties of the
 12 unitary business. You don't have to answer
 13 these unanswerable questions. All you care
 14 about is what were the expenses that generated
 15 the income that's going to be apportioned.
 16 Q: You mentioned cost accounting a moment ago.
 17 Would you talk a little more about that.
 18 A: You know, costs accountants have all sorts of
 19 ways of assigning costs for all different
 20 purposes. But early on, the courts recognized
 21 that just because you have an accounting
 22 methodology doesn't mean it is useful for
 23 apportioning income. And it is very difficult
 24 for a taxpayer to impeach an
 25 apportionment/unitary business system with

1 Q: And what do you understand to be the issue in
 2 this case?
 3 A: Well, RAC West does have nexus with South
 4 Carolina because, under the Geoffrey case, it
 5 has its trademarks being used in South Carolina
 6 by RAC East. It does receive a royalty based
 7 on the use of those trademarks. And so under
 8 Geoffrey it has nexus and it files a return.
 9 The question is, what is the proper way to
 10 apportion the income of RAC West. I view RAC
 11 West as a unitary business for the reasons
 12 outlined in my report. There is this synergy
 13 between the value of the intellectual property
 14 and the profitability of the stores that if the
 15 stores do well, the intellectual property
 16 becomes more valuable, and if the stores are
 17 dogs, then the intellectual property becomes
 18 less valuable. You have this inextricable link
 19 between the two. And that is, of course, one
 20 of the dominant characteristics of a unitary
 21 business. And so once I view this as a unitary
 22 business, then the proper way of taxing it,
 23 from a policy perspective, would be take the
 24 pizza pie that represents the profits of West
 25 and determine the taxing state's slice of that

16 (Pages 61 to 64)

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1 pizza pay.
 2 Q: So did you hear Ms. Wolverton yesterday; did
 3 you hear her testimony?
 4 A: I did.
 5 Q: Do you recall her saying anything about the
 6 relationship between the intellectual property
 7 owned by RAC West and the operation of the
 8 stores?
 9 A: I did. She was making exactly a case for it
 10 being unitary, and appropriately so. I think
 11 everything that she said indicates why RAC
 12 West, from a policy perspective, is a unitary
 13 business.
 14 Q: Did she say anything about the contribution of
 15 the intellectual property to the store
 16 operations?
 17 A: Yes, that the more valuable the intellectual
 18 property, the greater, all other things being
 19 equal, would be the profit at the stores. If
 20 you have a good trademark that has goodwill
 21 associated with it, it's better than a bad
 22 trademark. That opening a store known as Rent-
 23 A-Center is going to be more valuable than if
 24 I opened a store known as Rick's Rentals. And
 25 the better the RAC stores do, the more valuable

1 from, in this case, South Carolina. We'll put
 2 that in the numerator, and the denominator will
 3 be the gross receipts from all sources
 4 throughout the US.
 5 Q: And that's what the taxpayer did on the amended
 6 return?
 7 A: Correct.
 8 Q: And what did the Department of Revenue do in
 9 response?
 10 A: And the Department of Revenue, again applying
 11 separate accounting, said no, we're going to
 12 tax only the pepperoni. And the pepperoni in
 13 this case is the royalties. So we're not going
 14 to view you as a unitary business. We are
 15 going to apply the separate accounting and just
 16 sort of cherry pick, to mix the metaphors, and
 17 tax the pepperoni. And again, done on a gross
 18 basis.
 19 Q: And from a tax policy perspective, what are
 20 your observations about that effort?
 21 A: Well, if RAC West is indeed a unitary business,
 22 as I think it is, then the proper approach
 23 would be to apply the apportionment formula to
 24 the size of the entire pizza pie, which would
 25 be the net income of RAC West.

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1 the trademark is going to be and the more
 2 people are going to be willing to pay you for
 3 that trademark. Now, of course, we see that
 4 all the time with the McDonald's trademarks and
 5 all the other high visibility, high value
 6 trademarks.
 7 Q: What did the Department of Revenue do - first
 8 of all, how did the taxpayer file its returns,
 9 and secondly, what did the Department of
 10 Revenue do in response to that?
 11 A: Well, they filed an amended return using the
 12 single factor gross receipts formula, and they
 13 applied that to the entire operation of RAC
 14 West. So we can call this pizza RAC West. And
 15 they calculated the South Carolina slice of the
 16 pizza using the single factor gross receipts
 17 formula.
 18 Q: So they began with the net income of the
 19 entity?
 20 A: That is correct. So they added sort of on the
 21 first line the gross receipts that they
 22 received from their royalties and the rentals
 23 at their stores and the sales at their stores.
 24 That determines the size of the pizza. And they
 25 then said okay, what are the gross receipts

1 Q: What expenditures did the Department of Revenue
 2 allow against the royalty income?
 3 A: It did not allow any expenditures against the
 4 royalty income.
 5 Q: And what is the result of this?
 6 A: Well, the result, again, is to move from a net
 7 income tax to something other than that, a
 8 gross receipts tax, for example.
 9 MR. VON LEHE: Can I have just a moment, Your Honor,
 10 again?
 11 THE COURT: Yes.
 12 MR. VON LEHE: Thank you.
 13 (Off the Record)
 14 MR. VON LEHE: Thank you, Professor Pomp. Thank
 15 you, Your Honor. That concludes our direct
 16 examination.
 17 THE COURT: Cross?
 18 MR. RYAN: Thank you, Your Honor.
 19 PROFESSOR POMP - CROSS-EXAMINATION BY MR. RYAN:
 20 Q: Good morning, Professor.
 21 A: Good morning.
 22 Q: Can the acts of an agent create nexus?
 23 A: If that agent is involved in the solicitation
 24 activities, the answer is yes.
 25 Q: Now, in your reports, in the RAC Texas report,

17 (Pages 65 to 68)

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1 I think you testified earlier you discussed two
2 revenue rulings; is that correct?
3 A: Correct.
4 Q: One of those revenue rulings would be 08-1; is
5 that correct?
6 A: Correct.
7 MR. RYAN: Your Honor, may I approach the witness?
8 THE COURT: Yes.
9 MR. RYAN: I'd like to have that marked please
10 Respondent's One.
11 Q: Professor Pomp, can you tell me what this is?
12 A: You have handed me South Carolina Revenue
13 Ruling #98-3.
14 Q: Now, can you go to page 2, please.
15 A: Yes.
16 Q: In the first paragraph, do you see the
17 underlined sentence?
18 A: Yes.
19 Q: Can you read that aloud, please.
20 A: "Specifically, this document clarifies South
21 Carolina Revenue Ruling 98-3 and provides
22 examples to show activities and relationships
23 which will not by themselves create income tax
24 nexus with South Carolina." This is --
25 THE COURT: Stop for a minute. We've got 08-1 here.

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1 PROFESSOR POMP: Yes, I mispoke. This is South
2 Carolina Revenue Ruling 08-1.
3 THE COURT: Okay.
4 PROFESSOR POMP: I dropped down a line.
5 THE COURT: Go ahead now, I'm sorry.
6 Q: Continue.
7 A: I couldn't remember what you asked.
8 Q: Can you read the second sentence after that.
9 A: "A combination of several different activities
10 or relationships, even if each by itself does
11 not create nexus may create nexus with South
12 Carolina."
13 Q: Okay. Now, you make no mention of that
14 language in your report, do you?
15 A: No.
16 Q: You don't address that language in your report,
17 do you?
18 A: I do not.
19 Q: Can you look at the middle of the page. Do you
20 see the bolded language?
21 A: Yes.
22 Q: Now, it's bold and underlined, right?
23 A: Correct.
24 Q: Can you read that aloud, please.
25 A: "Each example described below is based solely

1 upon the facts indicated, assumes there are no
2 other facts and the person in the example has
3 no other nexus creating connections with their
4 activity in South Carolina."
5 Q: Did you mention this language anywhere in your
6 report?
7 A: No, but I think it's pretty obvious.
8 Q: Wouldn't you say that language impacts how that
9 document is interpreted?
10 A: Well, let's take the first example.
11 Q: I asked the question, sir, does that impact how
12 the document is interpreted?
13 A: I don't think it modifies these examples.
14 Q: I didn't ask if it modifies the examples. I
15 asked how it's interpreted.
16 A: Well, I don't know what interpreted means. I
17 mean I cited the examples in my report from
18 this revenue ruling. I don't think what I have
19 read affects what I used those examples for.
20 Q: Okay. Would it be fair to say that you think
21 separate accounting -- I'm done with the
22 revenue ruling, you can put it down. Would it
23 be accurate to say that you think separate
24 accounting is outdated?
25 A: It has fallen into disuse. It is not the

1 primary method that most states use.
2 Q: Is separate accounting somewhat in conflict
3 with the unitary business?
4 A: Yes, it is.
5 Q: Now, when you talked about -- one of your
6 methods you talked about the calculation of the
7 management fee, do you remember that?
8 A: Yes.
9 Q: Perhaps we can flip back to that chart on your
10 example. This one. Do you remember this?
11 A: Yes.
12 Q: Now, your calculation ended up with 10 percent
13 in this example. Did you actually look at the
14 books and records of the taxpayer to do this
15 calculation?
16 A: No.
17 Q: So you don't know if it's 10 percent in what
18 actually happened?
19 A: It was unnecessary. I was just trying to show
20 that the statement was wrong.
21 Q: Well, how do you know -- do you know if it
22 could be 95 percent of profit?
23 A: For every store? The statement coming from the
24 Department determination was being stated as a
25 general proposition based on misreading of the

18 (Pages 69 to 72)

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1 transfer pricing agreement. There was no
 2 attempt by the auditor to look at the profits
 3 of every store. So I didn't either.
 4 Q: So you don't know what the actual percentages
 5 are?
 6 A: No more than the auditor who wrote this
 7 statement did.
 8 Q: But they could have been 95 percent, couldn't
 9 they?
 10 A: For every store? Highly unlikely.
 11 Q: Now, you talked about expenses and how a
 12 business gets to deduct the ordinary and
 13 necessary business expenses, correct?
 14 A: Correct.
 15 Q: In tax policy, if a taxpayer does not
 16 substantiate expenses, do they get to deduct
 17 them?
 18 A: Normally a taxpayer must substantiate assuming
 19 it is possible to do so.
 20 Q: Would you agree that there are several tests
 21 for determining if a business is unitary?
 22 A: Yes.
 23 Q: Have you evaluated whether the RAC Texas
 24 management operations could be separated from
 25 the RAC Texas store operations?

1 MR. VON LEHE: Understood, Your Honor.
 2 THE COURT: As long as it is impeaching the
 3 witness's testimony, so what's your objection
 4 to this?
 5 MR. VON LEHE: Your Honor, my objection to it is
 6 that it is beyond the scope of this case which
 7 is before you. It has no relevancy to the
 8 assessment which has been made. This
 9 assessment has been made against individual
 10 companies. It's not a combined assessment. I
 11 had the pleasure of re-reading Media General
 12 last night after it was brought up by learned
 13 counsel. There was an assessment made in that
 14 case and the taxpayer protested it and the
 15 taxpayer said they wanted to use combined
 16 reporting. They protested an assessment the
 17 Department of Revenue had made on separate
 18 reporting. Here, we've got an assessment made
 19 on separate reporting. We protested that
 20 assessment. There has been no assessment based
 21 on any other method. So we shouldn't have to
 22 be faced with the task --
 23 THE COURT: That's back to the issue we had last
 24 night where I allowed him to proffer the
 25 testimony.

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1 A: I'm not sure what that means, separated.
 2 Q: To make them into two separate businesses.
 3 A: I did not investigate that.
 4 Q: Would that normally be part of your analysis of
 5 whether or not a business is unitary?
 6 A: No.
 7 Q: Did you write an article called "Designing a
 8 Combined Reporting Regime for a State Corporate
 9 Income Tax"?
 10 A: In Louisiana?
 11 Q: Yes.
 12 A: I co-authored an article, yes.
 13 MR. RYAN: I'd like to mark this Respondent's Two.
 14 Q: Now, in your report -- I mean, in this article,
 15 don't you state that combined reporting is the
 16 only way to impose a fair and uniform corporate
 17 income tax?
 18 MR. VON LEHE: Your Honor, I believe this goes
 19 beyond the direct examination, far, far off
 20 field of the direct examination. I had no
 21 questions of Professor Pomp about combined
 22 reporting.
 23 THE COURT: Well, South Carolina doesn't require
 24 that cross-examination be limited to the direct
 25 examination.

1 MR. VON LEHE: Very much so, Your Honor.
 2 THE COURT: Well, then under that umbrella, I will
 3 allow him to proceed and question this and only
 4 allow it to be determined or admissible if I
 5 determine that it is proper for them to proceed
 6 down that path. We've still got the issue that
 7 we've got to address later on about whether it
 8 is proper, as you just alluded to, whether this
 9 is a proper issue before the Court when it has
 10 not been a component of the assessment.
 11 MR. VON LEHE: Yes, Your Honor, that is correct.
 12 That is my objection.
 13 THE COURT: All right.
 14 MR. RYAN: If I may respond, Your Honor, just to
 15 clarify.
 16 THE COURT: Okay.
 17 MR. RYAN: I'm not offering this to say we should be
 18 using combined reporting. I'm offering it to
 19 show inconsistencies in views he's had.
 20 THE COURT: All right. I'll overrule the objection
 21 on those grounds.
 22 MR. VON LEHE: Very well, Your Honor.
 23 THE COURT: And set forth in the record that the
 24 testimony is offered in the specific manner
 25 that you set forth.

19 (Pages 73 to 76)

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1 MR. RYAN: Thank you, Your Honor.
 2 Q: Do you need me to repeat my question?
 3 A: Please.
 4 Q: I believe it's on the second page, don't you
 5 state that the only way to impose a fair and
 6 uniform corporate income tax, that combined
 7 reporting is the only fair way to impose a fair
 8 and uniform corporate income tax?
 9 A: I am a big proponent of combined reporting if
 10 done properly. Yes, perfectly consistent with
 11 what I'm arguing here, because if you read the
 12 article, it says that combined reporting is a
 13 logical extension of a formulary apportionment
 14 unitary business system. So it is entirely
 15 consistent with what I have argued here. This
 16 is the next step if you have a proper statute,
 17 etcetera.
 18 Q: If combined reporting is the only way to impose
 19 a fair and uniform corporate income tax in your
 20 opinion, how can the methods used by the
 21 taxpayer, which aren't using combined, how is
 22 that fair and uniform?
 23 A: It is certainly fairer than separate
 24 accounting. It is as good as if you had
 25 changed your statute to a combined reporting

1 of its taxable income. Other members of that
 2 group, however, have no nexus creating
 3 activities or property in the state and are
 4 thereby insulated from tax by that state on any
 5 part of their unitary income. As a result, the
 6 state only gets to tax that portion of the
 7 income of the unitary group that appears on the
 8 books of account of the corporation having
 9 nexus within the state, even though all the
 10 members of the corporate group are engaged in
 11 the same unitary business. Second paragraph.
 12 Another technique used by multi-state and
 13 multi-national corporate groups to minimize
 14 state income taxes is to create an intra-group
 15 expense on the books of a corporation having
 16 nexus with the state that is payable to another
 17 member of the unitary group located outside the
 18 state, typically in a tax haven. Yet another
 19 technique is for the members of the unitary
 20 group to set the prices charged for the
 21 transfer or provision of goods and services to
 22 related persons in a way that allows them to
 23 shift income from high tax states to low tax
 24 states. Tax planners may use some or all of
 25 these techniques simultaneously. Third

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1 system? No. I mean, it is a hierarchy. I
 2 think combined reporting is better than not,
 3 but formulary apportionment/unitary business is
 4 better than separate accounting. This would be
 5 the next logical step, in my opinion, for a
 6 state to take that is not combined reporting.
 7 But it doesn't mean that what they do is
 8 fundamentally defective. It's just not as good
 9 as what they might do.
 10 Q: Can you turn to page 706, please.
 11 A: Yes.
 12 Q: Do you see Part B?
 13 A: Yes.
 14 Q: What is the heading in Part B?
 15 A: Protection against tax minimization strategies.
 16 Q: Could you please read the first three
 17 paragraphs aloud.
 18 A: "The many techniques that tax planners have
 19 developed to exploit the weaknesses of a
 20 separate reporting system are too numerous to
 21 catalog in this article. One popular strategy
 22 for a corporate group is to isolate nexus
 23 creating activities and property of its unitary
 24 business in one corporation. That corporation
 25 is taxable by the state on an apportioned share

1 paragraph. A separate reporting state is not
 2 defenseless against these tax planning
 3 techniques. To combat them, however, its tax
 4 department must take aggressive action to
 5 detect their use and find some way under the
 6 separate reporting rules to subject the
 7 deflected income to tax. Sometimes the tax
 8 department will enjoy some measure of success.
 9 In some cases, however, the unitary group is
 10 successful in having its tax planning
 11 techniques upheld."
 12 Q: Now, in your statement in the first paragraph
 13 you refer to those businesses as unitary,
 14 correct?
 15 A: Yes.
 16 THE COURT: The first paragraph -- I didn't hear all
 17 of that question.
 18 Q: The first and second paragraphs of that article
 19 he just read from refer to the businesses as
 20 unitary?
 21 THE COURT: Okay.
 22 Q: Yet, when you're talking about what the state
 23 tax authorities can do you said they can use
 24 separate accounting, correct?
 25 A: No. Where? I'm sorry, what paragraph?

20 (Pages 77 to 80)

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1 Q: Go down to the third paragraph.
 2 A: Third paragraph.
 3 Q: Do you see where it says tax departments must
 4 take aggressive action?
 5 A: I'm sorry. Third paragraph. "Take aggressive
 6 action to detect their use and to find some way
 7 under the separate reporting rules." And I
 8 think you're confused between separate
 9 reporting and separate accounting. The whole
 10 thrust of this is about the income reported by
 11 a corporation, that is, income reported under
 12 unitary/formulary apportionment. And what
 13 we're saying in this article is that a tax
 14 department must take aggressive action to
 15 detect their use and find some way under the
 16 separate reporting rules. In other words,
 17 under the lack of combined reporting. Separate
 18 reporting here means you look at the income of
 19 a corporation and ask whether or not that
 20 income is accurate or not. Is the price
 21 charged appropriate? If you look at paragraph
 22 two, you apply that to this case, there's a
 23 transfer pricing report here. So no one is
 24 challenging whether the price is appropriate.
 25 Was this whole thing set up for a tax

1 very famous statement said no one is entitled
 2 to pay more than their share of tax. The
 3 question is, is what you've done appropriate or
 4 not. If I become --
 5 THE COURT: You said no one is entitled?
 6 PROFESSOR POMP: No one -- everyone is entitled to
 7 pay only their fair share of taxes.
 8 THE COURT: There you go.
 9 PROFESSOR POMP: Sorry. If I become --
 10 THE COURT: I didn't think Laurent Hand would make a
 11 statement that stupid.
 12 PROFESSOR POMP: Right. But I am capable.
 13 THE COURT: You just repeated it wrong.
 14 PROFESSOR POMP: Yes.
 15 A: If I become a resident, let's say of Florida,
 16 and let's say I do it solely for tax purposes.
 17 I hate Florida. It's God's waiting room. I
 18 hate being there. My dermatologist told me
 19 never go to Florida, you can't afford to be in
 20 the sun. By my tax accountant says you have to
 21 go, you can't afford not to go, and I go to
 22 Florida solely for tax purposes, but I do it
 23 legitimately. I am a resident of Florida. I'm
 24 not, you know, playing games. I am truly a
 25 bonafide resident of Florida. No one can

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1 minimization purpose is what is being discussed
 2 here. There's no issue in this case about
 3 whether that is true or not. And what you did
 4 not ask me to read, if you look on page 708 in
 5 the first full paragraph, that some or all of
 6 the various arguments suggested above will
 7 prevail in court is likely to depend on the
 8 facts and circumstances of each case. There
 9 can be legitimate reasons for creating a
 10 holding company, which of course we -- and
 11 special purpose subsidiaries are a common
 12 feature of corporate America. The case law is
 13 full of illustrations of the good, the bad and
 14 the ugly. And so the whole purpose of combined
 15 reporting is so that a tax department does not
 16 have to sort through the good, bad and the
 17 ugly. And I agree with that as fully today as
 18 when, I probably wrote that part, as when I
 19 wrote it.
 20 Q: Thank you, Professor. Would you agree with me
 21 that tax minimization plans could be exploited
 22 by taxpayers?
 23 A: There's the good, bad and the ugly. You are
 24 certainly entitled to engage in tax
 25 minimization strategies. Laurent Hand in a

1 challenge that, Your Honor, and say well,
 2 sorry, you're a resident but we think you did
 3 it for tax purposes, so you're still going to
 4 be a resident of our state. I go your state,
 5 I haven't lived there in 30 years. Yeah, but
 6 you went to Florida for tax reasons. I could
 7 become a LLP, an LLC, an S-Corp to minimize
 8 tax. All that is legitimate. I could put my
 9 plant in a state that has no tax like New
 10 Hampshire. No income tax like New Hampshire.
 11 All that is legitimate. So there are
 12 legitimate tax minimization strategies, and
 13 then there are the strategies where there is no
 14 business purpose or economic substance to what
 15 you did. You rented a file cabinet in Delaware
 16 and that's where you claim you're located. You
 17 rent a CPA in Delaware on a part-time basis.
 18 You really don't have offices or employees.
 19 You know, that's at the other end of the
 20 continuum. So it's a continuum. And again,
 21 it's the good, bad, and the ugly. I happen to
 22 like combined reporting. You know, if a state
 23 were to adopt that statute, we've noticed
 24 everyone and they do it properly, I would think
 25 that that was a positive development. But you

21 (Pages 81 to 84)

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1 can't do it at the 11th hour, and if you are
 2 going to do it, you've got to include all the
 3 members of the unitary family. You can't
 4 cherry pick which corporations you want. And
 5 then there is an issue about notice, but that's
 6 for you folks to fight about.
 7 Q: Are you familiar with South Carolina statute
 8 12-6-2320?
 9 A: I would have to see it.
 10 MR. VON LEHE: Your Honor, if I may in anticipation,
 11 I see the South Carolina Code being handed up,
 12 we've been at least trying today to stay out of
 13 evaluations of South Carolina law reserving
 14 that for the Court and for our arguments. I
 15 don't know where this is going, but it doesn't
 16 look good. So I object to -- I object to --
 17 THE COURT: That all depends on your perspective.
 18 If you allow him to open the door, then it
 19 would look good for you.
 20 MR. VON LEHE: Well, it could very well, Your Honor,
 21 but we have tried hard to stay on the right
 22 thing to do here. We've tried hard to keep
 23 Professor Pomp out of testimony about South
 24 Carolina law.
 25 THE COURT: Okay. Yes.

1 which will fairly represent the taxpayer's
 2 business activity in the state; or (d) the
 3 employment of any other method to effectuate an
 4 equitable allocation and apportionment of the
 5 taxpayer's income.
 6 Q: And where it says (a) separate accounting, if
 7 the directors wanted it to not apply to unitary
 8 businesses, couldn't they have said except as
 9 applied to unitary businesses?
 10 A: I would think one would not apply separate
 11 accounting if you were apportioning the income
 12 of A unitary business. But this is to
 13 anticipate all possible situations. So --
 14 Q: Would you -- I'm sorry.
 15 A: They weren't going to take anything off the
 16 table. It says that if the allocation, and
 17 there's allocation rules in here too, and the
 18 apportionment do not fairly represent the
 19 extent of the taxpayer's business activity. So
 20 it is a safety valve. If for whatever reasons,
 21 there may be idiosyncratic, unusual reasons,
 22 then we will look at other methods.
 23 Q: Would you agree that section 18 makes no
 24 mention of a unitary business?
 25 A: Yes.

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1 MR. VON LEHE: So I'll object to it on those
 2 grounds, if that is what, in fact, is coming.
 3 THE COURT: I will take that anticipatory objection
 4 of which we'll deal with apparently later,
 5 because he's already taken the book.
 6 Q: Can you turn to Tab 14, please.
 7 A: Yes.
 8 Q: This is UDIPTA?
 9 A: Everyone says UDIPTA, but there's a T in there.
 10 Q: Can you turn to section 18?
 11 A: Yes.
 12 Q: From a tax policy perspective, is section 18
 13 kind of a catchall?
 14 A: I would view it as a safety valve.
 15 Q: Explain why it's a safety valve.
 16 A: Well, it says if the allocation and
 17 apportionment provisions of this article do not
 18 fairly represent the extent of the taxpayer's
 19 business activity in this state, the taxpayer
 20 may petition for or the tax administrator may
 21 require, in respect to all or any part of the
 22 taxpayer's business activity, if reasonable,
 23 (a) separate accounting; (b) the exclusion of
 24 any one or more of the factors; (c) the
 25 inclusion of one or more additional factors

1 Q: Do the RAC East stores depend on RAC West
 2 trademarks the same way RAC West stores depend
 3 on RAC West trademarks?
 4 A: It's not something I looked at. So I don't
 5 really know.
 6 Q: Is there a reason you didn't look at it?
 7 A: I didn't think it was relevant to what I was
 8 doing.
 9 Q: Let's say, for example, that RAC East uses the
 10 same trademarks that the RAC West stores do.
 11 If we're able to separate RAC East as it is,
 12 why can we not separate the retail operations
 13 of RAC West from RAC West royalties?
 14 A: You mean actually spin it off into a separate
 15 entity?
 16 Q: Sure.
 17 A: Again, that involves business considerations as
 18 much as anything. It's nothing I looked at.
 19 And that's a pretty complicated question when
 20 you talk about reorganizing. So I don't know
 21 what the constraints might be.
 22 Q: So it would be fair to say you didn't evaluate
 23 whether the two operations of RAC West could be
 24 separated?
 25 A: That is correct. That is not relevant to my

22 (Pages 85 to 88)

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1 inquiry.
 2 Q: Now, you testified earlier about what the
 3 Department did in response to RAC West's
 4 returns. When were those returns filed?
 5 A: I don't know the dates. There was the initial
 6 filing and then the amended return. I don't
 7 know the time sequence.
 8 Q: Because your testimony discussed the amended
 9 returns, correct?
 10 A: Yes, I know that they have filed amended return
 11 using the single factor of gross receipts
 12 apportionment.
 13 Q: So if the Department issued the determination
 14 before that, was it really responding to the
 15 amended returns?
 16 A: If it was before that, no.
 17 Q: Okay. Now, if a taxpayer won't provide the
 18 Department with information as to where it
 19 conducts its services or which states it might
 20 do some things in and which states it won't do
 21 some things in, how is the Department supposed
 22 to figure out the amount of services given in
 23 one state as opposed to the amount of services
 24 that are going on in another state?
 25 A: And we're talking now hypothetically?

1 could get the reporter to read back that line
 2 or perhaps Mr. Ryan would repeat it. There
 3 would be management services, I couldn't
 4 understand what he said. Was it folk?
 5 MR. RYAN: I think I said persons, but I believe I
 6 did say folks. Persons.
 7 MR. VON LEHE: Okay. And so what was the question?
 8 If I could get it read back.
 9 MR. RYAN: If you don't mind, Your Honor, I'll just
 10 strike it and start again; will that work?
 11 MR. VON LEHE: That would be fine. I'd like to hear
 12 that. I'm sorry I didn't hear it -
 13 THE COURT: Okay. Strike the question and the
 14 answer.
 15 MR. RYAN: Thank you.
 16 THE COURT: And then start again.
 17 Q: Looking at RAC Texas, there are the management
 18 services operations and the retail store
 19 operations?
 20 A: I see. I was answering about sources of
 21 income. So there are management - yes, there
 22 are management services performed and there are
 23 also retail stores owned. That's correct.
 24 Q: Would that be different than the store to store
 25 example?

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1 Q: Yes.
 2 A: As opposed to the facts of this case? Well,
 3 hypothetically, if you have a recalcitrant
 4 taxpayer who doesn't provide you information
 5 that supports its filing position, then they
 6 are being unreasonable.
 7 Q: You gave another example, and pardon me while
 8 I flip through it.
 9 A: Sure.
 10 Q: Remember this? You talked about flows of value
 11 between the two.
 12 A: Correct.
 13 Q: In that example, aren't they both stores?
 14 A: They are both stores.
 15 Q: RAC West royalties and RAC West stores, they're
 16 not both stores? One is royalty; one is a
 17 store, correct?
 18 A: RAC West has two sources of income. One is
 19 royalty and the other is the rentals at the
 20 store and the sales at the stores. That's
 21 correct.
 22 Q: And RAC Texas, there would be the management
 23 services folk and the stores?
 24 A: That is correct.
 25 MR. VON LEHE: Your Honor, I'm sorry, I wonder if we

1 A: I don't know what different means. I mean, we
 2 are different and similar in an infinite number
 3 of ways. I don't know what that means.
 4 Q: The management services operations, is that a
 5 store?
 6 A: It's not a store. It's similar because it is
 7 an illustration of synergies and flows of value
 8 and the fact that you can't separate out things
 9 that are interdependent and part of the same
 10 organic whole. So they're similar in that
 11 sense.
 12 MR. RYAN: I think that's all the questions I have,
 13 Your Honor.
 14 THE COURT: Redirect?
 15 MR. VON LEHE: Your Honor, I do have one or two on
 16 redirect. Not much.
 17 PROFESSOR POMP - REDIRECT EXAMINATION BY MR. VON
 18 LEHE:
 19 Q: You were asked about section 18 of UDITPA I
 20 believe a few minutes ago.
 21 A: Yes.
 22 Q: And what are the UDITPA rules as to when that
 23 is ordinarily applied?
 24 A: Well, it's ordinarily applied - I wouldn't say
 25 ordinarily because it is the exception. It's

23 (Pages 89 to 92)

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1 when the allocation and apportionment
 2 provisions do not fairly represent the extent
 3 of the taxpayer's business activity, and then
 4 you have these other approaches if they are
 5 reasonable. You know, UDITPA is meant to be a
 6 uniform act. And so you don't want to start
 7 recognizing so many section 18 deviations or
 8 pretty soon you don't have the uniformity
 9 anymore. So section 18 was a safety valve. It
 10 was meant for the non-recurring, the somewhat
 11 idiosyncratic situations. But applied too
 12 broadly, you start to undercut the whole
 13 purpose of having a uniform act, so.
 14 Q: Do you know if there are any regulations with
 15 regard to this?
 16 A: The multi-state tax commission has promulgated
 17 regulations under section 18, and those are in
 18 Tab 14. And if you look on page 37 of that
 19 tab, you see the regulation that says, I guess
 20 it's the second full paragraph, that article
 21 14.18 permits a departure from the allocation
 22 and apportionment provisions of article 4 only
 23 in limited and specific cases. That article 4-
 24 18 may be invoked only in specific cases where
 25 unusual fact situations (which ordinarily will

1 unitary business/formulary apportionment. The
 2 taxpayer said we want separate accounting. And
 3 two levels of courts now have upheld the
 4 assessment. So I have been involved in that
 5 fairly recently.
 6 Q: I want to ask you with regard to you were asked
 7 a question did - I can paraphrase it. Did
 8 you evaluate a spinoff, just I assume, with
 9 regard to RAC West. Did you evaluate a spinoff
 10 of the intellectual property which that entity
 11 owns into another entity? And I believe you
 12 answered you did not.
 13 A: Correct.
 14 Q: You had not been asked to evaluate that, so you
 15 did not evaluate it?
 16 A: Correct.
 17 Q: You mentioned earlier certain synergies, I
 18 believe is the way it is in the record, that
 19 inure because that intellectual property is in
 20 that corporation. Do you recall the wording
 21 that you used at that time, the language that
 22 you used?
 23 A: Not precisely the wording, but that's certainly
 24 true what you're saying.
 25 Q: So, in general, you found what relationship?

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1 be unique and non-recurring) produce in
 2 congress results under the apportionment and
 3 allocation provisions in article 4.
 4 Q: Professor, let me ask you, show me where this
 5 is in your book. For some reason I'm having
 6 difficulty locating it.
 7 A: That is - I may have given you the wrong tab.
 8 Tab 14, and it is in the back after the
 9 language of UDITPA. The font changes and then
 10 the pages are marked.
 11 Q: Okay.
 12 A: And that is page 37.
 13 Q: All right, sir. Have you had experience with
 14 the application of this section?
 15 A: Yes, I have. I've been in cases where a
 16 taxpayer has attempted to assert that, and I
 17 was representing a state in that case. And it
 18 turns out the taxpayer was attempting to assert
 19 that in what was a unitary business, and they
 20 were arguing, it's a public record case, Your
 21 Honor, it's called Tesoro, T-E-S-O-R-O, out of
 22 Alaska. And it involved a Texas company that
 23 had gas activities in Texas and oil activities
 24 in Alaska and was arguing it was not unitary.
 25 Alaska had issued an assessment based on

1 A: We're talking RAC West now?
 2 Q: Yes, we are. Between the intellectual property
 3 and the stores.
 4 A: The component parts here, the intellectual
 5 property and the stores are so closely
 6 connected and necessary to each other that you
 7 can't divide the two. That would be another
 8 way to put it. There are all these synergies.
 9 These synergies, the interdependence, the flows
 10 of value. They're all synonyms for essentially
 11 the same concept, that this is a unitary
 12 business not capable of being divided up and
 13 measured independently of each other.
 14 Q: Did you give testimony concerning the
 15 contribution and benefit of the intellectual
 16 property to the stores and the stores to the
 17 intellectual property?
 18 A: Yes, I heard -
 19 Q: Did you give testimony along those lines?
 20 A: I did, and I think I said the same thing. That
 21 the success of the stores is what contributes
 22 to the value of the intellectual property and
 23 the value of the intellectual property
 24 contributes to the success of the stores.
 25 Q: Now, would that contribution exist if that

24 (Pages 93 to 96)

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1 intellectual property were not in that entity?
 2 If it was in a separate entity or -- would that
 3 same contribution, could it exist?
 4 A: I assume it could.
 5 Q: Through what way? Through some --
 6 A: Well, as the stores did better, the
 7 intellectual property is going to go up in
 8 value.
 9 Q: No matter where it exists?
 10 A: Yes.
 11 Q: Fair enough. Thank you.
 12 MR. VON LEHE: Your Honor, if I may.
 13 Q: You were asked a question a moment ago about a
 14 taxpayer that would not give the costs
 15 associated with its activities.
 16 A: No, it was not costs. I believe --
 17 Q: Expenses.
 18 A: No, it was not expenses either. I thought it
 19 was the location of activities as the question
 20 was asked.
 21 Q: It was.
 22 A: I thought so. I know we could have it read
 23 back, but that was the question I was
 24 answering. I might have misheard the question,
 25 but I thought the question was about the

1 Q: Okay. Would the same thing apply, would it or
 2 would not apply to management fees in a unitary
 3 business?
 4 A: Yes, that was my volume discount analogy. Same
 5 thing would apply to the management fees.
 6 Q: Okay. No further questions. Thank you.
 7 THE COURT: Follow up on those questions?
 8 MR. RYAN: Yes. Thank you, Your Honor.
 9 PROFESSOR POMP - RECROSS-EXAMINATION BY MR. RYAN:
 10 Q: Can you show me where in -- let me get it right
 11 this time, UDITPA it says that section 18 is an
 12 exception?
 13 A: On Tab 14, it is in the regulations that
 14 interpret UDITPA.
 15 Q: So those would be the multi-state tax
 16 commission regulations?
 17 A: Yes, that's what I stated. Regulations that
 18 are issued by the multi-state tax commission.
 19 Q: Do you know if those regulations have been
 20 adopted by South Carolina?
 21 A: I do not know.
 22 Q: Do you know when the multi-state tax commission
 23 promulgated those regulations?
 24 A: It was probably -- well, it's an ongoing basis.
 25 The multi-state tax commission is always coming

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1 location of activities.
 2 Q: And what was your response to that?
 3 A: I said that a taxpayer should reasonably be
 4 expected to support its filing position.
 5 Q: Now, is a unitary -- in your opinion, from a
 6 tax policy standpoint, is a unitary taxpayer
 7 being unreasonable or recalcitrant when it's
 8 unable to separate off its costs from its
 9 different business activities?
 10 A: No, that's the whole beauty of unitary, That
 11 you're not asked to do something which is
 12 impossible and which flies in the face with the
 13 unitary theory. Unitary theory says that when
 14 I am working on getting a vendor to give us a
 15 volume discount, I am simultaneously
 16 benefitting the entire corporate enterprise and
 17 it is impossible to sort out those expenses.
 18 And so to be asked to do that or to be asked to
 19 sort out the expenses of intellectual property
 20 from the store operations is to ask an
 21 impossibility. And there is certainly nothing
 22 unreasonable about a taxpayer who cannot do
 23 something that is impossible to do and that is
 24 inconsistent with the whole concept of a
 25 unitary business.

1 out with new regulations. I suspect that what
 2 we're looking at in interpreting section 18 was
 3 probably one of the earlier regulations, maybe
 4 going back to the '70s. But I don't know for
 5 sure, but it's an ongoing process where they're
 6 always tweaking the regs and coming out with
 7 new ones.
 8 Q: Thank you.
 9 MR. RYAN: No further questions, Your Honor.
 10 THE COURT: Specifically on those?
 11 MR. VON LEHE: No more questions, Your Honor.
 12 THE COURT: Professor, you stated that if you
 13 utilized combined reporting, you nevertheless,
 14 and this is paraphrasing, you nevertheless
 15 can't cherry pick the corporation, you've got
 16 to utilize them all. Referencing that comment
 17 to this case, and if you object to it,
 18 referencing that comment to this case, would
 19 that mean you would have to utilize RAC West,
 20 Texas and East as combined?
 21 PROFESSOR POMP: I don't know if they are part of
 22 the same combined group or not. It's a very
 23 intensive facts and circumstance inquiry. You
 24 would of thought Woolworth, now I don't know if
 25 the younger folks here remember Woolworth, but

25 (Pages 97 to 100)

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1 Woolworth -
 2 THE COURT: Unfortunately, I do.
 3 PROFESSOR POMP: Yeah. Well, I probably may be
 4 wearing something from there. But Woolworth
 5 had its domestic corporations as a combined
 6 group. And the issue was whether its foreign
 7 subsidiaries were part of that same group.
 8 Now, the name was Woolworth. They sold similar
 9 stuff, not identical. You would have thought
 10 if you knew nothing more, hey, it's Woolworth.
 11 It ought to be part of the same combined group.
 12 But you know what, the US Supreme Court said it
 13 wasn't. So you can really be misled by being
 14 really glib about this. It is an intensive
 15 facts and circumstance inquiry and there are
 16 cases holding that a dental consulting firm was
 17 combined with a farming operation. I had some
 18 cases where wholesale food was combined with
 19 retail clothing. A multi state pipeline
 20 construction company was combined with horse
 21 farming. You know, it looks odd until you get
 22 really dig into the facts. So I made no
 23 inquiry about this, but also, these are just
 24 three corporations. There may well be others
 25 that are part of the combined group. And you

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1 would have to include every member of that
 2 unitary family to get a proper combined return
 3 if you were doing it properly. You couldn't
 4 just say okay, we'll combine RAC West and RAC
 5 Texas and not RAC East because the statute has
 6 run. No, all the members of the combined group
 7 have to be included if you're doing it right.
 8 And that may extend beyond RAC West and RAC
 9 Texas. But you couldn't tell without a really
 10 detailed inquiry.
 11 THE COURT: All right. And follow-up questions on
 12 what I have asked?
 13 MR. VON LEHE: No follow-up questions, Your Honor.
 14 MR. RYAN: No, Your Honor.
 15 THE COURT: All right. You may step down.
 16 PROFESSOR POMP: Thank you.
 17 MR. VON LEHE: Your Honor, we have presented our
 18 portion of the case. We have no further
 19 witnesses.
 20 THE COURT: Let's just take a short break.
 21 (Break from 11:22 a.m. until 11:31 a.m.)
 22 THE COURT: Mr. Ryan?
 23 MR. RYAN: Thank you, Your Honor. The Department
 24 calls Joseph Southard.
 25 JOSEPH P. SOUTHARD, having been duly sworn, testifies

1 as follows:
 2 MR. SOUTHARD - DIRECT EXAMINATION BY MR. RYAN:
 3 Q: Good morning, Joe.
 4 A: Good morning.
 5 Q: Can you state your name for the record, please.
 6 A: Joseph P. Southard.
 7 Q: And Joe, who do you currently work for?
 8 A: No one.
 9 Q: Who did you used to work for?
 10 A: South Carolina Department of Revenue.
 11 Q: How long were you with the Department?
 12 A: Twenty-five years.
 13 Q: And what area of the Department did you work?
 14 A: Foreign audit section.
 15 Q: Did you work on the Rent-A-Center audits?
 16 A: Yes.
 17 Q: Let's discuss the audits process in general.
 18 Let's say you go to a corporation and issue
 19 them an audit report and that taxpayer
 20 disagrees with your audit, what can the
 21 taxpayer do?
 22 A: He can appeal it.
 23 Q: And who do they appeal it to?
 24 A: We used to have an appeals section. They can
 25 now take it before the lawyers who handle our

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1 cases.
 2 Q: So the litigation section?
 3 A: Litigation section.
 4 Q: What does the litigation section issue in
 5 response to an appeal?
 6 A: A determination, agency determination.
 7 Q: If I said Department determination, would that
 8 make sense?
 9 A: Yes.
 10 Q: Does the Department determination represent the
 11 agency's stance on an issue?
 12 A: Yes.
 13 Q: Can a Department determination differ from what
 14 you did in your audit?
 15 A: Yes.
 16 Q: Can a Department determination change what you
 17 did in an audit?
 18 A: Yes.
 19 Q: Let's talk about RAC Texas. Does RAC Texas
 20 file returns in South Carolina?
 21 A: No.
 22 Q: In your audit, did you determine whether RAC
 23 Texas was doing business in South Carolina?
 24 A: Yes.
 25 Q: What was your determination?

26 (Pages 101 to 104)

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1 A: They were doing business in South Carolina.
 2 Q: Does RAC Texas provide strategic assistance
 3 services to the South Carolina stores?
 4 A: Yes.
 5 Q: When you were auditing all of Rent-A-Center,
 6 because when you do an audit, you do the whole
 7 entity, correct?
 8 A: Correct.
 9 Q: When you were auditing Rent-A-Center, what
 10 brought RAC Texas to your attention?
 11 A: I think there -- I can't remember the total
 12 number of entities. I think there were four
 13 entities that we audited, and we noticed in the
 14 other deductions that there was a large
 15 deduction for strategic assistance fee. So
 16 that would be something we would want to
 17 pursue, because with an extremely large
 18 deduction like that it's reducing the bottom
 19 line taxable income.
 20 Q: So would you say the strategic assistance fee
 21 made you dig deeper?
 22 A: Yes.
 23 Q: Did you dispute the amount of the fee in your
 24 audit?
 25 A: No.

1 A: Yes.
 2 Q: Does RAC Texas deal in tangible personal
 3 property in South Carolina?
 4 A: No.
 5 Q: If a taxpayer doesn't deal in tangible personal
 6 property, would you as an auditor apply the
 7 three factor apportionment?
 8 A: No.
 9 Q: And why did you use standard gross receipts for
 10 RAC Texas?
 11 A: Well, we had to determine, we had to come up
 12 with a method to determine the amount of
 13 management fee income that was attributable to
 14 the operation in South Carolina.
 15 Q: Why didn't you include the Texas retail
 16 operations in that?
 17 A: Because they had no business in South Carolina
 18 whatsoever.
 19 Q: What do the revenues associated with RAC Texas
 20 retail stores have to do with RAC Texas'
 21 activities in this state?
 22 A: Nothing.
 23 Q: Now, you testified the three factor
 24 apportionment wouldn't apply and you didn't use
 25 gross receipts. Is that why you created a

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1 Q: Does the amount of management fee change
 2 whether or not you think there's nexus?
 3 A: No.
 4 Q: Does the amount of the management fee change
 5 whether or not you're going to pursue that item
 6 in an audit?
 7 A: No.
 8 Q: Are some things simply not worth your time to
 9 handle in an audit?
 10 A: Yes.
 11 Q: Can you explain why.
 12 A: If it doesn't produce enough revenue for the
 13 Department, for the State of South Carolina,
 14 it's not worth pursuing because there's no
 15 sense in making a taxpayer file a return or the
 16 Department to have to handle the return.
 17 Because if the income is so small, then the
 18 cost associated with handling that on either
 19 side, it just isn't worth it.
 20 Q: Thank you. Let's talk about how you determined
 21 the income for RAC Texas. Does RAC Texas
 22 operate retail stores in South Carolina?
 23 A: No.
 24 Q: Does RAC Texas operate retail stores in other
 25 states?

1 formula?
 2 A: Correct.
 3 Q: Do you know what statute gives you the power to
 4 create a formula?
 5 A: I think it's 12-6-2320.
 6 Q: Now, let's look at the audit report of Texas
 7 LP. I will guide you to it once I find it. I
 8 believe that's Exhibit One, Tab 2.
 9 A: Okay.
 10 Q: Can you turn to what is the fourth page you
 11 probably commonly know it as Schedule B1.
 12 A: Yes.
 13 MR. VON LEHE: The tab again, please.
 14 MR. RYAN: Sure, John. Tab 2 and we're about four
 15 pages into it.
 16 Q: Do you recognize this document?
 17 A: Yes.
 18 Q: Did you draft this document?
 19 A: Yes.
 20 Q: Does this document describe how you apportioned
 21 RAC Texas' income?
 22 A: Yes.
 23 Q: Now, looking at -- just so we can understand
 24 some of the numbers, where it says RAC East
 25 1.7274, about a quarter of the way down, do you

27 (Pages 105 to 108)

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1 see that?
 2 A: Uh-huh (affirmative response).
 3 Q: What is that?
 4 THE COURT: I don't have the exhibit book. If you
 5 could just put that exhibit up on the Elmo.
 6 MR. RYAN: Certainly, Your Honor. Would it be
 7 easier for me to just hand this to you, or you
 8 can have it?
 9 THE COURT: Well, you just put it up there and we
 10 all can look at it.
 11 Q: So where it says RAC East 1.7274 percent, what
 12 is that number?
 13 A: That is the sales ratio for RAC East for the
 14 year of 2003.
 15 Q: Where it says SAF expense 217523195, what is
 16 that?
 17 A: That is the strategic assistance fee expense on
 18 RAC East's return for the tax year 2003.
 19 Q: Now, how did you get the number 3757496?
 20 A: Simply multiplied the sales ratio for RAC East
 21 times the SAF or strategic assistance fee
 22 expense on the RAC East return.
 23 Q: Why did you choose the sales factor?
 24 A: Because the strategic assistance fee was based
 25 on sales activity.

1 file returns?
 2 A: Yes.
 3 Q: Would the Department advise the taxpayer on the
 4 various apportionment methods?
 5 A: Yes.
 6 Q: Do you know if RAC Texas ever contacted the
 7 Department?
 8 A: I can't say for sure. I don't think they did,
 9 but I can't say for sure.
 10 Q: Let's move on to RAC West. Does RAC West
 11 operate retail stores in South Carolina?
 12 A: No.
 13 Q: Does RAC West operate retail stores in other
 14 states?
 15 A: Yes.
 16 Q: What income does RAC West receive in South
 17 Carolina?
 18 A: Strictly royalty income.
 19 Q: Are trademarks owned by RAC West used in South
 20 Carolina?
 21 A: Yes.
 22 Q: And when you audited this matter, what
 23 apportionment method was RAC West using?
 24 A: I think they were using the three factor
 25 formula or double weighted sales formula.

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1 Q: Is the method we just went over, is that the
 2 method used for all the periods for RAC Texas?
 3 A: Yes.
 4 Q: Did the taxpayer provide you any documents to
 5 establish expenses related to the strategic
 6 assistance fee?
 7 A: No.
 8 Q: Had the taxpayer provided proof of expenses,
 9 would you have allowed a deduction for those
 10 expenses?
 11 A: Yes.
 12 Q: Let's talk about penalties. What penalties did
 13 you assess against RAC Texas?
 14 A: Failure to file and failure to pay penalties.
 15 Q: Did RAC Texas file returns?
 16 A: No.
 17 Q: Is that why you included failure to file?
 18 A: Yes.
 19 Q: Did RAC Texas pay taxes?
 20 A: No.
 21 Q: Is that why you included failure to pay?
 22 A: Yes.
 23 Q: All right. If a taxpayer like RAC Texas were
 24 to contact the Department, would the Department
 25 advise them as to whether or not they needed to

1 Q: Are you aware that a few weeks ago they amended
 2 their returns?
 3 A: Yes.
 4 Q: Have you seen those amended returns?
 5 A: Yes.
 6 Q: Now, what do the retail operations of RAC West
 7 have to do with RAC West's activity in South
 8 Carolina?
 9 A: Nothing.
 10 Q: Is that why you didn't include them in your
 11 apportionment?
 12 A: Correct.
 13 Q: Now, let's look at those amended returns. That
 14 is Tab 7.
 15 A: Seven.
 16 Q: Joe, if we can go to the return for income tax
 17 period ending 12/31/04.
 18 MR. RYAN: Your Honor, I'm going to put the page I'm
 19 talking about on the Elmo.
 20 Q: Can you see page 3 of the '04 SC 1120 which is
 21 on the overhead?
 22 A: Yes.
 23 Q: What is the total gross receipts from
 24 everywhere?
 25 A: \$424,477,000.

28 (Pages 109 to 112)

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1 Q: And what is the total gross receipts from South
2 Carolina?
3 A: \$861,437.
4 Q: Now, according to the return, that creates a
5 ratio of what amount?
6 A: .2032 percent.
7 Q: Now I'm going to have you simultaneously look
8 at -- I would put it up on the Elmo, but my
9 copy does not have what it's supposed to have
10 in it. What is under your Tab 21? What do you
11 have under 21?
12 A: Tab 21 is the apportionment revenue data from
13 Rent-A-Center West.
14 MR. RYAN: Unfortunately, Your Honor, I don't have a
15 copy to put up there.
16 THE COURT: That's fine.
17 MR. RYAN: Would it be easier if we just hand this
18 to you, Your Honor?
19 THE COURT: That's fine, yeah.
20 Q: Do you recognize this document, Joe?
21 A: Yes, I do.
22 Q: What is it?
23 A: This is a taxpayer apportionment data by state
24 of the type of income. We always ask for that
25 when we do an audit.

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1 Q: Did you review this document as part of your
2 audit?
3 A: Yes.
4 Q: Now, on that piece of paper, what is the grand
5 total for total revenue?
6 A: \$424,004,077.
7 Q: So that would be where we got the total gross
8 receipts that was on the return?
9 A: We verify that against the return.
10 Q: What does line 19 include?
11 A: Royalty income.
12 Q: And what is the total royalty income?
13 A: \$55,221,912.
14 Q: And that 55 million, would that be part of the
15 424 million in total revenue?
16 A: Yes.
17 Q: Based on those numbers and I know your strength
18 in math, can you give me a rough estimate of
19 what percentage that 55 million would be of
20 that 424 million?
21 A: About 13 percent.
22 Q: So if 13 percent of the revenues is royalties,
23 what percent of the revenues is not from
24 royalties?
25 A: Eighty-seven.

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1 Q: And what type of income did RAC West have in
2 South Carolina?
3 A: Royalty income only.
4 Q: So RAC West's business in South Carolina would
5 be part of which part, the 87 or the 13?
6 A: Thirteen.
7 Q: Does any of that other 87 have anything to do
8 with what goes on in South Carolina?
9 A: No.
10 Q: Have you looked at the 2003 and 2005 returns as
11 well?
12 A: Yes.
13 Q: In those years, was the percentage of revenue
14 from royalties to total revenues roughly the
15 same?
16 A: I think it was roughly the same, yes.
17 Q: Is your analysis and conclusion that you just
18 gave for 2004 the same for 2005 and 2003?
19 A: Yes.
20 Q: Now, let's talk about how the Department
21 figured out the amount of tax in its
22 determination. Is the amount in the
23 determination different than what you did in
24 your audit?
25 THE COURT: The amount of tax for RAC West?

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1 MR. RYAN: Yes, Your Honor.
2 THE COURT: Okay. That's fine. Just making sure.
3 Q: Is the amount of tax in the RAC West
4 determination different than what you did in
5 your audit?
6 A: Yes.
7 Q: Is this one of those examples of where the
8 lawyers can change what you did?
9 A: Yes.
10 THE COURT: And how do you feel about that?
11 MR. SOUTHard: I don't mind as long as it's
12 reasonable.
13 Q: Did the method used in the determination reduce
14 or increase the tax liability as opposed to
15 what you did?
16 A: I think it reduced it slightly.
17 Q: And the Department -- it's the Department
18 determination that reflects the Department's
19 position?
20 A: Yes.
21 Q: Does the Department's method as to RAC West
22 include any expense for the royalty income?
23 A: No.
24 Q: Did the taxpayers provide you any proof of
25 expenses?

29 (Pages 113 to 116)

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1 A: No. 2 Q: Had the taxpayers provided you proof of 3 expenses, would you have allowed the deduction? 4 A: Certainly. 5 Q: Now, what penalties did you impose against RAC 6 West? 7 A: I think it was substantial understatement. 8 Q: And who makes the determination of whether or 9 not a penalty applies? 10 A: The auditor. 11 Q: Now, at the time you applied the penalties, was 12 RAC West using three factor apportionment? 13 A: Yes. 14 Q: Did the taxpayers provide you any authority 15 supporting their use of three factor 16 apportionment? 17 A: No. 18 Q: Did the taxpayers present you any authority 19 supporting their use of gross receipts? 20 A: No. 21 Q: Now, if a taxpayer like RAC West had contacted 22 the Department, would the Department advise 23 them on the different apportionment methods? 24 A: Yes. 25 Q: Do you know whether or not RAC West contacted	1 A: Yes. 2 Q: -- conducted their operations? And you based 3 this on the premise that the strategic 4 assistance fee, also known as the management 5 services fee, as we've been discussing for the 6 last two days, is too high; is that correct? 7 A: It seemed rather exorbitant. 8 Q: For now I'm just going to call this strategic 9 assistance fee the management services fee 10 since that's the term we've been using 11 throughout this trial. There's nothing unusual 12 about a corporate group having a management 13 services entity, is there? 14 A: No. 15 Q: Anything unusual about that? 16 A: No. 17 Q: Many corporations have management services in 18 separate corporations, do they not? 19 A: Yes. 20 Q: Would this be true whether the members of the 21 corporate group are located within the same 22 state, South Carolina? 23 A: Yes. 24 Q: There are entities here that have management 25 services subsidiaries, are there not?
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1 the Department? 2 A: I don't know. I don't think so, but I don't 3 know for sure. 4 MR. RYAN: I have no further questions, Your Honor. 5 MR. VON LEHE: Your Honor? 6 THE COURT: Yes. 7 MR. VON LEHE: If I could have just perhaps five 8 minutes before beginning. 9 THE COURT: Okay. And you can had this back to Ms. 10 Geer while we're at it. 11 (Break from 11:49 a.m. until 11:56 a.m.) 12 MR. SOUTHARD - CROSS-EXAMINATION BY MR. VON LEHE: 13 Q: Good morning, Mr. Southard. 14 A: Good morning, sir. 15 Q: You testified that you made the audit in this 16 case. 17 A: Yes, sir. 18 Q: And I believe you said in your deposition, but 19 I'll ask you this morning, you were primarily 20 concerned with income shifting, were you not? 21 A: Yes. 22 Q: The term you used. And you believed that 23 income has been shifted from South Carolina to 24 another state based on the way the taxpayers' 25 --	1 A: Yes. 2 Q: So you have no objection to a management 3 services subsidiary in and of itself -- 4 A: No. 5 Q: -- would that be correct? But you do have an 6 objection when you view the payment between 7 these entities as being too high; is that 8 correct? 9 A: I wouldn't say objection. I'd say a concern. 10 Q: You have a concern. And that concern 11 precipitated this audit, did it not? 12 A: Well, not necessarily. This was a routine 13 audit of Rent-A-Center, which Rent-A-Center 14 has, I think there were four entities. I can't 15 remember exactly. I think there were four 16 entities we were looking at, and they were 17 paying a large strategic assistance fee to 18 somewhere else that we didn't know about. And 19 it affected the taxable income, so it's 20 something that we would want to look at from an 21 audit point of view. 22 Q: And once you looked at it, you made the 23 adjustment because you felt it was too -- that 24 that fee was too high? 25 A: No, not because it was too high. That they

30 (Pages 117 to 120)

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1 provided the management agreement, and I
 2 reviewed that and made a determination they
 3 were doing business in the state.
 4 Q: And you made that determination. And then what
 5 else did you do? You made an assessment, did
 6 you not?
 7 A: Yes, of the taxpayer.
 8 Q: And why did you not make that assessment based
 9 on the standard apportionment formula?
 10 A: It was -- it didn't fit into the definition, so
 11 we had to come up with --
 12 THE COURT: What is it? So the record will be
 13 clear.
 14 A: The apportionment formula for four factor or
 15 gross receipts didn't fit to -- in order to
 16 determine the amount of revenue that was
 17 generated in the state of South Carolina, I had
 18 to come up with kind of a hybrid.
 19 Q: Now, you did not deny the deduction to RAC
 20 East. You did not do that?
 21 A: No.
 22 Q: And would that have not have been the ordinary
 23 procedure if you thought a payment was too
 24 high? Would you not have ordinarily simply
 25 denied a deduction to the entity that was

1 judgment as the auditor, then we would allow
 2 it. Which we would allow it whether it was
 3 reasonable or unreasonable. We would then --
 4 what you would be doing is you're in effect
 5 shifting income from the state, you're shifting
 6 profit that was earned in the state, that was
 7 legitimately earned in the state to another
 8 state.
 9 Q: I understand that. And that's because that fee
 10 was too high?
 11 A: So it reduces -- reducing the taxable income,
 12 which in effect reduces the tax liability in
 13 the State of South Carolina.
 14 Q: All right, sir. And now wouldn't have that
 15 been cured -- cured simply by denying the
 16 deduction to the extent it was too high?
 17 A: Yes.
 18 Q: Would have been?
 19 A: Well, the --
 20 A: Why did you not do that? Was it because the
 21 RAC East audit was already closed and therefore
 22 you were prevented from doing that by the
 23 statute of limitations? Was that a factor?
 24 A: No, I was following the guidelines in Geoffrey.
 25 Q: Now, the Geoffrey case, are you familiar with

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1 taking that deduction?
 2 A: No.
 3 Q: You don't deny a deduction to an entity which
 4 is taking a deduction which you think is too
 5 much?
 6 A: Well, we look at it -- we look at the deduction
 7 and if it kind of fits in with the Geoffrey
 8 kind of situation, a Geoffrey, pure Geoffrey
 9 company has very large income, very little
 10 expense, hardly any expense, and so they allow
 11 -- we allow that deduction for the royalty
 12 expense, but we go after the entity that
 13 receives the income.
 14 Q: I believe you said in your deposition, but I'll
 15 ask you again today, that if this management
 16 fee had been based on costs, that that would
 17 have been all right?
 18 A: Well --
 19 Q: But it was too high, and therefore, this
 20 precipitated your making this adjustment that
 21 you made. I believe that's what you testified
 22 to, but is that the way you feel?
 23 A: Well, if it was reasonable --
 24 Q: Right, if it was reasonable.
 25 A: If it was reasonable, and that's just my

1 the case?
 2 A: Yes.
 3 Q: Are you very familiar with the case, is that
 4 true? You've applied it, at least?
 5 A: I applied the reasoning.
 6 Q: You've read it. Do you believe you understand
 7 it?
 8 A: I think I do.
 9 Q: And then you've applied it, I think you said.
 10 Now in the Geoffrey case, is it not true that
 11 the royalty thing was the reason that Geoffrey
 12 was considered to be taxable in South Carolina?
 13 Is that the reason the Court gave, the fact
 14 that it had intellectual property here?
 15 A: The fact that it had intellectual property and
 16 was earning income in South Carolina based on
 17 that employment of the intellectual property.
 18 Q: But in that case, the tax imposed against
 19 Geoffrey was imposed under its total corporate
 20 income, was it not? Would the South Carolina
 21 apportionment formula apply, the standard
 22 formula that Professor Pomp showed up here a
 23 few minutes ago?
 24 A: Yes, but that -- I think the total income was
 25 strictly royalty income.

31 (Pages 121 to 124)

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1 Q: That –
 2 A: Or the majority of it, 90, I don't know what
 3 the percentage was but it was extremely high.
 4 Q: So that matters to you as to what the nature of
 5 that income is in that entity, correct?
 6 A: Well, correct.
 7 Q: Okay. Now, in the agency determination, a
 8 statement is made that this management, the
 9 management services fee, strategic services fee
 10 is 95.5 percent of the profit of the stores
 11 going to RAC Texas leaving only 4.5 percent for
 12 the stores. You read the agency determination?
 13 A: Yes.
 14 Q: You recall that being in there?
 15 A: Yes.
 16 Q: Was this your impression of how this, of what
 17 the circumstances were?
 18 A: Yes.
 19 Q: In your audit report?
 20 A: That they were taking 95.5, .6 percent of the
 21 net income, I think it was, as I recall. I'd
 22 have to go read my audit to be sure.
 23 Q: Did you see the illustration a few moments ago
 24 as to how that management fee actually works?
 25 A: Yes.

1 A: If I determined that it was reasonable in
 2 relation to the cost of providing their
 3 services, yes.
 4 Q: Now, you said in your deposition that you
 5 thought that the reasonable fee would be cost?
 6 A: Yes.
 7 Q: This is what you said in your deposition. I
 8 think you gave me an example that if cost is
 9 \$10,000 but the fee was, excuse me, if the
 10 cost was 1,000 but the fee was ten, then their
 11 would be an overcharge of nine.
 12 A: Yes.
 13 Q: I believe that's the example you used. And so
 14 you think, you know, then we've got a huge
 15 amount of profits being taken out of this state
 16 that should not be?
 17 A: Correct.
 18 Q: Now, assuming you based this on something other
 19 than just a personal belief, in other words, if
 20 South Carolina law provides otherwise, you
 21 would follow the South Carolina law, is that
 22 correct?
 23 A: Yes.
 24 Q: And what if the South Carolina law said that
 25 this profit was reasonable? What if that is

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1 Q: The percentage against – first you take the
 2 percentage against operating income, excuse me,
 3 against operating expenses?
 4 A: Yes.
 5 Q: And that's attributed to the stores?
 6 A: Yes.
 7 Q: So it may or may not be these percentages which
 8 are shown in the agency determination?
 9 A: Yes.
 10 Q: Had you known that, would you have still made
 11 your adjustment?
 12 A: Yes.
 13 Q: Now, you said in your deposition, and I believe
 14 you said it again a moment ago, that as long as
 15 this fee that was paid by RAC East to RAC Texas
 16 was reasonable, I think is the term you used a
 17 moment ago, that you would not have made this
 18 audit?
 19 A: Well, we would have done a routine audit on the
 20 tax –
 21 Q: You would not have made this adjustment, excuse
 22 me, I misspoke. You would not have made this
 23 adjustment, isn't that was you said a moment
 24 ago? Is that correct that if the fee had been
 25 reasonable?

1 what the South Carolina law said, would that
 2 end this controversy before the Court, and
 3 therefore, this audit adjustment ought to be
 4 ended?
 5 MR. RYAN: Objection, Your Honor. He's asking for a
 6 legal conclusion.
 7 MR. VON LEHE: Your Honor, this is a – this is a
 8 person who administers the laws of the
 9 Department of Revenue. He has to know the law.
 10 If anyone knows it, he must know it.
 11 THE COURT: You can ask that question, but not the
 12 way you've asked it. You can ask it regarding
 13 his evaluation of the audit, but not this case.
 14 MR. VON LEHE: May I ask him that if in his
 15 administration of the laws of South Carolina as
 16 applied to this case? In that regard –
 17 THE COURT: You can ask the question and I'll see –
 18 Q: Would you apply the law of South Carolina to
 19 the facts; is that what ought to be done?
 20 A: Well, that's what I thought I was doing.
 21 Q: Now, are you familiar with Section 492 of the
 22 Internal Revenue Code?
 23 A: Yes.
 24 Q: You're familiar with it? Has it been adopted
 25 in South Carolina?

32 (Pages 125 to 128)

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1 A: No.
 2 Q: Section 482 has not --
 3 A: No, I mean it has been, but it's --
 4 Q: It has been adopted?
 5 A: Well, there's some, I think, modifications, not
 6 of 482, but they've adopted the Federal Code.
 7 Q: All right, sir.
 8 A: With some modifications.
 9 Q: You may answer the following question, I think
 10 we can -- I think the lawyers can come up with
 11 the answer on that that would be satisfactory.
 12 MR. VON LEHE: Let me ask, can we stipulate that 482
 13 has been adopted in South Carolina, Sean?
 14 MR. RYAN: Yes.
 15 Q: So we're going to make that assumption.
 16 A: Yes, sir.
 17 Q: Now, what is the reason for Section 482 of the
 18 Internal Revenue Code?
 19 MR. RYAN: Objection, Your Honor. He's not up here --
 20 - he doesn't give testimony as to the reason
 21 behind the Internal Revenue Code.
 22 MR. VON LEHE: I think that it's very pertinent to
 23 this case, Your Honor. He had to know the
 24 reason for Section 482 of the Internal Revenue
 25 Code and he's applied -- he's given his reasons

1 transfer pricing?
 2 A: Yes.
 3 Q: That was the primary topic of his testimony,
 4 was it not?
 5 A: Yes.
 6 Q: And he talked about Section 482 --
 7 A: Yes.
 8 Q: -- of the Internal Revenue Code?
 9 A: He did.
 10 Q: Did he state that this transfer price that was
 11 being used by this taxpayer was in fact
 12 reasonable? This management fee was
 13 reasonable?
 14 A: Yes.
 15 Q: Wasn't that the conclusion which he gave?
 16 A: Yes.
 17 Q: So I take it you disagree with that?
 18 A: Yes.
 19 Q: You do disagree with it. Do you have any
 20 reason for this disagreement?
 21 A: Well, we were never provided any documentation
 22 of a transfer pricing agreement when we were
 23 there doing the audit.
 24 Q: You had a copy of it, did you not?
 25 A: No, I didn't have any copies.

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1 for having done this audit, something which is
 2 certainly very much impacted by that, then
 3 we've got a serious problem with this audit.
 4 THE COURT: Okay. The problem is you're going to
 5 have serious problems with my ruling because I
 6 sustain his objection.
 7 MR. VON LEHE: Yes, Your Honor.
 8 Q: In your application, let me state this
 9 question. In your audit, did you consider
 10 section 482 of the Internal Revenue Code?
 11 A: No.
 12 Q: You did not? But you said that you did this
 13 because you thought that the profit was
 14 unreasonable. You have said that?
 15 A: Yes.
 16 Q: Now were you present for the testimony of John
 17 Wells yesterday?
 18 A: Yes.
 19 Q: Did you hear his testimony?
 20 A: Yes.
 21 Q: And what was the nature of that testimony as
 22 you understood it? What was he talking about
 23 in general?
 24 A: He talked about a lot of things.
 25 Q: Did he said -- did his testimony relate to

1 Q: I believe you said in your deposition that you
 2 looked at it. In your audit report you do say
 3 you looked at it.
 4 A: Well, I don't remember. I'd have to look at my
 5 audit report.
 6 Q: Well, in any case, in your deposition you say
 7 that you didn't care about the transfer pricing
 8 agreement because those things are all self-
 9 serving. This is what you said, do you recall
 10 that?
 11 A: Yes, they are self-serving.
 12 Q: All right. Is that primarily your reason for
 13 not being interested in --
 14 A: Well, you've got to realize that the document,
 15 the document is -- the taxpayer occupies both
 16 sides of the table. So basically, he's in
 17 negotiation with himself. And he's using this
 18 technique, this mechanism to basically shift
 19 income away from South Carolina.
 20 Q: What do you base that on? What do you have to
 21 base that on that this management services fee
 22 was excessive?
 23 A: Just my experience as an auditor and dealing
 24 with many major corporations that use these
 25 techniques, these tax strategies or schemes --

33 (Pages 129 to 132)

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1 Q: So you go into this thinking this is a tax
2 scheme; is that correct? If I understood what
3 you just said.
4 A: Well, that's basically what it is.
5 Q: That's what you said in your deposition, I
6 believe also.
7 MR. RYAN: Your Honor, I'm going to object at this
8 point to further questioning about the amount
9 of fees. The amount of fee is not in dispute
10 in this matter, so I don't see a relevance to
11 all of these questions.
12 MR. VON LEHE: Your Honor, he said, if --
13 THE COURT: One second. The line of questioning is
14 not the amount of the fees, it's the
15 reasonableness of the fees and it's based on
16 his assertion that he would not have pursued,
17 adjusted the -- made the adjustment in this
18 case if the costs were reasonable. So I think
19 it's a -- so now do you want to follow up on
20 that?
21 MR. RYAN: I would say the Department's position in
22 this matter has been that they're not disputing
23 the fee and didn't do what it did because --
24 according to the determinations because of the
25 reasonableness of the amount of the fees. So

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1 I don't think it's relevant, Your Honor.
2 MR. VON LEHE: My question Your Honor, are they
3 disputing the reasonable of the fee? That
4 would be my issue with this.
5 MR. RYAN: No, Your Honor. We're not disputing the
6 reasonableness of the fee.
7 THE COURT: So you stipulate that the fee was
8 reasonable?
9 MR. RYAN: I will stipulate we are not disputing the
10 reasonableness of it.
11 MS. GEER: That's a lawyer.
12 THE COURT: I kind of have to amen her comment on
13 that. We'll just go with that and, Mr. von
14 Lebe, you can take that statement for what it's
15 worth.
16 MR. VON LEHE: I shall, Your Honor. Thank you,
17 we'll proceed.
18 Q: Now, what about the state where the management
19 company is located? What about that state? If
20 this management fee is not reasonable, okay, if
21 it's overcharged. Is that state going to get
22 too much of the profit? Just disregard
23 whatever their tax law would be for the moment.
24 A: Well, that's what -- that's what the result
25 would be.

1 Q: Now, if we had a situation where -- I want to
2 ask you how you treat taxpayers in this
3 circumstance. You have taxpayers that are
4 paying fees from another state to taxpayers
5 located in this state. Do you look to see if
6 that management fee is unreasonable when it's
7 coming this way?
8 A: We would apply the same principles no matter
9 where the taxpayer was. We treat them the
10 same.
11 Q: If you did apply those principles, what would
12 be the result? If you audit the taxpayer who
13 was receiving a management fee in South
14 Carolina and reporting that, let's say it's
15 \$100,000, but we believe it should only be 50,
16 so it's 50 overstated, you audit that taxpayer
17 when you see that, what would you do?
18 A: Well, like I said, I would determine whether it
19 was reasonable or not and make an adjustment.
20 Q: Let's assume that that reasonableness is 50,
21 but they're picking up 100. What would you do,
22 give them a refund?
23 A: Well, if it required a refund, yes. It would
24 go either way.
25 Q: Have you ever said that a management fee coming

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1 into a taxpayer in South Carolina was too much?
2 Do you recall any audits like that?
3 A: No. Because the reason is because I'm a
4 foreign corporate auditor and I don't audit
5 returns in the state of South Carolina.
6 Q: Do you know if such adjustments are being made
7 at the Department?
8 A: I cannot say for sure.
9 Q: Back to where we've got. If this management
10 fee, if it is not enough, if it is not
11 reasonable, if it is too low, it's being paid
12 by a South Carolina entity to an out of state
13 entity and it's too low, if that occurs, then
14 what is the result in that other state? Is
15 that state not receiving too little income?
16 A: Right. Correct.
17 Q: I want to talk to you a little bit about the
18 sourcing of receipts and where income ought to
19 be sourced. And this is something you are very
20 familiar with; is it not?
21 A: Yes.
22 Q: Income allocation apportionment divisions of
23 the South Carolina laws?
24 A: Yes. Yes, sir.
25 Q: And you've you applied those for I believe you

34 (Pages 133 to 136)

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1 said quite a number of years?
 2 A: Yes, sir.
 3 Q: In the sourcing of receipts and under -- let's
 4 refer to this as ordinary circumstances, that
 5 is, to say when you're applying one of the
 6 apportionment formulas. And I'm going to
 7 assume for this that you have applied the gross
 8 receipts formula in some cases to taxpayers;
 9 would that be correct?
 10 A: Yes, sir.
 11 Q: Many times?
 12 A: Yes, sir.
 13 Q: You've applied the three factor formula many
 14 times?
 15 A: Yes, sir.
 16 Q: So you're familiar with both of these formulas?
 17 A: Yes, sir.
 18 Q: And in the ordinary circumstance where these
 19 formulas are applied, where do you source the
 20 receipts in the sales factor of that formula?
 21 What do you look to to determine what state
 22 those receipts ought to go to?
 23 A: Well, the first question we ask is what does
 24 the taxpayer do in South Carolina? What is his
 25 business in South Carolina? How does he earn

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1 his revenue in South Carolina?
 2 Q: And how did RAC Texas earn its revenue in South
 3 Carolina? Assuming it earned any.
 4 A: Well, through the -- I looked at the management
 5 agreement and made a determination that they
 6 were doing business in this state.
 7 Q: So it earned its income through the management
 8 agreement, payments from the RAC East?
 9 A: Yes. RAC East and the other entities that do
 10 --
 11 Q: The other, the smaller entities --
 12 A: -- operating -- the other smaller operating
 13 entities.
 14 Q: They've basically been disregarded by us during
 15 the last couple of days but they're in the same
 16 boat, correct?
 17 A: But they've paid the strategic assistance fee
 18 also.
 19 Q: They've paid the fee. But it's a smaller --
 20 smaller amount so to speak, as far as they're
 21 concerned.
 22 A: Well, it's still a significant amount.
 23 Q: It's significant and it's in the audit?
 24 A: Yes.
 25 Q: And it's in the audit?

1 A: Yes.
 2 Q: You picked them up? Now, when you apply the
 3 gross receipts ratio, okay, to a taxpayer that
 4 you consider to be doing business in South
 5 Carolina, are you looking at the gross receipts
 6 from within South Carolina numerator, Professor
 7 Pomp talked about it a while ago.
 8 A: Yes, sir.
 9 Q: When you look at that, what test do you use to
 10 determine what goes into that numerator?
 11 A: Well, we would, the first item we ask for is
 12 the apportionment work papers.
 13 THE COURT: You ask for what?
 14 A: Apportionment work papers, which all taxpayers
 15 have that. It's simply a summary of his income
 16 by state, by category. And we would look --
 17 Q: So the single factor formula, which I believe
 18 you mentioned a little earlier in South
 19 Carolina.
 20 A: Yes, sir.
 21 Q: To what kind of entity is that ordinarily
 22 applied?
 23 A: Service type entities. Those that don't deal
 24 with tangible personal property.
 25 Q: I'd like to hand this up to you for a moment to

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1 take at a look at.
 2 A: Yes, sir.
 3 Q: And if you don't mind, just read that for me.
 4 That portion.
 5 A: 12-6-2290, apportionment of remaining net
 6 income with principal profits are income
 7 derived from sources not otherwise described by
 8 this chapter. The principal profits or income
 9 of taxpayer derived from sources other than
 10 those described in Section 12-6-2250 or Section
 11 12-6-2310, the taxpayer shall apportion its
 12 remaining net income using a fraction in which
 13 the numerator is gross receipts from within the
 14 state during the taxable year and the
 15 denominator is total gross receipts from
 16 everywhere during the taxable year.
 17 Q: All right sir. Thank you. And that is the
 18 gross receipts formula?
 19 A: Yes.
 20 Q: And the gross receipts formula has in it the
 21 language you just read, gross receipts within
 22 this state, correct?
 23 A: Correct.
 24 Q: Now, are you familiar with the Lockwood Greene
 25 case?

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1 A: Yes, sir.
 2 Q: And would you mind telling the Court what the
 3 facts of that case were. To shorten things, to
 4 let you know what I'm interested in.
 5 A: Well, I can't --
 6 Q: Did it have to do with an engineering firm?
 7 A: Yes, sir. I think it was an engineering firm
 8 and the sourcing of the receipts was -- had to
 9 do with where the activity --
 10 Q: Took place.
 11 A: -- or the action took place.
 12 Q: And the court decided that it should be sourced
 13 to where the activity took place?
 14 A: They decided to source it to South Carolina
 15 because the engineering firm was using its
 16 labor, they used that, the labor to determine
 17 the sourcing, the labor cost.
 18 Q: And I will ask, but I assume you followed the
 19 Lockwood Greene case?
 20 A: Yes, sir.
 21 Q: It was a South Carolina Court of Appeals final
 22 decision, right?
 23 A: Yes. Yes, sir.
 24 Q: You mentioned that RAC Texas was, in your
 25 opinion, doing business in South Carolina. You

1 that fact.
 2 Q: Did you not hear the testimony that said that
 3 these people are employed by RAC East?
 4 A: Yes.
 5 Q: So why do you say RAC Texas' employees?
 6 A: Well, at the time I didn't know that.
 7 Q: All right. So if you had known the facts as
 8 you understand them for the last two days
 9 you've been here and listened to this
 10 testimony, would you still have done what you
 11 did?
 12 A: Yes.
 13 Q: Because?
 14 A: Well, because RAC Texas is being compensated
 15 for economic activity in South Carolina that
 16 benefits them.
 17 Q: So compensation for economic activity that
 18 takes place here?
 19 A: Right.
 20 Q: Does that activity have to take place here?
 21 A: Not necessarily.
 22 Q: So compensation for -- compensation from South
 23 Carolina in your judgment might be enough?
 24 A: Depends on what the activity is.
 25 Q: I want to go back to the Lockwood Greene case

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1 said, as I understood you to say, that you made
 2 that determination from reviewing the
 3 Management Services Agreement, correct? Did
 4 you not say that?
 5 A: Yes, sir.
 6 Q: How did you make that determination by virtue
 7 of reviewing the Management Services Agreement?
 8 A: Well, I don't have it here in front of me but
 9 -- is it Tab 10?
 10 Q: It is.
 11 A: Management duties. I just made a determination
 12 in my own mind that some of this activity had
 13 to take place in South Carolina for some of
 14 these actions to take place.
 15 Q: And did you --
 16 A: Such as hiring and -- hiring people. Hiring of
 17 employees by the company.
 18 Q: So for --
 19 A: So that they don't -- these people that are
 20 hired worked for other entities, other
 21 operating entities within the total corporate
 22 structure. So they are, they're RAC Texas'
 23 employees, the people that work in these
 24 entities to do their business. And they're
 25 being -- RAC Texas is being compensated for

1 and the sourcing of receipts for a moment.
 2 After what you've heard today and what you know
 3 today, is there any doubt in your mind that, if
 4 not all, virtually all of the activities that
 5 take place to earn this management fee take
 6 place in Texas?
 7 A: Say that again, please.
 8 Q: Yes. Don't all the activities or virtually all
 9 of the activities that take place to earn this
 10 management fee take place in Texas?
 11 A: Some activities do and some activities take
 12 place here in South Carolina.
 13 Q: Isn't it true that the overwhelming majority,
 14 if not all, take place in Texas?
 15 A: Probably -- probably correct.
 16 Q: Probably correct. What's your understanding of
 17 what's done in Texas concerning this Management
 18 Services Agreement?
 19 A: Probably some accounting, simple accounting.
 20 Administrative type of things. But also all
 21 those overhead expenses apply to the stores
 22 that are operating in Texas.
 23 Q: The salaries of everybody who's in Texas, those
 24 salaries are being paid by RAC Texas, are they
 25 not?

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1 A: Yes.
 2 Q: What's your understanding of what takes place
 3 in South Carolina?
 4 A: The only thing that I had is this Management
 5 Services Agreement.
 6 Q: Okay. Now, I want to go back to Lockwood
 7 Greene for a moment. You had taxed RAC Texas
 8 on that entire management services fee,
 9 correct?
 10 A: No. I only -- only a portion of it.
 11 Q: Only a portion of it?
 12 A: Yes, based on the sales factor of the operating
 13 entities that were paying the fee.
 14 Q: Weren't you trying to assign the amount of the
 15 fee that's attributable to South Carolina?
 16 A: Yes. I was trying to determine how much of
 17 that strategic assistance fee was contributed
 18 by the operating entities within the state of
 19 South Carolina.
 20 Q: But shouldn't you have been looking at the
 21 activities of RAC Texas in South Carolina,
 22 trying to make that judgment?
 23 A: Well, I only had so much information to go on
 24 and that's the judgment that I made.
 25 Q: Well, let me ask you this. Assuming Lockwood

1 A: Yes.
 2 Q: And everything that was there. So you made a
 3 personal observation. You went out there for
 4 the purpose of making these observations and
 5 you observed all that?
 6 A: We went out there to do a corporate income tax
 7 audit on all of their entities.
 8 Q: And a part of that --
 9 A: And that's -- and that's at the corporate
 10 headquarters, in this case. We did the audit
 11 at the taxpayer's location.
 12 Q: Did you have any observation of any RAC Texas
 13 employees doing anything in South Carolina?
 14 Did you make any observation of that?
 15 A: No.
 16 Q: Did you go out to a store and find out if
 17 anybody there worked for RAC Texas, etcetera?
 18 A: No.
 19 Q: Under your alternate apportionment formula that
 20 you referenced as an alternate apportionment
 21 formula, again we're still talking about RAC
 22 Texas, but I did want eventually to talk about
 23 RAC West. But under the alternate
 24 apportionment formula, I believe you referred
 25 to it in your -- I think you referred to it in

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1 Greene is applicable here, just assuming it's
 2 applicable.
 3 A: Yes, sir.
 4 Q: Wouldn't it look to where the services are
 5 being performed, where the activities are
 6 taking place in determining where to source
 7 that management fee?
 8 A: Well, yes, if you looked at it strictly. But
 9 some services were performed here and some
 10 services were performed in Texas. And Lockwood
 11 Greene, the majority of the services, if not
 12 all the services, were performed in South
 13 Carolina.
 14 Q: Didn't you just say a moment ago that you
 15 believed that a majority of the services that
 16 generated this fee were performed in Texas?
 17 A: Yes.
 18 Q: All right. Now, you conducted this audit at
 19 RAC Texas' headquarters, correct?
 20 A: Yes.
 21 Q: And did you see the employees there, over
 22 there?
 23 A: Yes.
 24 Q: Of course, obviously you observed the physical
 25 layout that was there, the building, etcetera?

1 your audit report as a form of separate
 2 accounting, did you not?
 3 A: I did. Or it fit -- it fit in that definition
 4 under 12-6-2320.
 5 Q: Yes. That's what you said in your audit report
 6 I believe. Something of that nature.
 7 A: Yes, sir.
 8 Q: And now in an alternate apportionment formula,
 9 would it -- do you agree with me that this
 10 alternate apportionment formula, which you have
 11 used, completely disregards the net income of
 12 that corporation, RAC Texas? It does not give
 13 any consideration to what the net income of
 14 that corporation is; is that true? If it's
 15 not, tell me how it --
 16 A: Well --
 17 Q: -- how the net income of the corporation is
 18 used.
 19 A: I'm looking at the income that was generated in
 20 the state of South Carolina. And --
 21 Q: Did you look -- go ahead.
 22 A: I looked at the whole return, yes.
 23 Q: You did look at the return?
 24 A: Well, not the -- the taxpayer, I really can't
 25 remember whether he provided me a return. They

37 (Pages 145 to 148)

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1 provided something -- or not at the time of the
2 audit.
3 Q: But if they'd given you the corporate income
4 tax return showing RAC Texas' corporate income,
5 suppose he'd given you that, would that have
6 had any effect on this audit adjustment? I
7 mean, this audit adjustment does not consider
8 the corporate net income, does it?
9 A: No.
10 Q: So you felt that you could not do an
11 apportionment method which took into effect
12 that corporate net income, therefore, you did
13 not --
14 A: Yeah, we would have -- we would have taken cost
15 into consideration if the taxpayer had
16 provided it based on the nature of the income
17 in South Carolina.
18 Q: But that would have had nothing to do with the
19 corporation's net income, would it?
20 A: Well, the taxpayer has two types of income and
21 that is from intangibles, the management fees,
22 and the sell of tangible personal property from
23 the stores. And the stores don't have any
24 relationship to South Carolina, what goes on in
25 South Carolina. Now, I mean, but if the

1 down at the bottom in a footnote?
2 A: Yes.
3 Q: So it says that. But nevertheless the
4 Department of Revenue has, for whatever it's
5 worth has thought that it might be helpful to
6 taxpayers to put it on its website. Is that
7 reasonable?
8 A: I guess.
9 Q: Now, this publication has a provision in it
10 that discusses Lockwood Greene and Geoffrey.
11 I'd like for you to read this comment.
12 A: "Considering Lockwood Greene and Geoffrey
13 together, it appears that gross receipts are
14 sourced to the state which is most
15 significantly associated with the production of
16 income, personal services where those services
17 are performed, intangibles, where those
18 intangibles are used in a business for the
19 production of income."
20 Q: All right. Thank you. Now back to the
21 alternate apportionment formula. Excuse me for
22 jumping ahead briefly. But you've applied what
23 you called an alternate apportionment formula.
24 Now, in that alternate apportionment formula,
25 you made a decision to separate the management

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1 taxpayer had provided the costs associated with
2 their activity in South Carolina, we would have
3 taken that into consideration. It's up to the
4 taxpayer to provide that, not the auditor.
5 Q: Before we leave the subject of sourcing, the
6 Department of Revenue has certain publications
7 on its website, correct?
8 A: Yes, sir.
9 Q: And among those publications, is there a book,
10 South Carolina Corporate Income Taxes?
11 A: There probably is.
12 Q: Do you recognize this?
13 A: Yes.
14 Q: Do you recognize that?
15 A: Yes, sir.
16 Q: All right, sir. Now, this book is under the --
17 has as its heading, Policy; is that right?
18 A: Yes, sir.
19 Q: It says it's written by three people. They
20 say, and it's entitled South Carolina
21 Department of Revenue Governor Mark Sanford,
22 Burnet R. Maybank, Director, and it has a date.
23 It says, I believe the opinions expressed are
24 personal opinions rather than opinions of the
25 Department of Revenue, does it not say that

1 fee from the operation of the stores; is that
2 correct?
3 A: Yes, sir.
4 Q: You did make that determination. This is a
5 regulation of the Department of Revenue which
6 I would like for you read. First of all, if
7 you'll look at and tell me if you're familiar
8 with it?
9 A: There are a lot of regulations, I don't
10 remember every one of them.
11 Q: Do you remember that one?
12 A: I might have read it one time.
13 Q: Well, would you please read it. What
14 regulation is it?
15 A: The regulation is 117-710.1. Proper allocation
16 and apportionment of income.
17 Q: Please read the regulation. It's short. It's
18 short.
19 A: The phrase "Transacting or Conducting his
20 business partly within and partly without this
21 state" as used in Section 12-6-2210, is
22 applicable to a single business operation which
23 is unitary or homogenous and is carried on
24 within and without the State. A taxpayer
25 operating two or more unrelated businesses,

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1 each of which is entirely within and without
 2 the State, is not subject to the provisions of
 3 this section but each business determines its
 4 South Carolina net income separately. A
 5 taxpayer operating a unitary or homogenous
 6 business within and without the state and a
 7 unrelated business either entirely within or
 8 without, is subject to the apportionment
 9 formulas with respect to the unitary and
 10 homogenous business, but not with respect to
 11 the unrelated business. Income from the
 12 unrelated business is allocated and apportioned
 13 separately as appropriate to the State where
 14 such business is conducted.
 15 Q: Now, I take it, and I'll ask a question from
 16 this. The concept of a unitary business, this
 17 concept is not foreign to this taxpayer's
 18 argument. The Department of Revenue recognizes
 19 a unitary business under the proper
 20 circumstances; is that correct?
 21 A: Yes.
 22 Q: And this regulation, in fact, recognizes it
 23 under certain circumstances?
 24 A: Yes.
 25 Q: It refers to unrelated businesses, this does,

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1 as to when you might or might not attempt to
 2 divide those business. Is it your judgment
 3 that this, that the management services which
 4 is being conducted in RAC Texas and the
 5 operation of the stores, that those matters are
 6 unrelated? Is that your judgment?
 7 A: They're completely separate businesses, types
 8 of businesses.
 9 Q: Now, you heard the testimony to the contrary
 10 both yesterday and today, did you not?
 11 A: Yes.
 12 Q: I assume you don't agree with that testimony?
 13 A: Well, no.
 14 Q: And what are your reasons?
 15 A: Again, from an auditor point of view, we look
 16 to the activity in the state of South Carolina.
 17 What is - what is done in the state of South
 18 Carolina. There is no sell of tangible
 19 personal property in the State of South
 20 Carolina. So you can find, in this case, you
 21 may combine - the taxpayer has combined two
 22 different types of activities, the management
 23 activity and the sale of tangible personal
 24 properties through the stores or rental.
 25 Q: So would it be your position that if an

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1 otherwise unitary business, one you and I can
 2 agree on as unitary, if - let's assume that
 3 for a moment. If it does something in South
 4 Carolina, which is a part of one of its
 5 function but not everything, then do you
 6 believe from that that you could separate that
 7 business, just because it's separate and apart
 8 that it's conducted in South Carolina,
 9 everything not conducted here?
 10 A: Well, in other words, if RAC Texas had stores
 11 in South Carolina? Is that what you mean?
 12 Q: No, I'm saying -
 13 A: Earn income from the sale of tangible personal
 14 property, is that what you're -
 15 Q: No, I'm saying this. I'm saying, we've got a
 16 unitary business, all right, let's just say
 17 there's one out there, okay. I mean it might
 18 be General Motors. Okay, whatever it is. It's
 19 something that we would identify as a unitary
 20 business. I'll talk another example, a better
 21 example. Let's take Exxon. This is one you
 22 would be familiar with I'm sure through the
 23 Exxon case. This unitary business, it
 24 somewhere out in Texas perhaps, or Oklahoma, it
 25 produces oil. It then refines that oil perhaps

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1 also out there or somewhere in between, and
 2 then here in South Carolina it sells gasoline.
 3 Now all it does in South Carolina is sell
 4 gasoline. It has no oil wells here, it has no
 5 refining here, all it's got here is gasoline
 6 stations. Now, is that a reason, the fact that
 7 all it does here, sell gasoline, is that a
 8 reason to divide up this business?
 9 MR. RYAN: Objection, Your Honor. Object on
 10 relevance grounds. Joe's not up as an expert
 11 on the unitary business. I don't understand
 12 why his opinion on another case is relevant.
 13 MR. VON LEHE: Your Honor, he's given us his reason
 14 the fact that all these people do in South
 15 Carolina is management services and I'm just
 16 trying to get to -
 17 THE COURT: I overrule the objection.
 18 Q: So let's think at those facts from Exxon case,
 19 which I'm sure you're very familiar with. What
 20 happened in that case? Do you recall?
 21 A: I'm really not familiar with the Exxon case.
 22 Q: You're not familiar with the Exxon case? All
 23 right. Well, I'll ask you this.
 24 A: I've heard about it, but I couldn't -
 25 Q: I'll ask you this. Assume this. Assume the

39 (Pages 153 to 156)

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1 South Carolina Supreme Court said, hey, look
 2 Exxon you're a unitary business, the fact that
 3 all you do in South Carolina is sell gasoline,
 4 that doesn't mean you can break off and
 5 separately report just your gasoline stations.
 6 So you're not aware of the case? Know about
 7 it?
 8 A: I've heard it, but I never really read it. So.
 9 But they're in the oil business so its all oil
 10 related business.
 11 Q: All right.
 12 A: It's all integrated business.
 13 Q: All right.
 14 A: You know, from exploration to transportation of
 15 it to processing of it, to refining of it,
 16 until it finally gets to gasoline and other
 17 types of fuels and lubricants, it's all
 18 together. There's no real distinction there.
 19 The only distinction is the activity they're
 20 engaged in to produce the final product.
 21 Q: So, therefore - I take it from that answer
 22 that if we could agree on a business being
 23 unitary, it wouldn't have to do everything here
 24 in South Carolina in order to be taxed as a
 25 single unitary business?

1 that the management services and the stores are
 2 unrelated? What reason do you have? What
 3 facts did you find to show that?
 4 A: Well, they're just two separate types of
 5 business in that entity.
 6 Q: You don't believe in -
 7 A: Normally, as I understand it, corporations, all
 8 corporations have overhead expenses but they
 9 use these tax planning techniques, such as in
 10 this case, to reduce their tax liability in
 11 states that they do business. So that's why we
 12 go and audit them.
 13 Q: Do you have a reason for believing that those
 14 businesses are unrelated? You say they're
 15 unrelated but why do you say that?
 16 A: When you say unrelated, I -
 17 Q: Well -
 18 A: I mean it's -
 19 Q: Whether they depend upon, contribute to each
 20 other. They're part of an unrelated, what I
 21 mean by unrelated?
 22 A: Well, they're unrelated in the fact that
 23 they're providing management services to all of
 24 their entities and in that respect, they have
 25 to, they have to have some management cross to

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1 A: Yes.
 2 Q: So we can agree on that?
 3 A: Yes.
 4 Q: Do you have any reason for disagreeing with the
 5 testimony that said, that you heard, that said
 6 that the management services are related, they
 7 contribute to and depend upon the operation of
 8 the stores insofar as RAC Texas is concerned?
 9 Did you hear all that testimony?
 10 A: Yes.
 11 Q: Do you have any reason for disagreeing with
 12 that testimony?
 13 MR. RYAN: Objection, Your Honor. Again I don't see
 14 the relevance of Joe's opinion on somebody
 15 else's testimony.
 16 THE COURT: Well, actually violates a -
 17 MR. RYAN: Pitting the witness, Your Honor.
 18 THE COURT: - I was going to say archaic, but it's
 19 not archaic, old rule called pitting the
 20 witnesses.
 21 MR. VON LEHE: Your Honor, let me put it
 22 differently.
 23 Q: Assuming the facts to be as you heard - start
 24 over again. What reason do you have for
 25 thinking, what reason do you have for thinking

1 give the company direction -
 2 Q: Does RAC Texas -
 3 A: - and control.
 4 Q: Does RAC Texas provide management services to
 5 its stores?
 6 A: Yes.
 7 Q: And yet, even though you know that to be a
 8 fact, the conclusion is still that they're
 9 unrelated?
 10 MR. RYAN: Objection, Your Honor. This unrelated
 11 question has been asked and answered
 12 repeatedly. He has stated they are unrelated.
 13 THE COURT: Is there a response to that?
 14 MR. VON LEHE: Yes, Your Honor. He didn't give me a
 15 reason and now I'm asking him based on that.
 16 He kindly gave -
 17 THE COURT: The last question was they're unrelated,
 18 so if you want to seek the reason then move to
 19 that.
 20 Q: Insofar as -
 21 THE COURT: I'm sustaining the objection. Move on.
 22 Q: Insofar as your statement a moment ago that
 23 yes, management services are given to the
 24 stores in RAC Texas then -
 25 A: Well -

40 (Pages 157 to 160)

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1 Q: Go ahead.
 2 A: It's two separate types of business. One is
 3 all their -- they're just management fees,
 4 management expenses, it's just that's all it
 5 is. The stores do something entirely different
 6 unrelated to the management expense. Their
 7 generating profitability should be through
 8 their activity. Is a management cost supposed
 9 to generate profit for the corporation.
 10 Q: For the corporation?
 11 A: Right. Is it supposed to be generating the
 12 majority of the profit. And I would think that
 13 would be the activity of the stores, as you say
 14 the full value of the stores going into the
 15 marketplace to sell and rent their product.
 16 Q: What about the arranging of all the purchases
 17 by the management services that you heard? Is
 18 it your understanding that the management
 19 services function arranges all of the
 20 purchases, including the purchases for RAC
 21 Texas?
 22 A: Yes, sir.
 23 Q: And would that not be reflected in the retail
 24 operation of that company?
 25 A: I guess it would be reflected in the strategic

1 A: Well, RAC Texas has two streams of income. One
 2 is through management fees, okay. And the
 3 other is through the operation of the stores
 4 strictly in Texas. That's their income stream.
 5 Q: And you found instruction, I believe, in
 6 examples that were given here a few minutes ago
 7 based upon the fact that the operations of the
 8 stores were extensive as compared to what was
 9 being included in the numerator. That the
 10 denominator was extensive as compared TO what
 11 was included in the --
 12 A: Yeah, the --
 13 Q: -- in the numbers here?
 14 A: The denominator included the entire sales --
 15 Q: Yes.
 16 A: -- of the company.
 17 Q: Yes. And you object to that?
 18 A: Well, I didn't feel that it was representative
 19 of what goes on in South Carolina.
 20 Q: Insofar as RAC Texas is concerned, again, have
 21 you been able to point to anything that doesn't
 22 belong in South Carolina?
 23 MR. RYAN: Objection, Your Honor. Asked and answered
 24 several times.
 25 MR. VON LEHE: I'm still looking for an answer for it

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1 assistance fee that's charged to those
 2 companies.
 3 Q: Isn't it related to the operation of the retail
 4 stores?
 5 MR. RYAN: Objection, Your Honor. He just answered
 6 that very question.
 7 MR. VON LEHE: Your Honor, yes, he said reflected.
 8 I don't know about related.
 9 MR. RYAN: I think they're splitting hairs, Your
 10 Honor.
 11 THE COURT: Well, you know, I'll let him go. He's
 12 on cross, so I'll let him ask that one.
 13 Q: Are those management -- is inventory purchasing
 14 relating to the -- to the stores, to the stores
 15 that RAC Texas operates?
 16 A: Yes, if that's what they're doing.
 17 Q: Now, you said in analyzing this alternate
 18 method, you decided that you're going to treat
 19 them as separate businesses. Did you say that?
 20 A: Well, I treated it as separate income streams.
 21 Q: What's the difference, may I ask? What is the
 22 difference? I asked you if you decided to
 23 treat them as separate businesses. Your answer
 24 was I decided to treat it as separate income
 25 streams. What's the difference?

1 though, Your Honor.
 2 MR. RYAN: He's answered it, Your Honor. He might
 3 not like the answer but it's been answered.
 4 THE COURT: Hold on one second. Let me go back.
 5 I'm going to overrule that objection based on
 6 my notes.
 7 Q: Tell me please what these activities in South
 8 Carolina are that you think are extensive? I'm
 9 assuming you think --
 10 A: Simply --
 11 Q: -- they're not de minimus and they're not
 12 minimal. I'm assuming that.
 13 A: I mean, simply from the management services
 14 agreement my judgment is that there were
 15 activities taking place in South Carolina.
 16 Q: All right, sir. Now with regard to the
 17 alternate apportionment formula and the method
 18 which you used against RAC Texas. You took the
 19 total payment from RAC Texas -- excuse me, from
 20 RAC East to RAC Texas, you began with that, did
 21 you not? And to that you applied the sales
 22 factor of the South Carolina apportionment
 23 formula. Is this correct?
 24 A: Correct, yes, and the other entities.
 25 Q: Yes. And that's how you derived your estimate

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1 of the amount of the fee --
 2 A: That was contributed --
 3 Q: Which was contributed in South Carolina?
 4 A: -- by activity in South Carolina, yes.
 5 Q: But does that have any relationship to the
 6 profit of the stores in South Carolina?
 7 A: The strategic assistance fee?
 8 Q: Your method of computation? Does your method
 9 of computation have any relationship to the
 10 profit of the South Carolina stores?
 11 A: I simply used the sales ratio.
 12 Q: Yes.
 13 A: Because the management fee is based on sales,
 14 based on profitability of the entity.
 15 Q: Yes. I was just going to get to that. The
 16 management fee is based on profitability, is it
 17 not?
 18 A: Right.
 19 Q: But the method you used has no relationship to
 20 the profitability of the South Carolina stores,
 21 does it?
 22 A: Well, it's based on sales. I thought that was
 23 reasonable. Sales determines profitability.
 24 Q: They do if they're above expenses, correct?
 25 A: Well, yes. I mean.

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1 Q: So your method of computation you can't -- that
 2 method does not tell you how much of that
 3 management fee comes from South Carolina, does
 4 it?
 5 A: Well, I thought it would. I thought it did,
 6 that's why I did it.
 7 Q: It is your belief that it did. But was it your
 8 belief also that it reflected the income of the
 9 South Carolina stores?
 10 A: No, it reflected the income of RAC Texas.
 11 Q: Wasn't that based on the income of the stores?
 12 Isn't that the management fee?
 13 A: The sales ratio is a reflection of gross -- of
 14 sales within the state versus sales everywhere.
 15 That doesn't take profit or any of that stuff
 16 into consideration. It's just simply a sales
 17 ratio.
 18 Q: I want to ask you a couple questions about RAC
 19 West.
 20 A: Yes, sir.
 21 Q: Now, RAC West -- give me just one second,
 22 please. Excuse me.
 23 A: Sure.
 24 Q: Seem to have lost something. Now, with regard
 25 to RAC West, you separated the royalty payment

1 from the operation of the stores, correct?
 2 A: Yes.
 3 Q: Is it not your belief that those -- that that
 4 intellectual property, those trade names and
 5 trademarks, is it not true in your opinion that
 6 they contribute to the profitability of those
 7 RAC West stores?
 8 A: Well, they probably do. When we go and audit,
 9 we don't think about that. We're just looking
 10 at numbers. We don't think about this whatever
 11 contributes to the profitability.
 12 Q: All right. If --
 13 A: I mean, that's fine if it does. Whatever --
 14 whatever makes you profitable, do it.
 15 Q: Now, if those, existence of that intellectual
 16 property in RAC West, would you agree with me
 17 that the existence of that intellectual
 18 property in there has an intrinsic value to RAC
 19 West, an internal value to RAC West?
 20 A: Sure.
 21 Q: There would be no question about that --
 22 A: Sure.
 23 Q: -- in your mind? Now, in fact, it does own its
 24 own intellectual property, does it not?
 25 A: I guess it does.

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1 Q: I know that as a fact?
 2 A: I think it does.
 3 Q: Again, any doubt about it in your mind?
 4 A: No.
 5 Q: Now, if it -- isn't it true that that intrinsic
 6 value of that intellectual property, that that
 7 intrinsic value is greater because it's inside
 8 that entity, that it is greater than its
 9 licensing value would be?
 10 MR. RYAN: Objection, Your Honor.
 11 A: How would I know that? I mean, I just, it
 12 would just be pure speculation on my part.
 13 Q: You know what the --
 14 A: I mean, the taxpayer would know that and would
 15 have to make a calculation based on the history
 16 of it, and based on a lot of things.
 17 Q: Now, you know that it licenses that
 18 intellectual property to other entities for
 19 three percent of royalties, correct?
 20 A: Yes, sir.
 21 Q: You know you're aware of that?
 22 A: Yes, sir.
 23 Q: Yet its ownership of it. So it gets three
 24 percent from other entities?
 25 A: Yes, sir.

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1 Q: But its ownership of it, isn't it - wouldn't
2 it be reasonable to assume that the ownership
3 of it is worth more to it than the licensing
4 amount that it gets from other entities?
5 MR. RYAN: Objection, Your Honor. I fail to see the
6 relevance of Joe's opinion on this. He's not
7 here as an expert, so his opinion on the value
8 of things is irrelevant.
9 THE COURT: Any response?
10 MR. VON LEHE: Yes, Your Honor. I think it's a very
11 relevant question. If he knows the answer to
12 it, I think it's very relevant. We're talking
13 about intrinsic values and contribution
14 independence in an entity.
15 THE COURT: Do you dispute that that is a component
16 of the audit?
17 MR. RYAN: I dispute that that is a component of the
18 audit.
19 THE COURT: All right.
20 MR. VON LEHE: Well, and my response to that is I
21 think it's very much a component of the audit.
22 If they recognize intrinsic value of this
23 intellectual property in RAC West, then they
24 would have known they were dealing with a
25 related business. That the stores are in fact

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1 related to the intellectual property and there
2 weren't any grounds for trying to separate it.
3 MR. RYAN: I'll go with that relevance, Your Honor.
4 THE COURT: Okay.
5 Q: So isn't it a fact that there's an implicit
6 royalty here that inuring to this company by
7 virtue of its ownership of this intellectual
8 property?
9 A: Yes.
10 MR. VONE LEHE: Your Honor, if you could give me
11 just a moment. We're coming towards the end of
12 things.
13 Q: Now, you imposed a penalty on this taxpayer,
14 correct?
15 A: Yes, sir.
16 Q: Now, I believe you said in your deposition that
17 you always impose this penalty and it's up to
18 somebody further up to get rid of it?
19 A: Yes, sir.
20 Q: That is correct that it's always imposed,
21 understated value?
22 A: Usually, yes.
23 Q: But in some cases you might not impose a
24 penalty if you thought they had grounds not to,
25 would that be true?

1 A: Yes, it all depends on the circumstances.
2 Q: That there are criteria, the Department has
3 criteria about imposing penalties, does it not?
4 A: Yes.
5 Q: Have you ever lifted a penalty?
6 A: I don't have that authority to lift the
7 penalty.
8 Q: Once you impose it, that's it?
9 A: Once I impose it, that's it.
10 Q: But I'm going to ask you whether or not you
11 would impose this penalty. At the time these
12 amended returns were filed for RAC West, I do
13 not believe you were still employed with at the
14 Department; is that correct?
15 A: Yes.
16 Q: It was just a month ago.
17 A: Yeah.
18 Q: Maybe less than that. Maybe three weeks ago
19 they amended their returns to use the -
20 instead of using three factor formula to use
21 the single factor gross receipts formula. I
22 think you just said on your direct examination
23 that you were aware of that.
24 A: Yes. Yes, sir.
25 Q: Now, if you had been employed there, what would

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1 be your judgment at the time since you know as
2 much about this case as anybody. If you had
3 had an amended return at that time, would you
4 still have applied a penalty to RAC West?
5 A: Well, not on an amended return.
6 Q: You applied the penalty because they used the
7 three factor formula; is that correct or not?
8 A: No, because of substantial understatement.
9 Q: Caused by the three factor formula?
10 A: Probably that's what caused it, using the
11 incorrect method.
12 Q: If the single factor formula had been, had been
13 applied would that not have - would that have
14 made any difference to you?
15 A: Yes, that would have been the correct method.
16 Q: So it might have made, may well have made a
17 difference, is that correct?
18 A: (Nods head affirmatively.)
19 Q: Now, you talked about a minute ago in response
20 to some questions about taxpayers can call the
21 Department of Revenue to find out how to file
22 their returns, correct?
23 A: Yes, sir.
24 Q: Did you say that? Isn't it a fact, is it not
25 a fact that the Department of Revenue goes to

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1 great lengths to try to inform taxpayers
 2 generally on how to file their returns?
 3 A: Yes, sir.
 4 Q: They have instructions to go with tax returns,
 5 do they not?
 6 A: Yes, sir.
 7 Q: Rather sophisticated and elaborate instructions
 8 on corporate returns, correct?
 9 A: More detail in corporate return.
 10 Q: Okay. When these taxpayers, when RAC West
 11 filed their tax return with the Department of
 12 Revenue what, if anything, in those
 13 instructions would have indicated to it that it
 14 could not apply the standard apportionment
 15 formula?
 16 A: I don't think there's anything in there.
 17 Q: There's nothing in there about the type of
 18 method which you decided to use; is that
 19 correct?
 20 A: No.
 21 Q: In the instructions?
 22 A: No.
 23 Q: So what would put a taxpayer on notice of this?
 24 A: What would put it --
 25 Q: What would put them on notice that they would

1 income and they know their expense and they
 2 know how to structure all of that to determine
 3 whether or not a product line is profitable or
 4 isn't profitable, or this business is
 5 profitable or that one's not. Or this one is
 6 not -- is contributing too much cost or this
 7 one is contributing a whole lot of revenue.
 8 They have all of those abilities to make that
 9 determination.
 10 Q: What makes you think that -- let's take RAC
 11 Texas. What makes you think that RAC Texas can
 12 separate out or knows, either one, the expenses
 13 associated with the management fee? What do
 14 you base that on?
 15 A: Well, they should know what their management
 16 expenses are.
 17 Q: They should, you say?
 18 A: Yeah.
 19 Q: They should. But do you know if they do or
 20 not?
 21 A: Well, I don't know if they do, but they should.
 22 I mean obviously it's -- the expenses are in
 23 the return.
 24 Q: The expenses are the in return but this audit
 25 adjustment that you made, they can't put it on

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1 -- should call the Department of Revenue and
 2 ask them? Is that the concept?
 3 A: If they any questions about the method they
 4 should be using or our income stream doesn't
 5 fit your standard run of the mill apportionment
 6 formula, they can call and found out.
 7 Q: You don't expect every -- every corporate
 8 taxpayer filing a return to call the Department
 9 of Revenue and ask about how they ought to file
 10 a return, do you, and whether or not they ought
 11 to follow the standard instructions?
 12 A: No, but it's available for anyone who wants to
 13 ask.
 14 Q: All right, sir. You talked about this taxpayer
 15 not providing expenses against the management
 16 fee or against the royalties?
 17 A: Correct.
 18 Q: On direct examination, you talked about that?
 19 A: Right.
 20 Q: What information do you have or what makes you
 21 believe that this taxpayer or these two
 22 taxpayers have that information?
 23 A: Well, I mean they have a financial accounting
 24 department. They know what their costs are.
 25 They know their operation. They know their

1 the return.
 2 A: But those are -- those expenses also include
 3 expenses associated with the operation in the
 4 state of Texas.
 5 Q: Isn't it a fact --
 6 A: Which doesn't do any business in South
 7 Carolina.
 8 Q: Isn't it a fact that by requiring these
 9 taxpayers to separate their income from the
 10 rest of their business, that you have required
 11 something that these taxpayers do not do? They
 12 don't do this, do they?
 13 A: I don't know whether, I mean --
 14 Q: Do you have any evidence to show that these
 15 taxpayers --
 16 A: No.
 17 Q: -- have ever broken out expenses associated
 18 with a management services, or on the other
 19 hand, on the royalty payments?
 20 A: Do I have any evidence?
 21 Q: Yes. You audited them.
 22 A: Well, it's up to the taxpayer to provide that.
 23 That's not up to me to provide that. I mean
 24 income has expense associated with it. You the
 25 taxpayer have to provide me with that.

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1 Q: Even if it's not available?
 2 A: Well, it has to be available. It's up to them
 3 to develop it so we can get a net income.
 4 Q: You disregarded the net income of these
 5 businesses?
 6 A: Well because they didn't -- but that's because
 7 it included the sale of tangible personal
 8 property in another state and none of those,
 9 none of that revenue and none of that expense
 10 is associated with production of income in
 11 South Carolina.
 12 Q: Thank you, Mr. Southard.
 13 THE COURT: Redirect?
 14 MR. RYAN: No questions Your Honor.
 15 THE COURT: You may step down. We're going to take
 16 a break for lunch.
 17 MR. RYAN: Your Honor, may I release Mr. Southard to
 18 then go home and enjoy retirement.
 19 THE COURT: You can release him to go home. He has
 20 to decide if he enjoys retirement.
 21 MR. SOUTHARD: I think I'll stay until the end then.
 22 THE COURT: All right. That may be part of his
 23 enjoyment.
 24 (Lunch break from 1:16 p.m. until 2:34 p.m.)
 25 THE COURT: Call your next.

1 do with government activities broadly and how
 2 government finances those activities. It has to
 3 do with the effects of government instruments
 4 such as taxes and subsidies and other government
 5 instruments on the welfare of individuals and
 6 the well-being of the country.
 7 Q: Can you summarize for the Court your work
 8 history.
 9 A: Sure. I did my undergraduate degree in
 10 Australia. As you can tell from the accent I'm
 11 from Melbourne, Australia. I came to the United
 12 States to do PhD in economics at UCLA. And then
 13 took my first position academic, full-time
 14 academic position with the University of Western
 15 Ontario in Ontario, Canada. I then moved to the
 16 University of New Mexico, University of Central
 17 Florida, which is lovely state to live in. And
 18 now to Georgia State University.
 19 Q: Were you ever here at the University of South
 20 Carolina?
 21 A: Yes, I was. I left out the fighting Gamecocks.
 22 I was a professor in the then Moore School of
 23 Business. That's scary, I skipped 11 years of
 24 my life.
 25 Q: Sometimes I feel like they pass that quick. As

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1 MR. RYAN: Thank you, Your Honor. The Department
 2 calls Dr. Glenn Harrison to the stand.
 3 DR. GLENN HARRISON, having been duly sworn,
 4 testifies as follows:
 5 DR. HARRISON - DIRECT EXAMINATION BY MR. RYAN:
 6 Q: Good afternoon, Dr. Harrison.
 7 A: Good afternoon, sir.
 8 Q: Can you please state your full name for the
 9 record.
 10 A: Glenn William Harrison.
 11 Q: And Dr. Harrison, where are you currently
 12 employed?
 13 A: I'm employed at Georgia State University. I
 14 hold the C.V. Starr Chair in risk management and
 15 insurance. I am also the director of the Center
 16 for Economic Analysis of Risk in the Robinson
 17 College of Business.
 18 Q: And what are your primary areas of research?
 19 A: Primary areas of research are applied economics,
 20 experimental economics, environmental resource
 21 economics, international trade policy and public
 22 finance.
 23 Q: Can you describe public finance in a little more
 24 detail.
 25 A: Sure. That's the field of economics that has to

1 part of your teaching experiences, have you ever
 2 taught a course on law and economics?
 3 A: Yes. I've taught that for many, many years.
 4 Q: Can you tell us briefly what that course is
 5 about.
 6 A: Sure. That course covers the connections
 7 between law and economics at a very general
 8 level for students that are often pre-law.
 9 That'll be about usually 40 to 50 percent of the
 10 students. So it will introduce them to the
 11 manner in which economic principles apply in a
 12 legal context, and also the extent of what the
 13 manner in which laws, statutes, regulations, the
 14 Constitution, impact economic activity. So it's
 15 meant to be looking at the interaction between
 16 law and economics.
 17 Q: Have you ever testified as an expert at trial
 18 before?
 19 A: Yes, I have.
 20 Q: Have you ever testified as an expert in South
 21 Carolina Administrative Law Court?
 22 A: Yes, I have.
 23 Q: Can I have you turn to tab 20, please, of
 24 Exhibit One.
 25 A: I've got it.

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1 Q: Do you recognize this document?
 2 A: Yes, it's my CV.
 3 Q: Is this your most recent CV?
 4 A: I believe it is, and I can check that very
 5 quickly. Yes, it is.
 6 Q: Does this CV adequately reflect your experience,
 7 research and which of the areas you've worked
 8 on?
 9 A: Yes, it does.
 10 Q: In general, what types of issues where you
 11 addressed, were you asked to address in this
 12 case?
 13 A: I was asked to address questions concerning the
 14 economic aspects of the case. Specifically the
 15 question of economic nexus between the RAC
 16 Texas, RAC West and South Carolina. I was asked
 17 to evaluate the Department's determination and
 18 the extent to which it reflected the economic
 19 principles underlying the tax code that's
 20 applied in South Carolina.
 21 Q: And in your academic research and expert witness
 22 experience, have those led you to examine the
 23 economic rationale of tax statutes?
 24 A: Yes, they have. And indeed, I have spent a
 25 great deal of my academic life publishing in

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1 that area and doing policy research in that
 2 area, as well as in the expert testimony.
 3 MR. RYAN: Your Honor, I would like to offer Dr.
 4 Harrison as an expert in economic principles,
 5 and also the economic rationale of tax statutes.
 6 THE COURT: I think he's been qualified --
 7 MR. VON LEHE: Your Honor --
 8 MS. GEER: Yeah, I'm sorry, I didn't catch that last
 9 part.
 10 MR. VON LEHE: I couldn't catch that last part.
 11 Economic principles I heard. I didn't heard
 12 that economic --
 13 MR. RYAN: Economic rationale of tax statutes.
 14 MR. VON LEHE: Once more please?
 15 MR. RYAN: Sure. Economic rationale of tax statutes.
 16 MS. GEER: Your Honor, we would agree to him being an
 17 expert in economics or economic principles, but
 18 not the economic rationale of tax statutes.
 19 THE COURT: All right. Do you want to give a
 20 specific reason why or just --
 21 MS. GEER: Can I do some --
 22 THE COURT: Voir dire?
 23 MS. GEER: -- ask some questions on that topic?
 24 THE COURT: Yes.
 25 DR. HARRISON - VOIR DIRE EXAMINATION BY MS. GEER:

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1 Q: Dr. Harrison, when you say that you've spent
 2 your time doing economic rationale of tax
 3 statutes, I want to ask you some questions about
 4 that. First of all, have you ever been
 5 qualified as an expert in that field before?
 6 A: I'm not familiar with the exact designation that
 7 I was qualified for previously in this Court.
 8 I mean not this particular Court.
 9 Q: Are you referring to the Carmax case?
 10 A: Carmax and also ESA. So, I don't know whether
 11 the designation included those or not.
 12 Q: Well, as for the Carmax case, you were qualified
 13 as an expert in economics and law and economics
 14 but not economic rationale behind tax statutes.
 15 A: Okay. I believe your memory of it. I just
 16 don't recall.
 17 Q: All right. Have you ever written any articles
 18 that discuss allocation and apportionment
 19 issues?
 20 A: Not allocation and apportionment issues as such,
 21 no.
 22 Q: Nexus issues?
 23 A: Not nexus issues, no.
 24 Q: Sourcing issues?
 25 A: I have talked about sourcing issues from an

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1 economist viewpoint in terms of their incidence,
 2 that is to say the impact that they have on
 3 people in one region when there's a tax in
 4 another region or there's a geographically
 5 discriminatory tax.
 6 Q: All right. Well have you ever written any
 7 articles that discuss the economic rationale
 8 behind UDITPA, for example?
 9 A: No, not that specifically no.
 10 Q: Okay. What about behind an allocation and
 11 apportionment statute in general?
 12 A: Not that specifically. I've published much more
 13 generally than any one general principle in
 14 there.
 15 Q: Okay. Ever taught a class on any of those
 16 topics?
 17 A: No, I wouldn't teach a class in such a narrow
 18 topic. But I've certainly taught in questions
 19 of tax incidence, the nature of tax statutes in
 20 general.
 21 Q: When you're talking about tax statutes in
 22 general, you're not talking about allocation and
 23 apportionment statutes?
 24 A: That's a component. I've taught a lot about
 25 international trade taxes and taxes as they

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1 apply to domestic companies that have foreign
2 activities. I haven't taught narrowly and with
3 respect to interstate taxes. That an issue I
4 have not taught in.
5 MS. GEER: Your Honor, we would say he is not
6 qualified on the tax statutes that are at issue
7 in this case.
8 THE COURT: Any response?
9 MR. RYAN: I proffer him as an expert on economic
10 rationale of tax statutes in general. He's
11 published on that subject matter. He's talked
12 about the general economic theory of tax
13 statutes in his work and in teaching. I think
14 that he's an expert.
15 THE COURT: I didn't hear about the, in his
16 teachings. Dr. Harrison, so you have articles
17 regarding the economic rationale of tax
18 statutes?
19 DR. HARRISON: Yes. For example, I can give you one
20 on page ten of my CV and there are general
21 equilibrium analysis of regional fiscal
22 incidence back in 1984. In fact, Charles
23 McClure was a published commentator on that
24 article.
25 THE COURT: All right. And you've taught that, maybe

1 you say state taxes and international taxes.
2 What about multi-state tax?
3 A: Sure. I mean every time I look at regional
4 fiscal incidence, which is my catch word for
5 domestic taxes across different states or
6 different local jurisdictions, I've looked at
7 multiple states. And indeed, that's been the
8 focus of my attention, and indeed the paper that
9 I refer to that McClure was commenting on was
10 drawing the formal theoretical analogy between
11 international tax theory and domestic tax
12 theory. I was explicitly in that paper
13 commenting on how similar most of the
14 propositions in interstate tax incidence were to
15 international tax incidence. So from a
16 theoretical viewpoint, from a principle's
17 viewpoint they're identical. And indeed that
18 was the purpose of the article, that was one of
19 the reasons Charles McClure, who is one of the
20 leaders in this area of tax incidence, was one
21 of the commentators and he's published, he has
22 a published commentary after my paper.
23 Q: All right. So do these articles discuss any
24 allocation or apportionment statutes of any
25 state?

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1 not that specific class but that subject line in
2 classes; is that what I'm hearing?
3 DR. HARRISON: Oh, yes sir. Many years.
4 THE COURT: Now do you want to follow up on --
5 Q: Yeah, I'm sorry, I don't follow exactly what you
6 were saying that you had taught on. You've
7 taught on regional, international tax stuff, tax
8 statutes?
9 A: Uh-huh (affirmative response).
10 Q: What about these types of statutes that are at
11 issue here? What have you taught about them?
12 A: When I use the term regional fiscal incidence,
13 that's actually an economist's jargon for what
14 a lawyer might call state tax incidence or local
15 tax incidence.
16 Q: Okay.
17 A: I've also taught extensively on inter-
18 jurisdictional tax matters in terms of
19 international taxation and I've studied
20 questions -- I've consulted with the World Bank
21 for many decades on those sort of issues. But
22 specifically, with respect to the regional, what
23 I call regional fiscal incidence, that one is
24 much closer to what we're talking about here.
25 Q: Right. But what I'm not following is, I heard

1 A: They did not talk about apportionment statutes
2 of a particular state. They talk more about
3 principles.
4 Q: And what about in your classes? Did you teach
5 on any specific, on any particular state's
6 allocation or apportionment statutes?
7 A: No. Although last term I did talk to my theory
8 of risk class about some of the ways in which
9 risk management is called tax minimization is
10 masquerading as risk management. I mentioned
11 that to you in deposition.
12 Q: Yes, you did.
13 MS. GEER: Your Honor. I still just don't think --
14 I mean he has it sounds like some expertise in
15 some tax statutes, but not in the types of
16 statutes that are at issue in this case. So --
17 THE COURT: Well, that goes to the weight of his
18 testimony, not to his qualification of his
19 testimony, does it not?
20 MS. GEER: I don't think so. I mean, we're going to
21 be assuming the Department's going to be asking
22 him for the economic rationale behind South
23 Carolina's allocation and apportionment statutes
24 and he's never taught about it or written about
25 it. I don't see how he has expertise in that

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1 area.
 2 THE COURT: Well, he certainly -- there's no doubt
 3 we're going to get an expert in economic
 4 principles and also law and economics, we
 5 wouldn't have a problem there.
 6 MS. GEER: That's true, Your Honor. We would agree
 7 to that.
 8 MR. RYAN: I think if he's got an expertise on how the
 9 rationale tax system works and you put any state
 10 in front of him, he's got the expertise to
 11 analyze it.
 12 THE COURT: Well, we will find -- I can't --
 13 MR. RYAN: If law and economics will satisfy, I will
 14 go with that.
 15 THE COURT: Okay. Let's just go with that.
 16 MS. GEER: We don't have an objection to that.
 17 DR. HARRISON - CONT. DIRECT EXAMINATION BY MR. RYAN:
 18 Q: Dr. Harrison, let's talk about RAC West. Now,
 19 as part of your preparations for this matter,
 20 you read the depositions of Hugh Tollack and
 21 Dawn Wolverton?
 22 A: Yes, I did.
 23 Q: Did you review any publications relative to this
 24 matter?
 25 A: Yes. I looked at, initially at the Department's

1 A: This is what's referred to as a single factor
 2 apportionment formula. It's an actual
 3 apportionment in terms of the gross receipts
 4 from within the state divided by the total gross
 5 receipts from everywhere during the taxable
 6 year.
 7 Q: Would you consider that to be a broad statute?
 8 MS. GEER: Your Honor, I would object to this. We
 9 would not object to Dr. Harrison publishing any
 10 portion of the statute and then commenting on
 11 its economic rationale. But we do not -- we
 12 object to him construing it, interpreting it,
 13 anything along those lines.
 14 MR. RYAN: Just repeating it, what part did you agree
 15 with that I can do?
 16 MS. GEER: You can publish it. He can publish any
 17 portion of the statute.
 18 MR. RYAN: Okay.
 19 MS. GEER: And he can speak to the economic, what he
 20 thinks is the economic rationale behind the
 21 statute.
 22 Q: What is the economic rationale behind that
 23 statute?
 24 A: Well, this particular statute, you're talking
 25 about 2290 or --

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1 determinations in both matters. I looked at the
 2 -- some of the -- I actually read at some
 3 length, the KPMG pricing study that was referred
 4 to earlier that Dr. Wells discussed yesterday.
 5 And I also reviewed South Carolina statutes as
 6 they were applied in this case. And I have, as
 7 part of my general reading, looked at some of
 8 the academic literature in this area, some of
 9 the writings of Professor Pomp, some of the
 10 writings of Professor McClure that I know that
 11 Professor Wilder was referring to, and that's
 12 about it.
 13 Q: In your opinion, what is the economic goal of an
 14 apportionment statute?
 15 A: Well the goal of an apportionment statutes from
 16 an economic perspective is to find a tax level
 17 that is reasonable given the economic nexus of
 18 the parties with the taxing entity.
 19 Q: I'm going to show you part of the South Carolina
 20 Code.
 21 MR. RYAN: May I approach the witness, Your Honor?
 22 THE COURT: Yes.
 23 Q: Will you look at section 12-6-2290, please.
 24 A: Yes.
 25 Q: What type of apportionment formula is that?

1 MS. GEER: I'm sorry, one more objection. I don't
 2 think he can speak to what the legislature's
 3 intent was in this particular statute. He can
 4 speak to this type of statute generally, just --
 5 THE COURT: That wasn't the question he asked. He
 6 just asked what was the --
 7 MS. GEER: He asked --
 8 THE COURT: He said economic rationale and he
 9 specifically asked --
 10 MS. GEER: And I apologize if I did not speak clearly
 11 the first time, but we don't think that he can
 12 give economic rationale behind this legis -- why
 13 this legislature did it, but --
 14 THE COURT: Well, he can't give the legislative
 15 intent.
 16 MS. GEER: Right. Okay. That's all I was going to
 17 say.
 18 THE COURT: So I instruct you to answer the question
 19 under the umbrella of economics.
 20 DR. HARRISON: Absolutely.
 21 MS. GEER: Thank you, Your Honor.
 22 Q: Go ahead.
 23 A: Well, again, I was raising the question -- you
 24 asked about 2290. But 2290 sort of kicks in if
 25 2250 doesn't apply. So in terms of the economic

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1 rationale, these sort of go together. So do you
 2 want me to talk about both of these?
 3 Q: Sure.
 4 A: So 2250 is the one that's designed for economic
 5 entities that engage in manufacturing and trade
 6 intangibles, production and distribution in
 7 South Carolina. 2290 is then intended, in a
 8 general way, to pick up of these economic
 9 entities that don't fit into 2250, with of
 10 course the caveat that 2320 is there to pick up
 11 the residuals, those that don't fit into either
 12 of those in terms of coming up with an
 13 economically reasonable tax burden.
 14 Q: If a taxpayer only had royalty income in this
 15 state but had royalty income from the sale of
 16 goods in other states, would a formula such as
 17 that section set forth in 26-2290 be
 18 economically accurate in determining the base of
 19 the activities?
 20 A: Yes, that would be -- that would fit in
 21 perfectly. If the numerator consisted of
 22 royalty income and the denominator consisted of
 23 royalty income, you're comparing apples in South
 24 Carolina with apples elsewhere. Yes.
 25 Q: What if the denominator included retail

1 make it go down. It just has to.
 2 Q: Are you familiar with how the Department
 3 determination calculated RAC West's taxable
 4 income?
 5 A: Yes, I do recall how that was done.
 6 Q: Would you describe your understanding?
 7 A: Sure. Essentially it used the three percent -
 8 this is RAC West that you're talking about, the
 9 intellectual property?
 10 Q: Yes.
 11 A: It used the percentage that it obtained from the
 12 KPMG pricing study, which was three percent, to
 13 apportion to South Carolina.
 14 Q: What was your understanding of why or why not
 15 there are no expenses in that?
 16 A: Because the taxpayer refused to provide that
 17 information. And my understanding is that the
 18 auditor is under no -- he actually would be
 19 forbidden to make up numbers. He has to go on
 20 what the taxpayer provides. And if the taxpayer
 21 chooses to pay more taxes than they should when
 22 they were asked for the expenses, that's
 23 entirely their choice.
 24 Q: Is the Department's method economically
 25 reasonable?

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1 activities?
 2 A: Well, I call those oranges. So they would have
 3 a numerator defined over apples and a
 4 denominator defined over apples and oranges and
 5 that would not, in general, it might with
 6 particular values if there were virtually no
 7 oranges there, but in general that would not
 8 provide an accurate reflection of the economic
 9 connection of the entity with South Carolina.
 10 Q: Are you familiar with the amended returns filed
 11 by RAC West?
 12 A: Yes, I am.
 13 Q: From an economic standpoint, do you think the
 14 amended returns accurately reflect RAC West's
 15 activities in South Carolina?
 16 A: No, from an economic viewpoint. Again, they're
 17 combining apples in the numerator, which is
 18 royalties, with apples and oranges in the
 19 denominator where the oranges are the retail
 20 activities. So it's not accurately reflecting
 21 the type of activity that is undertaken in South
 22 Carolina.
 23 Q: What impact would including the retail
 24 operations in the denominator have on the ratio?
 25 A: Well, it's simple mathematics. It's going to

1 A: Given the information that was available to the
 2 auditor in terms of trying to tie the tax burden
 3 to the economic nexus with the state of South
 4 Carolina, I believe it was.
 5 Q: Is the Department's method all out of proportion
 6 with what goes on in this state?
 7 A: Well, it's in proportion to what goes on in the
 8 state. It would have been a more accurate tax
 9 assessment as indeed the auditor said and I
 10 believe the Department's determination said, if
 11 it took into account some of the expenses. But
 12 as I just indicated, those were asked for and
 13 the taxpayer apparently refused to provide that
 14 information.
 15 Q: Does the Department's method tax more than 100
 16 percent of the income here in South Carolina?
 17 A: No.
 18 Q: Do you believe the exclusion of the retail
 19 operations from the Department's calculations
 20 was reasonable?
 21 A: Oh, in fact, it was not just reasonable, it
 22 would be absolutely essential if it was to
 23 follow the statute and come up with a tax burden
 24 that fairly represented the economic nexus of
 25 the entity with South Carolina.

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1 Q: Now, Dr. Harrison, you heard a great deal of 2 testimony today, we all have, about whether or 3 not RAC West is a unitary business. Let me ask 4 you this. Is the issue of being a unitary 5 business, whether or not, is that determinative 6 of your analysis in this case? 7 A: No, not in the least. I think the concept of 8 unitary business is just a, from an economist 9 viewpoint, a red herring in the whole case. 10 Q: Can you explain what you mean by that. 11 A: Well, the notion of a unitary business, 12 certainly again from an economist perspective, 13 and I appreciate that there are more - there 14 are cases on how the Supreme Court wants a 15 unitary business to be defined. But again, from 16 a economist's perspective, a unitary business is 17 defined tautologically by the inability to 18 separate out the accounts of the divisions. 19 Indeed, in the classic article that Professor 20 Wilder referred to by Charles McClure back in 21 1983, he goes to great lengths on page 4 to 22 indicate his entire exposition is really an 23 explication of that tautology. He is defining 24 a unitary business as a business that cannot be 25 -- whose accounts cannot be easily separated.	1 question two or three minutes into the trial as 2 to the strange nature, I'll interpret it as the 3 strange nature of RAC East having as a 4 subsidiary someone that has to pay -- the nature 5 of the legal structure that's set up there. I 6 see them all as one large entity that is 7 connected, and I find it difficult to 8 understand, again in terms of the economic 9 principles involved, how it's either not all a 10 unitary business or they're not a unitary 11 business. It's really just a legal fiction the 12 way it's been set up right now. To think of RAC 13 West as one unitary business and RAC Texas as 14 another, that seems to be just a convenient 15 fiction and it bears no relationship to the 16 underlying economics. And that's the 17 perspective that I have on this. 18 Q: Have you published any articles about the 19 different fields of accounting? 20 A: Yes, I have. 21 Q: Are you familiar with those different fields of 22 accounting? 23 A: Yes. 24 Q: Can you tell me about them? 25 A: Yes. And that's something an economist would be
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1 So is some sense, he's not that -- if something 2 is unitary, you've essentially assumed away one 3 of the issues here, and that is the issue as to 4 whether you can indeed identify the expenses and 5 the costs of the royalty part and the retail 6 part, just to focus on RAC West. So I think the 7 concept of a unitary business is, as you 8 indicated, something of a force field. It's 9 kind of one of those invisible fields that the 10 petitioner would like to kind of say it's 11 unitary, therefore, you can't touch it, you 12 can't do anything. And that's just nonsense. 13 That's just wrong from an economist viewpoint. 14 It's wrong in terms of the use of accounting 15 principles. And I think it's -- I find it 16 shocking. 17 Q: Now, if an entity chooses to place two 18 businesses together under the same corporation, 19 does that automatically mean they're unitary? 20 A: No, not at all. 21 Q: What impact does RAC East's use of the same 22 management and has the same close value with RAC 23 West have in your analysis of whether RAC West 24 is a unitary business that can't be separated? 25 A: Well, I find it -- actually, the Judge asked a	1 familiar with in the natural course of our work. 2 There's really two broad areas of accounting as 3 they're usually defined. Financial accounting, 4 which is the type of accounting you do for 5 external parties. That you might do for tax 6 purposes but you might also do for reporting to 7 the SEC. And then managerial accounting, which 8 is the accounting that you do for internal 9 purposes. And cost accounting is one of the 10 subsets of managerial accounting. So there's 11 others. For example, forensic accounting, 12 various types of accounting that you might do. 13 But the big ones are financial accounting, which 14 is really trying to keep a record, usually 15 following generally accepted accounting 16 principles, of the transactions of the company 17 for external purposes. And they might be for 18 tax purposes; they might be for other financial 19 reporting purposes. They don't need to be 20 necessarily the same. And managerial accounting, 21 which can be thought of intuitively as the 22 accounting for managerial purposes, the more 23 forward looking purposes of accounting. If the 24 company wants to find out how certain divisions 25 are performing, how certain stores, whether they

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1 are profitable, it would engage in managerial
2 accounting and cost accounting.
3 Q: Did you hear -- were you here yesterday for Hugh
4 Tollack's testimony?
5 A: Yes, I was.
6 Q: Did you hear him testify about how they can
7 figure out the profitability of an individual
8 store?
9 A: Yes, I did. He did say that it was possible to
10 figure out the profitability of the store.
11 Q: Would that be a form of -- what form of
12 accounting would that to know, to make that
13 determination?
14 A: Well given that they have no obligation, as I
15 understand it, and I don't know the full range
16 of their legal obligations for reporting
17 federally or state-wise, but I'm inferring from
18 the testimony that I've heard that they don't
19 have any obligation to do that as part of
20 financial accounting. That would be a very
21 natural thing to do as a part of managerial
22 accounting. And frankly, a company this size,
23 I would be stunned if they didn't have a
24 significant and sophisticated managerial
25 accounting in place.

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1 Q: Would one or more of the fields of accounting
2 you just described be able to separate the
3 revenue and expenses from one part of the
4 business from the revenue and expenses of
5 another part of the business?
6 MS. GEER: Your Honor, I object to this question.
7 He's not qualified and, in fact, his deposition
8 stated that he was not an expert in managerial
9 accounting, so although I'm sure there are
10 managerial accountants out there that can
11 testify as to whether this could be done
12 accurately, I don't think he's qualified to
13 testify on this.
14 MR. RYAN: My question Your Honor was would one or
15 more of the fields of accounting, so if one of
16 the other fields of accounting that he is an
17 expert in can handle it, I think he's an expert
18 to go on.
19 MS. GEER: I also didn't think we qualified him as an
20 expert in accounting.
21 THE COURT: He's partially laid the groundwork by
22 saying that in economics there is -- that part
23 of economics is a consideration of financial and
24 managerial accounting. If you're going to go
25 further down the path you're heading, you need

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1 to lay the groundwork.
2 MR. RYAN: Okay.
3 THE COURT: Or finish laying the groundwork.
4 Q: From your knowledge of economics, is it possible
5 to determine revenue and expenses from one part
6 of a business from the revenue and expenses of
7 another part of the business?
8 A: Yes. That is something that an economist that
9 works in the field of industrial organization
10 would do. And indeed, they would rely on some
11 of the principles from accounting in doing that.
12 But that's a standard thing that's done in
13 economics in the field of industrial
14 organization. And indeed, as I mentioned in
15 deposition, I've published in a peer reviewed
16 paper or two in that area.
17 Q: Can you tell us about that paper.
18 A: Sure. That's a paper -- I should probably give
19 you the full title of the paper. And it's
20 mentioned on page 16 of my CV, it's item number
21 11 under the topic of Law and Economics. The
22 title of the paper is Mooresville Honda Company,
23 a Case in Forensic Accounting. And that was
24 published in the Journal of Accounting Education
25 in 2004. And I can tell you briefly about the

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1 paper and the tools in it.
2 Q: Please do.
3 A: It had to do with a fairly scandalous piece of
4 litigation to do with bribery of Honda cars.
5 And as many people in South Carolina would know,
6 Rick Hendrick, was a convicted felon for bribing
7 Honda dealers for many, many years. And I was
8 engaged as an expert witness in a lawsuit
9 against what were referred to as "dirty
10 dealers," dealers who engaged in bribery and
11 against Honda Company on behalf of dealers who
12 were clean dealers, and there were several of
13 them here in South Carolina and several in North
14 Carolina. The relevant part of the case is that
15 we had to ascertain what part of -- there were
16 several parts when you're making profit, when
17 you're running a Honda dealership. There is the
18 new car sales, there's used car sales, there's
19 repairs. And it turns out that that's a
20 tremendous profit center. So when somebody
21 sells a new car, one of the largest amounts of
22 profit they make is not from the new car
23 division, the actual profit they make there,
24 although on Hondas, they did. But they make an
25 extraordinarily large profit on the maintenance

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1 that has to be done pursuant to the warranties.
 2 So we had to apportion and ascertain using
 3 principles of managerial and cost accounting
 4 what fraction of the profits from these various
 5 divisions could be attributed to the cars that
 6 were diverted away from the clean dealers. So
 7 in other words, the clean dealers got less cars
 8 in a time when Hondas were extremely popular.
 9 So to calculate damages, we needed to ascertain
 10 what portion of the profits in each of these
 11 divisions, think of there being three divisions,
 12 there's more, but three major divisions were
 13 attributable to the diverted cars. So that
 14 called on us to look at how you would apportion
 15 variable costs in different divisions, how you
 16 would apportion fixed costs across different
 17 divisions, and what accountants call variously
 18 semi fixed or semi variable costs. That's an
 19 expense category that has some elements of the
 20 fixed costs, which doesn't vary with respect to
 21 the output, and some elements of a variable
 22 costs that does vary with output. So that paper
 23 was an exercise in precisely the type of
 24 apportionment that we're talking about here. As
 25 I mentioned, it was published and peer reviewed

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1 in the Journal of Accounting Education.
 2 Q: Have you seen any evidence or heard any
 3 testimony in this case that would lead you to
 4 believe that an economist couldn't separate RAC
 5 West's retail operations from RAC West's royalty
 6 operations?
 7 A: No.
 8 Q: Now, Dr. Wilder commented on a discussion or a
 9 paper by Charles McClure. Have you read that
 10 paper?
 11 A: Yes, I have. This is the 1983 NBDR paper which
 12 was subsequently published in a volume that
 13 McClure edited.
 14 Q: What is your understanding of McClure's
 15 exposition on the subject?
 16 A: I thought it was an excellent paper. What he
 17 was trying to do was to codify from an
 18 economist's perspective what the unitary
 19 business concept means and some of its
 20 implications for tax policy. The concept had
 21 already by then appeared in a number of Supreme
 22 Court cases and was due to appear in several
 23 others that had been heard before the Supreme
 24 Court. So, in that sense, McClure was reacting
 25 to the Court's interpretation of these -- of

1 that term and proposing an economist's
 2 definition of what a unitary business was. But
 3 it was a well argued piece. I mean McClure is
 4 a respected scholar in this area.
 5 Q: And based on your understanding of McClure and
 6 your understanding of the economics, if separate
 7 accounting could accurately separate the profits
 8 of a particular business, can separate
 9 accounting be used?
 10 A: Yes. And, in fact, he explicitly said so in
 11 footnote 79.
 12 Q: Even if a business calls itself unitary?
 13 A: Yes. He, in fact, said minor difficulties with
 14 separate accounting should not force unitary
 15 combinations that might lead to quite unofficial
 16 results. In fact, McClure was quite clear that
 17 he understood that people could get up to
 18 mischief, and I'll use that term broadly in
 19 terms of whether it's tax evasion or tax
 20 minimization. I don't want to get into the
 21 intent. I'm just saying he was well aware, as
 22 indeed Professor Pomp was in the article that
 23 you had him read from. But this occurs in the
 24 background, so that when everyone wants to talk
 25 about apportionment issues, when one wants to

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1 talk about the economics of these things, you
 2 have to be aware that there are incentives for
 3 companies to engage in mischief.
 4 Q: For an economist, when you're looking at the
 5 unitary issue, I'll call it, is your first
 6 question whether or not a business is unitary or
 7 is your first question whether or not a business
 8 can be -- whether it can be, separate accounting
 9 could accurately reflect that business?
 10 A: Well, I tend to avoid the term unitary business
 11 in general. I'm happy to answer your question
 12 directly, but let me answer it indirectly if I
 13 may. Precisely because the term has loaded and
 14 I think mistaken correlates in the legal
 15 literature, and I don't want to get into term --
 16 I'm just saying I'm well aware that the word,
 17 that word has some meanings in terms of
 18 lawsuits. I'll answer as an economist. As an
 19 economist, the real issue is you need to go
 20 beyond just hand waving discussions of
 21 interdependence and relatedness. You need to
 22 exactly get at the question, can you, with some
 23 degree of reliability, not necessarily
 24 uniqueness but reliability, apportion the
 25 revenues and the expenses from the various

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1 divisions. Let's call them divisions. Let's
2 forget whatever the particular legal fiction is
3 about, you know, which company is where because
4 that's something of a shell game that is
5 apparent. But the critical issue here if you
6 take the entity as a whole, can you with some
7 degree of reliability for tax purposes apportion
8 the revenues and the costs of different
9 divisions or types of activities? For me, as an
10 economist, that's the overriding concern.
11 Q: Have you read Professor's Pomp's reports?
12 A: Yes, I have.
13 Q: And did hear Professor Pomp's testimony today?
14 A: Yes, I did.
15 Q: Do his opinions change your opinions in any way?
16 A: Not in the least.
17 Q: Let's talk about RAC Texas. What is your
18 understanding of what RAC Texas does?
19 A: Well, RAC Texas provides management services,
20 certainly to RAC East, and I believe also to RAC
21 West, but I don't know -- I don't know that as
22 I sit here. But it certainly provides it to RAC
23 East and hence to the stores that operate in
24 South Carolina and that are, you know, the focal
25 point of the nexus here that a lot of the

1 Services Agreement say that it does, or what
2 have I heard in terms of evidence, in terms of
3 what goes on there? Because they are two
4 different things.
5 Q: What does the management -- what is your
6 understanding what the Management Services
7 Agreement says?
8 A: It says that RAC Texas handles leasing.
9 Q: What is your understanding of whether or not RAC
10 Texas is compensated for handling these things?
11 A: Well, my understanding is that it is compensated
12 for handling all leasing, although the reality
13 as we found from the evidence yesterday is that
14 a good portion of the activity of leasing occurs
15 in South Carolina with personnel in South
16 Carolina, to be sure who are paid by RAC East.
17 But that is part of the leasing process, as your
18 questions with Mr. Tollack explained.
19 Q: From an economic standpoint, when a lease is
20 negotiated for land in South Carolina, where
21 does that transaction take place?
22 A: The transaction takes place in South Carolina.
23 It would be a lease that is subject to the laws
24 and subject to the enforcement and receive the
25 benefits of the legal infrastructure in South

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1 activities of RAC Texas are clearly directed
2 towards the stores in South Carolina. And
3 that's critical in terms of establishing
4 economic nexus. It also operate stores in
5 Texas, and I heard the testimony that clarified
6 that the manner in which it operates stores in
7 Texas is similar to, but interestingly different
8 from, the manner in which stores are operated in
9 RAC East and RAC West. In other words, some of
10 the testimony is that some of those stores to
11 some extent are used as testing grounds, as
12 proving grounds, so that they serve a purpose in
13 allowing the management services to be refined.
14 And that makes perfect sense. So those are the
15 two activities that it engages in.
16 Q: Have you reviewed the KPMG pricing study?
17 A: Yes, I did.
18 Q: Have you reviewed the Management Services
19 Agreement from RAC Texas?
20 A: Yes, I did.
21 Q: Now let's talk about some of the specifics of
22 the Management Services Agreement. Is it your
23 understanding that Texas LP handles leasing for
24 the operating entities?
25 A: Well, are you asking me does the Management

1 Carolina for the protection of that lease.
2 Q: Now, to the extent someone in Texas is working
3 on leasing for South Carolina stores, when does
4 value attach to the leasing services?
5 A: Well, I think one has to be careful in terms of
6 saying when does it attach. It attaches when
7 the transaction is consummated or when the
8 transaction is made. That means, in general,
9 step back from leases. If I want to buy some
10 object from you, and you and I agree on a price,
11 the value originates when we actually make the
12 trade, not when we say we'll make the trade,
13 when we actually make the trade. So that alerts
14 us already to the fact that there are two sides
15 to the creation of value, and indeed, and
16 Professor Pomp talked and indeed the legal
17 literature talks about the difference between
18 origin of payment approaches and place of
19 activity approaches. And that just isn't in
20 that. That's a correct legal, if you like,
21 phraseology to match the fact that there are two
22 sides to a transaction. So from my point of
23 view, value occurs when the transaction is
24 consummated, and there are two sides to every
25 transaction.

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1 Q: So your understanding of what goes on with the 2 leasing process of South Carolina stores, where 3 does value attach to those services? 4 A: Well, the value attaches, from my point of view, 5 when the transaction occurs, and hence, it 6 would occur in South Carolina because that's 7 where the transaction is legally consummated. 8 Q: Does handling leases create economic nexus with 9 South Carolina? 10 A: Yes, of course it does, particularly if the 11 value that is created that we just talked about 12 in one late event in terms of the transaction 13 and the actual legal transaction occurs in South 14 Carolina. And most particularly from an 15 economic viewpoint if that activity, that 16 leasing activity is directed towards South 17 Carolina. So if that economic activity is 18 directed towards South Carolina in the sense of 19 wanting to lease some property in South Carolina 20 for the purposes of making a profit in South 21 Carolina, then that creates an economic nexus to 22 South Carolina. 23 Q: Now, if RAC Texas is compensated for handling 24 leases and a South Carolina store manager goes 25 to visit a potential site before it's leased,	1 any legal dispute regarding a lease, what impact 2 would that have on your analysis of economic 3 nexus? 4 A: Well, again, if the litigation had to occur in 5 South Carolina, then there would be nexus in 6 South Carolina. I mean, if the litigation has 7 been undertaken pursuant to the judicial system 8 in South Carolina, just as the petitioners find 9 themselves availing themselves to this beautiful 10 court today, they would be using the 11 infrastructure in that case as well. 12 Q: Let's talk about hiring and firing. Were you 13 here for -- did you hear Hugh Tollack's 14 testimony yesterday about the involvement of the 15 store manager in the hiring and firing process? 16 A: Yes, I did. 17 Q: What impact does that have on your analysis of 18 whether or not there's economic nexus between 19 RAC Texas and the state of South Carolina? 20 A: Well again, it just confirms that in addition to 21 directing economic activity towards South 22 Carolina, there's some physical labor activity 23 going on in South Carolina to affect the hiring 24 and the firing. And, indeed, we talked at some 25 length, admittedly I'm prompted by your
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1 from an economic standpoint, is RAC Texas being 2 compensated for the actions of that store 3 manager? 4 A: Yes, it would appear that it is, and indeed, 5 that seems fairly clear on its face. Some of 6 the physical activity occurs here in South 7 Carolina. Quite apart from our discussion about 8 the creation of value, some of the physical 9 activity involved, some of the labor involved 10 occurs in South Carolina. 11 Q: From an economic standpoint, what does that -- 12 what impact does that information have on your 13 analysis of whether or not there's economic 14 nexus between RAC Texas and South Carolina? 15 A: Well, it just adds an extra leg to the argument 16 that there is clear economic nexus with South 17 Carolina. It's not just that the economic 18 activity, the services are out of state and 19 directed towards South Carolina, that's one 20 basis, but another basis is that there's actual 21 activity, labor, and possibly capital, but labor 22 being used in South Carolina. So that's just an 23 additional basis for saying the economic nexus 24 exists. 25 Q: Now, if RAC Texas were responsible for handling	1 questions about the specifics about what the 2 store manager had to do. 3 Q: Now, to the extent that employees in Texas work 4 on hiring and firing for South Carolina stores, 5 when and where does value attach to those 6 services? 7 A: Well, the value again attaches when transactions 8 are occurring and then when the economic 9 activity is directed towards South Carolina, it 10 occurs in South Carolina. 11 Q: In terms of economics, where is RAC Texas aiming 12 its activities when it hires someone for a South 13 Carolina store? 14 A: Oh, it's very clearly on its face aiming it at 15 South Carolina. So I don't think there can be 16 any dispute about that. 17 Q: Does hiring and firing, as you understand RAC 18 Texas does, does that create economic nexus 19 between RAC Texas and South Carolina? 20 A: Absolutely. Again, on two bases, not just the 21 fact that it's directed -- the managerial 22 services are directed at South Carolina, but 23 that there's some physical activity occurring in 24 South Carolina, as the testimony of Mr. Tollack 25 demonstrated.

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1 Q: Now, having read the Management Services
2 Agreement and the pricing study, what is your
3 understanding of whether or not those documents
4 break apart the revenue for what goes on in
5 Texas and the revenue for what goes on in South
6 Carolina?
7 A: My understanding is that they don't. In fact,
8 they assume that literally everything occurs in
9 Texas and that there is no activity in South
10 Carolina. That's quite apart -- they don't
11 speak to the question of whether the services
12 are directed towards South Carolina, but they do
13 speak to the question of labor and capital,
14 whether those resources are used in South
15 Carolina. And they assume that all of it occurs
16 in Texas, whereas, in fact, some part of it
17 occurs here in South Carolina.
18 Q: Now, if RAC Texas were responsible for handling
19 any legal claims related to hiring and firing,
20 what impact would that have on your analysis of
21 the economic nexus between RAC Texas and South
22 Carolina?
23 A: Well, none, again, since some of those
24 activities would occur in South Carolina, it
25 would be, it would still have economic nexus for

1 study, is the amount of the management fee
2 determined by that pricing study based upon RAC
3 Texas being responsible for training?
4 A: Yes. The presumption in that pricing study is
5 that RAC Texas would undertake all of the
6 training activities.
7 Q: Does the pricing study split responsibility for
8 training in any way?
9 A: No, it does not.
10 Q: From your analysis of that pricing study, is the
11 amount of fee paid to RAC Texas reduced to
12 account for the actions of the store managers
13 and what goes on in South Carolina?
14 A: No, there's no mention of that whatsoever.
15 There's no way in which that state could
16 undertake that type of production.
17 Q: Now, during the -- let's just move on to
18 payroll. During the period at issue, what
19 entity was responsible for handling payroll in
20 South Carolina stores?
21 A: Well, payroll was provided by RAC Texas. It was
22 handled by RAC Texas.
23 Q: Are you aware or did you hear testimony that RAC
24 Texas sends paychecks into South Carolina?
25 A: Yes. I think the comment was that they're

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1 South Carolina.
2 Q: Let's talk about training. Based upon your
3 reading of the Management Services Agreement and
4 the pricing study, what Rent-A-Center entity is
5 responsible for training?
6 A: Well, that would be -- based on the pricing
7 study and the management study, it would be RAC
8 Texas.
9 Q: From an economic standpoint, where does training
10 of a South Carolina employee occur?
11 A: It occurs in South Carolina, and to some extent,
12 it occurs in Texas when they prepare training
13 materials. So there's some preparation of
14 training materials, but that's a case where the
15 actual training itself clearly occurs in South
16 Carolina, as the testimony Mr. Tollack showed
17 us.
18 Q: And to the extent an employee in Texas prepares
19 those materials, when and where does value
20 attach to those materials?
21 A: When they're used. Again, it came to a
22 transaction, when it's generating value in the
23 value added sense. When it's generating value,
24 and that occurs in South Carolina.
25 Q: Now, based on your analysis of the pricing

1 primarily done electronically these days, but
2 they essentially send paychecks into South
3 Carolina.
4 Q: Are you aware that during the audit period they
5 actually sent paper paychecks in?
6 A: Actually, I do recall something like that being
7 discussed, yes.
8 Q: Where is RAC Texas directing its efforts when it
9 handles payroll for a South Carolina store?
10 A: Well, very clearly South Carolina.
11 Q: And from an economic standpoint, when and where
12 does value attach to the payroll services?
13 A: When the transaction is consummated. When it
14 has value, and that's in South Carolina. Again,
15 the principle here is a simple but for
16 principle. But for the employee in South
17 Carolina and but for the funds in Plano, Texas,
18 or wherever they're being held, there would be
19 no value. But the value actually -- if the
20 funds just sat in Plano and weren't actually
21 paid to somebody in South Carolina, if the
22 training materials just sat on the shelf in
23 Plano and they were not sent to or used by
24 somebody in South Carolina, there would be no
25 value. So the value, in that sense, comes in

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1 South Carolina.
 2 Q: Let's move on to advertising and advertising
 3 strategy. Did you hear Hugh Tollack testify
 4 about advertising strategy?
 5 A: Yes, I did.
 6 Q: And was it your understanding that RAC Texas
 7 comes up with the advertising strategy?
 8 A: Yes. They choose the national spokesman for the
 9 commercials.
 10 Q: Is an advertising strategy an intangible asset?
 11 A: It can create an intangible asset, yes. The
 12 strategy itself can be viewed as an intangible
 13 asset.
 14 Q: From an economic standpoint, is an advertising
 15 strategy, is that a valuable asset?
 16 A: It can be, yes. And it can be a very -- it can
 17 be a very valuable asset.
 18 Q: Now, if RAC Texas has paid for use of the
 19 advertising and marketing strategy in South
 20 Carolina, what impact does that have on your
 21 analysis of whether there's economic nexus
 22 between RAC Texas and South Carolina?
 23 A: Oh, it has no impact. It's clear that there is
 24 a nexus here. Again, it was purposefully, some
 25 of the advertising was purposefully directed to

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1 directing its efforts?
 2 A: Very clearly to South Carolina.
 3 Q: If there were no customers in South Carolina,
 4 what impact would that have on the need for more
 5 inventory in South Carolina?
 6 A: Well, it's a fairly immediate one. If there --
 7 but for the existence of customers in South
 8 Carolina, there would be no need for that
 9 activity as it is directed towards South
 10 Carolina.
 11 Q: Let's look at the pricing study which is, I
 12 think I have this memorized.
 13 A: Thirteen.
 14 Q: Thirteen. Thank you. Exhibit One, Tab 13.
 15 Let's look at page 15.
 16 A: Okay.
 17 Q: I think that's the one. Excuse me, page 14.
 18 THE COURT: What's the tab?
 19 MR. RYAN: Tab 13, Your Honor.
 20 THE COURT: And page 14. Okay.
 21 MR. RYAN: Sorry about that.
 22 A: I've got it.
 23 Q: Can you see the, look at the bottom paragraph
 24 and see the sentence starting with the lines "in
 25 the event that"?

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1 South Carolina. Some of it indicates that
 2 advertising may be more general. It may be
 3 general advertising that is intended to improve
 4 the brand name of RAC in general. But to the
 5 extent that that leads to value being created in
 6 the stores in South Carolina, which is the issue
 7 here, then it's South Carolina.
 8 Q: If there was a dispute related to advertising,
 9 RAC Texas was responsible for handling that
 10 dispute, what impact would that have to whether
 11 or not there's economic nexus between RAC Texas
 12 and South Carolina?
 13 A: That would have no impact on the analysis.
 14 Q: Would it strengthen it or weaken it, your
 15 analysis?
 16 A: Well, it would have no impact in the sense that
 17 the analysis actually occurs here. As I've been
 18 saying, the extent that the value of that
 19 litigation or the value of that economic
 20 activity only occurs because of things that
 21 happen in South Carolina, then it confirms the
 22 fact that there's nexus to South Carolina.
 23 Q: Let's talk about purchasing and inventory. When
 24 RAC Texas purchases goods to be sold in the
 25 South Carolina stores, where is RAC Texas

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1 A: Yes, yes, I have that.
 2 Q: Can you read that sentence aloud, please.
 3 A: Sure. "In the event that a customer does not
 4 return the equipment and/or is not able to make
 5 the payments, any legal proceedings will be
 6 managed by RAC management." Continue?
 7 Q: No, that's good. Based on that statement, if
 8 RAC Texas were to handle a dispute in this
 9 state regarding the return of equipment or
 10 failure to make payment, would that establish
 11 economic nexus with the state of South Carolina?
 12 A: Yes, indeed, because it's enjoying the benefits
 13 of the judicial infrastructure in South
 14 Carolina.
 15 Q: Let's talk about trademark management. What's
 16 your understanding of who manages and protects
 17 the trademark owned by RAC West?
 18 A: That's most likely RAC Texas because it's the
 19 lawyers, even though RAC West owns the
 20 trademarks and intellectual property, my
 21 understanding is that in the -- I would
 22 therefore suggest that to some degree there's a
 23 clear relatedness between RAC West and RAC
 24 Texas. But RAC Texas employs the lawyers that
 25 chase down the evildoers who are stealing the

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1 intellectual property or property rights.
 2 Q: Is RAC Texas compensated for protecting those
 3 trademarks?
 4 A: Yes, it is.
 5 Q: Are those the trademarks owned by RAC West used
 6 in South Carolina?
 7 A: Yes, they are.
 8 Q: So is RAC Texas compensated for protecting the
 9 trademarks in South Carolina?
 10 A: Yes, it is.
 11 Q: Let's talk about the apportionment for RAC
 12 Texas. Are you aware that the Petitioners
 13 assert that if nexus is found, RAC Texas should
 14 apportion its income pursuant to 12-6-2290?
 15 A: That's right. That's their amended return. No,
 16 no, sorry. We're talking about RAC Texas now.
 17 Q: Correct.
 18 A: Yes. That's correct. That's my understanding.
 19 Q: From an economic standpoint, would the gross
 20 receipts method of 12-6-2290 be economically
 21 accurate in determining the activities of RAC
 22 Texas in South Carolina?
 23 A: No, because it suffers from exactly the same
 24 economic dilution that we talked about with
 25 respect to RAC West and their -- in terms of

1 Court.
 2 MR. VON LEHE: Your Honor, I must rise to object to
 3 that statement. There's absolutely no
 4 foundation been laid for a statement like that
 5 from this witness. Nothing.
 6 THE COURT: You're objecting to the misleading the
 7 Court. Any response to that?
 8 MR. RYAN: We can just strike that portion.
 9 MR. VON LEHE: I mean, Your Honor, he knows absolutely
 10 nothing about the books and records of this
 11 taxpayer or how this taxpayer handles its
 12 affairs.
 13 THE COURT: All right. I'll strike that portion of
 14 the testimony regarding misleading the Court.
 15 MR. VON LEHE: Thank you, Your Honor.
 16 Q: What do the RAC Texas retail operations have to
 17 do with the activities of RAC Texas in South
 18 Carolina?
 19 A: Well, they provide some input to improve the
 20 quality of the management services. That was
 21 something that I was not aware of until I heard
 22 testimony yesterday from Mr. Tollack. So they
 23 do serve a purpose of allowing RAC Texas to
 24 refine, fine tune its management services. But
 25 apart from that they're -- apart from that

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1 their amended filing, that you've got apples in
 2 the numerator and apples and oranges in the
 3 denominator and that would misrepresent the
 4 economic nexus of the activity occurring in
 5 South Carolina.
 6 Q: Would it be fair to say your analysis and the
 7 testimony you gave regarding why RAC West should
 8 not use gross receipts would be the same
 9 testimony you give as to why RAC Texas should
 10 not use gross receipts?
 11 A: It's exactly the same logic, yes.
 12 Q: Does Dr. Wilder's assertion that RAC Texas is a
 13 unitary business change your analysis?
 14 A: No, because I don't -- no.
 15 Q: Have you seen or heard any evidence in this
 16 matter that would lead you to believe that the
 17 revenue and expenses of the RAC Texas management
 18 operations couldn't be separated from the
 19 revenue and expenses of the RAC Texas retail
 20 operations?
 21 A: No. And, in fact, that would be something that
 22 would be quite standard to be done within such
 23 a large corporation. And any claim otherwise
 24 would be either they have incompetent
 25 accountants or they're trying to mislead the

1 contribution, they're separate activities, they
 2 are a retail store.
 3 Q: Have you reviewed the Department's method in its
 4 determination for RAC Texas?
 5 A: Yes, I have.
 6 Q: Is the Department -- from an economic
 7 standpoint, is the Department's method
 8 reasonable?
 9 A: Yes, it is. Given the information that was
 10 available to the auditor and the information
 11 that he had available, it strikes me as the best
 12 that could be done in terms of reflecting the
 13 economic nexus of the activity in South
 14 Carolina.
 15 Q: What is your understanding of the proof of
 16 expenses provided to the auditor?
 17 A: My understanding is, again, same as with RAC
 18 West, that he asked them to provide that and
 19 they declined for whatever reason and that he's
 20 then obliged not to make up numbers. So it's
 21 not his responsibility to try to reduce the tax
 22 burden. But he clearly intended, he said so and
 23 it was clear in the Department's determination,
 24 that this be a proper tax and net income tax,
 25 but he needed information on expenses in order

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1 to be able to effect that. So it's somewhat
 2 disingenuous to say that --
 3 MR. VON LEHE: Your Honor, again, I must object to
 4 this. Your Honor, I object to the witness's
 5 disparaging remarks against this taxpayer for
 6 something for which he knows absolutely no
 7 background has been laid. Your Honor, he has no
 8 firsthand knowledge, whatsoever, as to how these
 9 taxpayers keep their books and records,
 10 absolutely nothing. And no background has been
 11 laid. And on top of that to make disparaging
 12 remarks about it, I think it needs to be struck.
 13 THE COURT: Well, he said it's somewhat disingenuous
 14 and he never completed the sentence.
 15 MR. VON LEHE: Your Honor, true, but I thought he got
 16 far enough along for me to understand what he
 17 meant.
 18 THE COURT: I think for me to understand what someone
 19 means they have to complete their sentence, in
 20 most instances, unless it's a compound sentence
 21 or an independent clause, independent, to get
 22 into the the grammatical aspects of it. But at
 23 this point in time I'm going to -- just ask the
 24 question again and let's go forward. As for me
 25 striking it, it would be useless because he

1 earlier, and also the information contained in
 2 the Department's determination, which I read.
 3 And that is that information was requested from
 4 the taxpayer and they declined to provide it.
 5 Q: Now, having reviewed the Department's method,
 6 does the Department's method, from an economic
 7 standpoint, tax more than 100 percent of the
 8 taxpayer's activity in South Carolina?
 9 A: No, it does not.
 10 Q: Is the method used by the Department out of all
 11 proportion with what business RAC Texas
 12 transacts in South Carolina?
 13 A: No, it is not out of all proportion. As
 14 indicated in the determination and by the
 15 auditor, the amount would have been lower if
 16 information about expenses had he deemed
 17 reliable would have been provided. But I would
 18 not say that it's out of proportion given the
 19 information that was provided to the auditor and
 20 to the Department.
 21 Q: Did you hear Dr. Wilder talk about where
 22 services should be sourced?
 23 A: Yes, I did.
 24 Q: What are your thoughts on his opinion?
 25 A: Well, Dr. Wilder was expressing the opinion that

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1 hasn't completed the sentence so there's no
 2 completion of the thought.
 3 MR. VON LEHE: Your Honor, let me also say this.
 4 With regard to the question, no background has
 5 been laid that this witness knows anything about
 6 the books and records of this company, nothing.
 7 He talked about he heard the agent say
 8 something. That's it.
 9 THE COURT: All right. An expert witness can testify
 10 about what he has also heard in the courtroom,
 11 as well as matters which an expert hears outside
 12 of the courtroom which an expert would commonly
 13 rely upon in the field of his profession.
 14 MR. VON LEHE: Yes, Your Honor.
 15 THE COURT: But we haven't gotten anything laid on
 16 that, so with all that said, let's just start
 17 again --
 18 MR. VON LEHE: All right, Your Honor.
 19 THE COURT: -- and if you need to object again, I'll
 20 hear your objection.
 21 MR. VON LEHE: Very well, Your Honor. Thank you.
 22 Q: What is your understanding of why the
 23 Department's method in its determination does
 24 not include expenses?
 25 A: Well, it's based on the testimony of the auditor

1 that should be determined by this value added
 2 concept, and with respect to an esteemed former
 3 colleague, I think he simply is in error there.
 4 The value added concept is a concept of
 5 economics that tells us, that provides one way
 6 to value a transaction, to value an economic
 7 activity. And it's defined in any dictionary,
 8 not just an economics dictionary. It does not
 9 tell us where to source the income. It tells us
 10 the value of the income. It's one way to
 11 ascertain the dollar value of the income. It
 12 doesn't speak to, at all, whether it's sourced
 13 in one location or another location or where the
 14 labor and capital are or where the final
 15 transactions are. So it's simply a mistake in
 16 an application of economic principles to claim
 17 the value added tells us it's sourced in one
 18 place or the other.
 19 MR. RYAN: Thank you. I have no further questions.
 20 THE COURT: Hold on one moment.
 21 MR. VON LEHE: Pardon, Your Honor?
 22 THE COURT: Hold on one moment.
 23 MR. VON LEHE: Yes, Your Honor.
 24 THE COURT: All right. Proceed.
 25 MS. GEER: Your Honor, would you allow us a ten

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1 minute break before we cross?
 2 THE COURT: Yes.
 3 (Break from 3:40 p.m. until 3:59 p.m.)
 4 MS. GEER: Your Honor, I have one just sort of
 5 procedural question. I asked him in the voir
 6 dire a lot of questions about his expertise.
 7 Can we just stipulate that that will be -- I
 8 know voir dire is sometimes preliminary but that
 9 that's part of the record, that I don't have to
 10 replew that ground?
 11 THE COURT: I think voir dire is a challenge of
 12 expertise --
 13 MS. GEER: Right.
 14 THE COURT: -- through voir dire, it goes to -- if the
 15 Court reviews what I did and finds that the
 16 ruling was incorrect as a result of your voir
 17 dire, then that's part of the record already.
 18 MS. GEER: Okay. Thank you, Your Honor.
 19 THE COURT: It can also be considered in determining
 20 weight, too.
 21 DR. HARRISON - CROSS-EXAMINATION BY MS. GEER:
 22 Q: Dr. Harrison, good afternoon. How are you?
 23 A: Very good, thank you.
 24 Q: I know we've met before, but I'm Bryson Geer
 25 here on behalf of the Petitioners. I first want

1 A: By itself it sounds a little incomplete but --
 2 Q: All right.
 3 A: -- I did say things like that.
 4 Q: Okay. Well, and here today you focused a lot on
 5 value, that you believe the value is where the
 6 customer receives the benefit of the services;
 7 is that accurate?
 8 A: Well, those are the questions I was asked. In
 9 context, the deposition questions you were
 10 asking were what if the services provided and,
 11 you know, there were no customers in South
 12 Carolina, so it's a slightly different context.
 13 But the questions I was asked by Mr. Ryan asked
 14 me about value and where is that created.
 15 Q: Right. All right. So you believe that out of
 16 state service providers that have customers in
 17 South Carolina have nexus with South Carolina,
 18 correct?
 19 A: Yes. If there are transactions in South
 20 Carolina and customers in South Carolina, and so
 21 that's the but for that we talked about. But
 22 for the services in that state, the labor and
 23 capital in that state and the labor and capital
 24 in this state and the purchaser of the services
 25 in this state, there would be no value. And in

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1 to talk to you about your opinions on -- well,
 2 actually first, can I just -- I think we've
 3 already established this, but clarify that all
 4 the opinions that you're here giving today are
 5 based on your opinions from an economic
 6 perspective, correct?
 7 A: That's correct, and the materials that I've
 8 reviewed which I indicated to you.
 9 Q: All right. And what I'm getting at is you're
 10 not here giving any legal conclusions?
 11 A: Oh, most definitely not.
 12 Q: Okay.
 13 A: That's above my pay grade.
 14 Q: All right. So let me ask you some questions
 15 about nexus to begin with. And this is, of
 16 course, as to RAC Texas. All right. So your
 17 opinion is that RAC Texas has economic nexus
 18 with South Carolina, and this was the wording in
 19 your deposition, I think you used a little bit
 20 different but consistent wording today, that it
 21 provides a service with the expectation of
 22 payment to a South Carolina customer?
 23 A: Yes. I think it was -- that was in context of
 24 a series of questions that we had.
 25 Q: Okay.

1 addition, there's a requirement that it be
 2 directed purposefully towards South Carolina.
 3 Q: All right. So let me make sure I understand
 4 your opinion on this. When an out of state
 5 service provider provides a service like
 6 management services to a customer in South
 7 Carolina with the expectation they're getting
 8 paid, they're not doing it pro bono, does that
 9 out of state company have nexus with South
 10 Carolina?
 11 A: Yes, it has an economic nexus.
 12 Q: All right. I should have said economic nexus.
 13 And is that true for any out of state business,
 14 service provider or not, that has a customer, a
 15 paying customer in South Carolina?
 16 A: Yes. I was stating that as a general principle.
 17 Q: Okay. For example, if a -- strike that. Since
 18 you are saying any service provider out of state
 19 that provides a service to South Carolina has an
 20 economic nexus with South Carolina, does that
 21 mean necessarily that the fact that RAC Texas is
 22 providing services to an affiliate, that the
 23 fact that there's an affiliate involved has no
 24 impact on your opinion?
 25 A: No, not with respect to the nexus question. It

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1 does have some implications on the manner in
 2 which that thing is priced.
 3 Q: Okay.
 4 A: But we'll put that aside.
 5 Q: As to economic nexus it is relevant?
 6 A: That's correct, yes.
 7 Q: So if RAC Texas was providing management
 8 services to Joe's Rental Center in South
 9 Carolina, RAC Texas would still have economic
 10 nexus, in your opinion?
 11 A: Well, it depends. It would in a sense that
 12 value is being created in South Carolina for
 13 that service. On the other hand, the other
 14 aspect of, the other leg of economic nexus is
 15 that it is purposefully directed at South
 16 Carolina. So that's why the connection with RAC
 17 East and the stores here, that they are RAC
 18 stores, speaks directly to the fact that it is
 19 directed at South Carolina, in addition to the
 20 fact that there is two sides to the transaction.
 21 So there's two factors here that are of some
 22 importance, and I don't want to lose that second
 23 factor.
 24 Q: All right. So the second factor is the
 25 directing your activities to the state?

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1 A: That's correct.
 2 Q: All right. And tell me again how that if it's
 3 Joe's Rental Service versus RAC Texas, how is
 4 your -- what is your opinion?
 5 A: Well, if the person directed their activities
 6 towards Joe's and provided services towards Joe,
 7 then it would meet the criteria for economic
 8 nexus.
 9 Q: Okay. And that is true regardless of whether
 10 that out of state company owns any property in
 11 South Carolina or ever sends an employee to
 12 South Carolina; is that correct?
 13 A: That's correct. As I indicated, the case is
 14 only strengthened when one argues that there are
 15 activities physically in South Carolina.
 16 Q: And did you hear the testimony that all of the
 17 RAC Texas -- I'm sorry, I'm moving out of nexus,
 18 for the benefit of the Court. I'm going to be
 19 asking questions that relate to sourcing of the
 20 management fees of RAC Texas. Did you hear the
 21 testimony that all of the RAC Texas employees
 22 are located in Texas?
 23 A: That's correct, that they are located in Plano,
 24 Texas.
 25 Q: All right. And did you also hear the testimony

1 that all the work that is performed by the RAC
 2 Texas employees was done in Texas?
 3 A: Well, I'm not sure what you mean by the work
 4 that the RAC -- RAC Texas employees do because
 5 --
 6 Q: Let me clarify my question for you.
 7 A: Sure.
 8 Q: Did you hear the testimony that the RAC Texas
 9 employees are in their Texas office when they
 10 perform their services under the Management
 11 Services Agreement?
 12 A: Well, you're adding several components there.
 13 Q: Okay.
 14 A: Let me just tease them apart, if I can, in terms
 15 of how I'm interpreting your question. I
 16 certainly heard the testimony that the RAC Texas
 17 employees are in Plano, Texas, but they may
 18 wander elsewhere but they're primarily there.
 19 That's to be sure. But I also heard testimony
 20 that RAC East employees --
 21 Q: Yeah, and I don't want to ask about RAC East
 22 right now.
 23 A: I understand.
 24 Q: Okay.
 25 A: I'm just a little confused by your question

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1 because it seems to be compounding those
 2 together and I just want to be very clear.
 3 That's all.
 4 Q: I'm not compounding. Put the RAC East employees
 5 to the side. The RAC Texas employees, when
 6 they're performing management services, is it
 7 your understanding that they are located in
 8 Texas?
 9 A: When they are performing their part of the
 10 management services, and that's not all of the
 11 management services I would believe, but they're
 12 part, they are in Texas, yes.
 13 Q: All right. So I'm going to get to what I think
 14 your next comments on the South Carolina
 15 employees in RAC East, where you were going with
 16 that. All right. So we've heard some
 17 testimony, I think you're referring to it, that
 18 there is some activity done by store employees
 19 of RAC East that place some part of the process,
 20 let's take hiring for example, you heard the
 21 testimony that the RAC East store managers would
 22 actually hire the person that's coming to work
 23 in the South Carolina store; is that correct?
 24 A: Right. That they would play some role in the
 25 hiring and firing.

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1 Q: All right. And I believe it's your testimony or
2 inference that at least the Department is making
3 this case that RAC Texas is somehow being
4 compensated for these job activities that the
5 South Carolina employees are performing; is that
6 your opinion in this case?
7 A: I don't want to speak for the Department, of
8 course, but that would certainly be my opinion.
9 Q: Okay.
10 A: That the agreement compensates them for certain
11 services and that some part of those services
12 are physically conducted in South Carolina.
13 We'll put aside who pays for the salaries, but
14 they're physically done in South Carolina.
15 Q: All right. Well, let me ask you, let's -- I
16 want you to assume these facts. Assume that RAC
17 East pays their store employees, their store
18 managers for their role in the hiring and firing
19 process; assume that for me.
20 A: Okay.
21 Q: And assume that RAC Texas pays its employees for
22 the management services it provides, that's fact
23 two.
24 A: Okay.
25 Q: And assume fact three, that the RAC Texas

1 A: So I'm treating it --
2 Q: Activity by employees, how about that?
3 A: Well again, the value is created when there is
4 a transaction, somebody does something and
5 somebody pays for it. And if one of those
6 people, one of those somebodies is in South
7 Carolina, my definition of nexus --
8 Q: All right.
9 A: -- it's tied to the transaction. Whether it's
10 contractual or otherwise, it's tied to the
11 transaction. I think what you're trying to do,
12 which is okay but wrong, I mean if I understand
13 it.
14 Q: No --
15 A: No, I mean it in a sense of I'm just trying to
16 understand what I think you're saying is it's
17 tied to the physical activities, and what I'm
18 saying is the economic nexus is tied to the
19 economic transaction.
20 Q: I understand. And actually, you may not
21 remember this, but I have moved away from nexus
22 and am now interested in the sourcing issues.
23 So I'm interested in talking about where
24 activity takes place.
25 A: Okay.

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1 management agreement, the fee that's paid under
2 that to RAC Texas from RAC East does not
3 compensate RAC Texas for the work that those
4 South Carolina employees are doing. Got all
5 three?
6 A: Yeah. The last one strikes me as kind of
7 factual, but in the interest of our
8 hypothetical, I'll --
9 Q: And just as a hypothetical.
10 A: Okay.
11 Q: How would that affect your opinion?
12 A: Well, there's still -- it wouldn't impact the
13 basis of the existence of economic nexus. It
14 would impact, as I said, the fact that there are
15 physical activity in South Carolina to
16 strengthen the case for economic nexus. So it
17 would weaken my case for economic nexus, but
18 there would still be some economic nexus as I
19 indicated earlier.
20 Q: But there would be no activity in South
21 Carolina; is that correct?
22 A: There wouldn't be any -- no, there would be
23 activity in South Carolina because the
24 transaction is consummated in South Carolina.
25 Q: Okay.

1 Q: I understand that your view may differ from --
2 may not look to where the activity is taking
3 place, but that's the context in which I'm
4 asking you these questions. So let's see. So
5 just to make sure that we're on the same page,
6 if those three facts that I gave you are true,
7 would you agree with me that there are no
8 employees performing services in South Carolina
9 for either RAC Texas, I'm sorry, for RAC Texas?
10 A: There are no physical employees but there's
11 still economic activity.
12 Q: Okay. What do you mean by that?
13 A: Well, that's actually what I was trying to get
14 at earlier and I apologize for connecting it --
15 Q: Oh, yeah.
16 A: -- connecting it to nexus, pardon the
17 expression. To me, the word economic activity
18 and value generating economic activity speaks to
19 a transaction.
20 Q: Okay. You're on a transaction?
21 A: Yeah.
22 Q: And I was focusing on the employees.
23 A: I understand you're focusing on employment, but
24 as an economist what I'm saying is one needs to
25 focus on the transaction. But I'll be happy to

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1 answer your question.
 2 Q: Thank you. All right. And did you also hear
 3 Dr. Wells' testimony in this case?
 4 A: Yes, I did.
 5 Q: Did you hear his testimony that the comparables,
 6 the companies that he looked at to benchmark the
 7 management fee, that they are all engaged in the
 8 same type of activities, such as having some
 9 role in the hiring, having some role in the
 10 firing, as the employees of RAC Texas?
 11 A: I heard it. I didn't believe it.
 12 Q: And why don't you believe that?
 13 A: He has no way of knowing that. He was just
 14 making that up. As he indicated himself, he
 15 didn't know that much about the -- as he was
 16 sitting here on the witness stand at least in
 17 response to questions, he didn't seem to know
 18 too much about who was doing what in those
 19 specific firms. That's completely reasonable
 20 given the date that he did the study and his
 21 distance from it now. But it's quite important
 22 in terms of the interpretation of the veracity
 23 of the pricing study for its tax purposes. I
 24 mean it's created entirely for a tax purpose, so
 25 it's important that one have that sort of

1 to give any opinions on that topic in this
 2 matter; is that correct?
 3 A: I had been asked to look at the KPMG pricing
 4 study but I hadn't been asked to give opinions
 5 on transfer pricing. I think that -- I seem to
 6 recall the context was in relation to its
 7 importance for tax purposes. The IRS code, it
 8 has a massive role there, as you know and
 9 everyone knows. I do know about transfer
 10 pricing, that's a standard thing for an
 11 economist in an industrial organization.
 12 Q: Right. Well --
 13 A: And it's simple economic principles.
 14 Q: -- we have not been given notice that you will
 15 be talking about any of those issues so that's
 16 why I'm trying to stop that.
 17 MR. RYAN: Your Honor, I ask that opposing counsel
 18 let the witness finish before she interrupts
 19 him. It's been reoccurring.
 20 THE COURT: Okay. I'll caution her to do that,
 21 although she also has the right to object if
 22 it's not responsive. But --
 23 MS. GEER: I will not. And I apologize, but I think
 24 I asked my question slowly so he sometimes
 25 started to answer them before I finished because

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1 information when it's being used in this
 2 context.
 3 Q: All right. Well, how about assume for me that
 4 his testimony is accurate. If his testimony is
 5 accurate, then wouldn't that mean that the
 6 management fee does compensate the stores --
 7 A: No, because --
 8 Q: -- for their activities?
 9 A: I'm sorry.
 10 Q: No, it's okay.
 11 A: Not necessarily because there are many other
 12 factors of the transfer pricing study that I
 13 thought were quite dubious.
 14 Q: Right.
 15 A: But if all of those other things were taken care
 16 of, then that would mean that it would be
 17 included. But they were not taken care of.
 18 Q: You're not an expert in the field of transfer
 19 pricing; is that correct?
 20 A: Actually, I have taught in that field for many
 21 years. But I didn't present myself today as an
 22 expert in that. But I know the field well and
 23 I've taught in it for many years.
 24 Q: When I asked you that question in your
 25 deposition, you said that you had not been asked

1 he thinks I'm finished. And I apologize since
 2 I'm not intending to interrupt you, Dr.
 3 Harrison.
 4 THE COURT: Okay. All right. Let her finish asking
 5 her question before you start answering --
 6 DR. HARRISON: Fair enough.
 7 THE COURT: -- and don't cut him off unless it's
 8 unresponsive and then make an objection.
 9 MS. GEER: Yes, Your Honor.
 10 THE COURT: Those are our rules.
 11 Q: All right. And you believe that income is
 12 earned in the location where the customer is
 13 located; is that correct?
 14 A: I believe that income is earned where the
 15 customer is. But for the customer there would
 16 be no income. That's right.
 17 Q: Okay. I'm going to pull up one of our charts.
 18 So looking at this chart, tell me from an
 19 economic perspective where you would source
 20 income of engineering firm.
 21 A: And remind me again, I didn't --
 22 Q: I'm sorry.
 23 A: -- see this chart, it was too far away.
 24 Q: Sure. All right. So the yellow box is the
 25 taxing state and the blue engineering firm is in

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1 the taxing state and it is providing engineering
2 services to a customer who is in the blue box
3 out of state. The customer is sending money to
4 the engineering firm and the services obviously
5 are going this way. So under you economic --
6 from an economic perspective, where would you
7 source that income?
8 A: I can answer you if I can ask one more question.
9 Q: Yes.
10 A: Is the engineering firm purposefully directing
11 activity towards that state, to the blue state?
12 Q: Why don't we answer it both ways.
13 A: Okay. If it is purposefully directing activity
14 to the blue state, which is I guess North
15 Carolina is blue, then the answer is it would be
16 in that state.
17 Q: Okay.
18 A: But there would be -- if it was not purposefully
19 directing it, then it could be in either
20 depending on the, and I'm using these pointing
21 to the place of activity, the origin of payment
22 view, depending on the preponderance of the
23 activities, where the activities lay. And by
24 activities I'm talking about the economic
25 transactions, where they take place, where the

1 stores, as indeed this is the case we have here,
2 that the managerial services provided by RAC
3 Texas are clearly directed to the stores in
4 South Carolina, and other stores to be sure, but
5 we're here concerned with the value that's
6 created in South Carolina. So in that context,
7 it's important that the services are directed to
8 help those stores. That's why they have value
9 because they're helping those stores, as indeed
10 the Petitioner's experts testified at some
11 length.
12 Q: And give me, I'm sorry, give me the example of
13 the other situation of where they're not.
14 What's an example of where they wouldn't be
15 purposefully directing their activities?
16 A: Well, it might be somebody who is simply
17 providing a service and it just happens to be
18 purchased in, such as a book being purchased in
19 South Carolina. But the purposeful direction is
20 somebody who is directing their economic
21 activity towards South Carolina. I can't think
22 of any clear example right now, but some of the
23 ones that Professor Pomp was talking about
24 seemed to be just fine. The idea of somebody
25 who does not have an ongoing relationship with

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1 benefits come to those transactions.
2 Q: What do you mean by directing the activities?
3 You said that there was a caveat or a different
4 answer if they were directing activities. What
5 do you mean by that?
6 A: Sure. Well, it's the contrast from somebody
7 that does not take into account the specific
8 state and the specific -- the specific customer
9 that they're targeting, that they're aiming at,
10 that they're providing services in this economic
11 forum, in this case the blue state. So it could
12 be that there is some -- I could think of
13 examples and Professor Pomp talked about some of
14 those examples where services were just provided
15 but it wasn't directed at a particular customer
16 in the sense of directing it to the state, such
17 as providing services to, in this case, an
18 affiliated company that was in the state, coming
19 back to our particular case here.
20 Q: Okay. I'm just not sure if I follow you. So if
21 it's an affiliated company, it's not
22 purposefully directed?
23 A: No, it can be purposefully directed otherwise,
24 but with an affiliated company it's sort of
25 obvious that it's purposefully directed to those

1 somebody in the target state, for example. I'm
2 trying to relate it to the facts of this case
3 where there's clearly an ongoing relationship to
4 exploit, and I say that in the good sense of the
5 word, the economic forum in South Carolina. And
6 that's what we face here in this case.
7 Q: And so in this case who are you -- what are you
8 saying is the forum in the economic marketplace?
9 A: It's the --
10 Q: Go ahead.
11 A: It's the RAC stores in South Carolina. They're
12 the ones that are -- they're the ones that are
13 at the core of the value that is being discussed
14 here that provides some basis for the Department
15 of Revenue getting some taxes. There are stores
16 here, there are customers here, and clearly RAC
17 Texas is providing services directed to them.
18 I suspect they would say so themselves.
19 Q: Who is to them though?
20 A: Oh, to the RAC East stores in South Carolina.
21 Q: Okay.
22 A: Sorry.
23 Q: Now are you aware that your view has been often
24 referred to by courts and commentators as the
25 origin of payment view?

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1 A: Yes, I'm aware of that. I'm not going to
 2 express any legal opinions -
 3 Q: I know -
 4 A: -- on these things.
 5 Q: -- I'm just asking whether you're aware -
 6 A: Since I teach law and economics, I know
 7 something of the background cases.
 8 Q: Okay. Are you aware that there's another
 9 viewpoint that courts and commentators have
 0 referred to as the place of activity test that
 1 looks to the place where the services are
 2 performed?
 3 A: Yes. I am aware of that. And in particular,
 4 that's one of the features of the Lockwood
 5 Greene case.
 6 Q: And would it be fair to say that that view looks
 7 at the activities that actually generate the
 8 income and looks to the place where the
 9 activities are performed?
 0 A: Yes, and there are subsequent cases, I'm
 1 thinking particularly of Quill and that was
 2 codified by Geoffrey in South Carolina courts
 3 that look at the origin of payment view. So I'm
 4 just saying, yes, there are views in various
 5 cases. I'm not an expert. I'm not here

1 want to follow?
 2 MR. RYAN: Objection, Your Honor. I think that's
 3 calling for a legal conclusion.
 4 THE COURT: There again, yes, if she's asking from a
 5 legal perspective as when you were asking
 6 questions and they were objecting, but no if
 7 she's asking from an economic perspective, which
 8 that is not clear at this point in time.
 9 MS. GEER: I'm asking from an economic perspective.
 10 A: Well, let me answer from the economic
 11 perspective, but also understand that I'm a
 12 specialist in economics and law. So I'm aware,
 13 for example, that the Constitution and due
 14 process clause constraints all of the entities
 15 you talked about. So let me just say nobody is
 16 completely free.
 17 Q: Right.
 18 A: That's all I'm trying to say, that there's a
 19 legal context that constrains them -
 20 Q: Okay.
 21 A: -- but within that context, the legislature, for
 22 example, the South Carolina legislature, my
 23 understanding is that they could have chosen
 24 either of these if they had wanted to. They
 25 could have specified that. But I really am not

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interpreting the law.
 Q: Thank you. All right. Would you agree with me
 that a state is free to choose the rules by
 which it will source the income earned by a
 multi-state taxpayers?
 A: It's free to try to choose, yes. By that I mean
 -- let me clarify because I want to be -- it's
 free to choose but it's often prescribed by
 statute and regulations. And actually we have
 a wonderful example here where the Department of
 Revenue is not free to do anything it wants.
 It's free to do reasonable things that reflect
 economic nexus. So when you say free to choose,
 in the context of statutes and regulations, an
 agency has some freedom, you know, 2320 speaks
 exactly to that, but it's not completely free,
 it's constrained that it be reasonable, it be
 justifiable, and it reflect, in fact it's
 mandated that it choose a rule that reflect the
 economic nexus of the entity with the state in
 its view.
 Q: Okay. And maybe I can clarify a little bit. Is
 a state legislature or a state supreme court,
 would you agree that they're free to choose from
 between these two views as to which view they

1 an expert in what they're empowered to do.
 2 Q: I appreciate that. Thank you. Would you agree
 3 with me that the goal of the standard
 4 apportionment formula is to fairly reflect in-
 5 state activities of business?
 6 A: It's to fairly -- I just qualified the word in-
 7 state.
 8 Q: Okay.
 9 A: But it's to fairly reflect the economic nexus
 10 with the state.
 11 Q: Okay.
 12 A: If by in-state you're thinking of it in the
 13 sense that I am, and that is that value is
 14 created in South Carolina, the economic activity
 15 is in South Carolina, then I'm fine. But if
 16 you're thinking that it requires that the
 17 employees be, all of them be in South Carolina,
 18 then the answer is no.
 19 Q: How about if I stated, would you agree that the
 20 goal of the standard apportionment formula is to
 21 fairly reflect a taxpayer's business activities?
 22 A: Yes, that's a reasonable statement. Yes.
 23 Q: And you would agree that the Department's
 24 ability to deviate from the standard
 25 apportionment formula is limited in that their

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1 alternative formulas be reasonable?
 2 A: Oh, yes. In fact it's required that in 2320
 3 that that be the case.
 4 Q: Do you agree that there's an important due
 5 process principle that's furthered by the
 6 apportionment formula and that the taxpayers can
 7 know in advance what the tax burden will be if
 8 they choose to engage in activity in South
 9 Carolina?
 10 MR. RYAN: Objection, Your Honor, she's asking him
 11 for a due process opinion, I believe, a legal
 12 conclusion.
 13 THE COURT: I have to hear that question one more
 14 time.
 15 MS. GEER: I'll ask it again.
 16 Q: Would you agree that an important due process
 17 principle is furthered by the apportionment
 18 formula and that taxpayers can know in advance
 19 what the tax burden will be if they choose to
 20 engage in activity in South Carolina?
 21 THE COURT: All right. Why would that not be asking
 22 for a legal conclusion if it starts with, the
 23 phraseology begins with an important due
 24 process?
 25 MS. GEER: Let me rephrase, Your Honor.

1 A: When it's used it's often as, you know, if you
 2 touch it a little bit, then you can't do
 3 anything else. It's almost like this force
 4 field that if you just conceive that it's
 5 unitary in some sense, a whole bunch of things
 6 seem to automatically flow. And from an
 7 economist's viewpoint, that's far too dogmatic.
 8 Now, I don't want to speak to the legal
 9 definitions here, no legal implications, but I
 10 completely agree that these are interrelated
 11 companies/firms/activities, whatever they are,
 12 and that they're synergies, they're economies of
 13 scale, economies of scope. I understand those
 14 perfectly well. To me, that does not constitute
 15 a unitary business in the dogmatic sense in
 16 which many people use that term. That's my
 17 objection to it.
 18 Q: Okay. So let me ask you some specific questions
 19 about the relationship between these two -
 20 between the two business activities of these two
 21 entities. Does the fact that the advertising
 22 and marketing activities of RAC Texas
 23 contributes to the profits of RAC East have any
 24 impact on your opinions in this matter?
 25 A: Well, yes, to the extent that that means that

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1 THE COURT: Okay.
 2 Q: From an economic perspective, is it important
 3 for taxpayers to know what their tax burden in
 4 South Carolina will be?
 5 A: Yes. Yes, it is important for them to have
 6 guidelines and principles to be able to
 7 ascertain that and that enables them to
 8 undertake investments, what lawyers would call
 9 reliance expenditures. That's important.
 10 Q: All right. I'm going to ask you some questions
 11 about unitary business, even though I know you
 12 don't like that term. When you talk about the
 13 term unitary, you're talking about it from the
 14 economic perspective, correct?
 15 A: Yes. And I have some awareness that there are
 16 some court cases on this issue. But I'm
 17 certainly speaking from an economist's
 18 perspective.
 19 Q: Okay. And as I understand your testimony today,
 20 whether RAC Texas or RAC West are unitary is
 21 irrelevant, in your opinion?
 22 A: No, I just would not use that term. I think the
 23 term - here's the difficulty I keep facing when
 24 I'm hearing everything to do with unitary.
 25 Q: Yes.

1 RAC East is able and willing to place some value
 2 on those services. So think of RAC East in this
 3 context as the customer and, indeed, you've been
 4 representing and RAC East as a customer, it's an
 5 affiliated customer but it's a customer, the
 6 extent that it enhances the profitability of the
 7 stores which are owned by RAC East have been in
 8 this particular legal structure that's set up,
 9 does indeed mean that they are valuable, that
 10 it's valuable business activity.
 11 Q: Okay. And does the fact that RAC Texas arranges
 12 for, does the purchasing which can result in
 13 getting volume discounts for all the inventory
 14 that goes into the RAC East stores and that that
 15 contributes to the profits of RAC East, is that
 16 relevant to your opinion in the same way?
 17 A: Yeah, it's exactly the same principle. That
 18 means that the stores, the RAC stores are
 19 willing to place positive value on this -
 20 actually RAC is, I mean, we keep saying RAC
 21 East, RAC West, the entity is willing to set up
 22 a store in South Carolina because there is
 23 positive value from doing that. That's
 24 certainly true.
 25 Q: And those questions both relate to RAC Texas.

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1 As to RAC West, does the fact that there's the
2 interrelationship between the RAC brand name and
3 the retail stores in that as the value of the,
4 I'm sure you heard this testimony from Ms.
5 Wolverton, as the value of the intellectual
6 property goes up, that helps store sales go up
7 because more people know about the name and you
8 get more customers in and inversely, that as you
9 sell more products the value of the intellectual
10 property goes up. Did you consider that or is
11 that relevant at all?

12 A: Absolutely, because it's, again, it's precisely
13 why the customer, the affiliated customer is
14 willing to pay for the product and it's valuable
15 in South Carolina. So there is economic value
16 created for that reason.

17 Q: All right. I'm want to ask you some questions
18 about the separating out of the two revenue
19 streams. Let's start with RAC Texas.

20 A: Sure.

21 Q: All right. Is the reason why you believe that
22 RAC Texas' two revenue streams can be separated
23 out is because it has chosen to do only one of
24 those in South Carolina?

25 A: No, no, no. My opinions there are general

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1 opinions based on my knowledge of what is
2 typically, commonly done in firms in terms of
3 managerial accounting, cost accounting, but
4 that's a fairly trivial cost to do.
5 Q: Doesn't the unitary business concept look at the
6 relationships between, sorry, look at the
7 relationships between the entities and the
8 activities to determine whether separation is
9 justified?

10 A: I have no idea what that question means.

11 Q: Okay.

12 A: Sorry.

13 Q: You say that unitary business is not something
14 we should look at; is that correct?

15 A: No, no, no. I mean the concept is often used in
16 a dogmatic way that if you do -- it's a bit like
17 the old M.C. Hammer, you can't touch this. If
18 it's unitary business, you can't possibly
19 separate these things out. It's treated in a
20 very dogmatic way, not by you but by a large
21 part of this literature that talks about it. So
22 I think that the concept has outlived its
23 usefulness. I am perfectly willing to talk
24 about highly interrelated firms and highly -- if
25 there's a fiction of a firm here and a firm here

1 or a division here and a division here and it's
2 one firm is not the issue. I'm perfectly
3 willing to agree that these are highly
4 interrelated, that they're synergies. There
5 are, in other entities as well, such as
6 hospitals, in a hospital there's a synergy
7 between the different divisions, but it is
8 trivial, it's commonplace, it's standard to be
9 able to apportion the costs, even the fixed
10 costs, even the variable costs from different
11 divisions from the fixed costs, to different
12 activities. And, indeed, that's commonly done
13 in order to figure out is this a profit center.
14 So what I'm saying is based on my general
15 knowledge about how economic firms are set up,
16 how the role of accounting in determining the
17 economic value of different divisions of a large
18 firm, I'm not going to use the big "U" word, you
19 can apportion these things. But I don't want to
20 use the word unitary because in McClure's
21 definition, as I said earlier, that is
22 tautologically defined as a firm where you can't
23 separate these out. So that's why you often
24 here people -- when Professor Pomp was
25 testifying, the moment one sort of -- he started

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1 by assuming that it was a unitary firm and then
2 given that assumption, he's abso -- and the way
3 certainly the way that McClure has defined it,
4 it's completely correct to say you couldn't,
5 it's impossible to separate them out as Mr. von
6 Lehe was talking about. That's why you want to
7 resist that term because the term, it carries
8 with it far too many incorrect economic
9 connotations. Sorry to be long winded --

10 Q: No, no, no.

11 A: -- but it's important.

12 Q: Let me ask you this. I want you to give me an
13 example of a situation where it would be
14 difficult to separate it out.

15 A: I can't think of a situation where it's
16 difficult or impossible. I can think of some
17 where it's harder than others, but in most
18 instances there are more, there are often
19 several reasonable ways to split it out. And
20 the relevant question here is whether the
21 auditor in this case would have accepted that
22 split out, whether the Department of Revenue
23 would have accepted or would it have been
24 regarded as reasonable for that person. And I
25 can think of many simple ways that that could

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1 have been done in this instant case.
 2 Q: So are you basically saying that from an
 3 economic perspective you believe that any
 4 business that operates multiple business lines
 5 can be -- cost can be allocated?
 6 A: Yes. And that's done standardly in managerial
 7 accounting and cost accounting. There's whole
 8 disciplines. The specifics of that I'm not an
 9 expert on --
 10 Q: Right.
 11 A: -- but I certainly know their role. I've
 12 testified on their role, I've published on their
 13 role --
 14 Q: Right.
 15 A: -- and I've taught on their role. That's a
 16 standard -- and you can see why it's important.
 17 If you want to decide if RAC, if the RAC entity,
 18 let's call it the RAC entity wants to decide,
 19 should we open or should we close down a store
 20 in South Carolina, it has to decide is that a
 21 profitable store and it has to do more than just
 22 look at the variable returns in the store. It
 23 has to worry about the fixed costs from RAC
 24 Texas and RAC West. It has to take those into
 25 account when it's deciding is it a profitable

1 That's the relevant issue here. Would the
 2 Department's auditor have accepted some
 3 reasonable allocation of those, and the answer
 4 is, I believe, yes.
 5 Q: So you would agree that there are multiple
 6 different ways that a managerial accountant
 7 could go about making an allocation?
 8 A: There are multiple or there are different ways,
 9 yes. And indeed several of them are reasonable.
 10 The fact that there are multiple ways to do this
 11 doesn't make it speculative, it just means that
 12 one has to choose between alternative rules for
 13 apportionment. This is quite standard in cost
 14 accounting and managerial accounting. And
 15 indeed, to be honest, it's true in financial
 16 accounting.
 17 Q: Have you looked at the taxpayer's books and
 18 records in this case?
 19 A: No, I have not.
 20 Q: Did you look at the auditor, any of the audit
 21 work papers?
 22 A: I don't recall doing that. Often those are
 23 provided to me, but I don't recall looking at
 24 them in this case.
 25 Q: You told me in your deposition that you had not

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1 store. I would be astounded, based on my
 2 general knowledge, if a firm of this size was
 3 not easily able to do that type of calculation.
 4 That would be -- I would be shocked.
 5 Q: All right. So are you saying that there is no
 6 business that is so interrelated and so
 7 interconnected that a managerial accountant
 8 couldn't go in there and separate it out?
 9 A: I don't want to say there's no business but --
 10 Q: How about the bulk?
 11 A: The bulk of them I think can be apportioned and
 12 I've taught case studies and I've looked at case
 13 studies and, again, hospitals are a classic
 14 example where, in fact, there's indeed whole
 15 areas of just hospital cost accounting that are
 16 highly synergistic and yet they're very, very
 17 concerned should we close down this cardiac
 18 center, should we expand this birthing wing.
 19 They have very, very precise ways of doing this.
 20 Now, they're not unique. This is what a lot of
 21 people think. Because there's no single way to
 22 do it, there are no generally accepted
 23 accounting principles in this area, even those
 24 don't prescribe unique ways of allocating, but
 25 there are many reasonable ways to allocate.

1 yet reviewed them. Have you reviewed them
 2 between your deposition; would that help you
 3 remember?
 4 A: No, I have not. Thank you.
 5 Q: And I can't remember if we've asked you this
 6 before, but are you a certified public
 7 accountant?
 8 A: Most definitely not.
 9 Q: Okay.
 10 A: I have taught CPAs, but I am not a CPA.
 11 Q: Now, do you know how many transactions occur
 12 each year for these two companies?
 13 A: No. I would guess lots.
 14 Q: Okay. And do you know, would you say hundreds
 15 of thousands?
 16 A: As I said, I don't know but I would guess lots.
 17 I suspect it would be in excess of hundreds, I
 18 don't know. It's a big company.
 19 Q: And how many accounts would be in there general
 20 ledger?
 21 A: I've got no idea.
 22 Q: Would you expect it to be a lot?
 23 A: Yeah. Yeah.
 24 Q: And you made a comment during your testimony
 25 that I think you referred to these companies as

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1 legal fictions; did I hear that correctly? 2 A: Yes, I heard you guys mumbling about that. 3 Q: Well, my question is how do you call a company 4 that's got, you know, operating thousands of 5 stores and hundreds of employees and all these 6 assets, how can you say that that has no 7 substance? 8 A: I didn't say that. I said, I was referring to 9 the structure, the way these things are 10 structured. When I first looked at the jigsaw 11 puzzle of who owned what and who reported to 12 whom, as a chaired professor of risk management, 13 we spent a lot of time, and we talked about this 14 in deposition, think about why one does 15 sometimes structure divisions in a certain way. 16 There are some legitimate reasons for doing 17 that, as I pointed out to you from a risk 18 management perspective, I thought oh, my 19 goodness, how on earth did this structure get 20 derived, what's the rationale for it. Now, that 21 wasn't something I was asked to look at, but it 22 was something that indeed, as the Judge 23 commented, it was the first thing that struck 24 me. I said, this looks really weird. And so 25 what I was referring to is the way these jigsaw	1 Q: All right. But you know nothing about the 2 details of this structure in order to give an 3 opinion on it at this time? 4 A: Well, I don't say I know nothing. I know based 5 on learning about what these firms do and what 6 they don't do. I have no idea, other than 7 possible purposes of tax minimization, why RAC 8 East is not set up just like RAC West and why 9 they're not all one large company. But that's 10 not the question I was asked to look at, but 11 since you asked me, I'm giving you my opinion. 12 MS. GEER: Your Honor, would you mind if we spoke to 13 our clients for one moment? 14 MR. VON LEHE: Thank you again, Your Honor. 15 (Off the Record) 16 MS. GEER: I just have one more question. I should 17 have asked it, I apologize. 18 THE COURT: Well, it would be difficult to ask - 19 MS. GEER: We lost our witness. 20 (Off the Record) 21 THE COURT: Proceed. 22 Q: Dr. Harrison, one last question. Can a group of 23 companies sometimes end up with a strange 24 looking structure as a result of acquisitions of 25 other companies?
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1 puzzles are divided up struck me as a fiction. 2 The firm's very real, the activities are very 3 real. There's one very big firm here from my 4 view as an economist. The fiction I was 5 referring to was the way the different entities 6 have been kind of sliced up in a certain way to 7 achieve certain purposes. Now, I don't want to 8 express here my opinion as to what those 9 purposes are, but it struck me as very strange 10 to see this sort of this patchwork quilt, for 11 example. 12 Q: But you would agree with me that companies have, 13 can have valid business purposes versus 14 nefarious purposes for setting up corporate 15 structure such that there are multiple 16 affiliates, risk management is one reason; would 17 you agree with that? 18 A: Absolutely right. Yes. I just didn't see it in 19 the particular structure here. That's all. 20 Q: Didn't see what? 21 A: I did not see an easily justifiable rationale, 22 speaking as an economist and an expert in risk 23 management, for this particular structure. But 24 I - that's all I'm doing is explaining my use 25 of the word legal fiction here.	1 A: Yes. That is possible. And it's also possible 2 to just restructure, but that's certainly 3 possible. 4 MS. GEER: That's all the questions we have, Your 5 Honor. 6 MR. RYAN: No further questions for this witness, 7 Your Honor. 8 THE COURT: Well that means you can step down. 9 MR. RYAN: Your Honor, at this time, just because I 10 haven't done it sooner, I appreciate madame 11 court reporter reminded me, I'd like to move in 12 Respondent's Exhibits One and Two. One will be 13 the Revenue Ruling that Professor Pomp talked 14 about when he was on the stand. My 15 understanding is John has no objection to that. 16 MR. VON LEHE: That is correct, Your Honor. 17 MR. RYAN: The second would be the - Respondent's Two 18 would be the article that Professor Pomp wrote, 19 and I know that John has an objection on that 20 one. 21 MR. VON LEHE: Yes, I'd like to pose an objection to 22 that article, Your Honor. As you know, that 23 article dealt with combined reporting and 24 Professor Pomp was examined about having written 25 that article on combined reporting and why

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1 combined reporting was a good thing. One of the
2 arguments that I understand is being made by the
3 Department of Revenue now is that combined
4 reporting may be before this Court. I do not
5 believe it is. That's a matter that you've
6 asked us to brief you on. I do not believe it
7 is rightfully before this Court, therefore, if
8 combined reporting is not before this Court,
9 then that article is irrelevant.

10 THE COURT: Originally you said that you were asking
11 about this as far as impeachment purposes.

12 MR. RYAN: His explanation in that article discusses
13 not only combined reporting, it discusses the
14 challenges and difficulties of separate
15 reporting.

16 THE COURT: ell, could we have that portion of the
17 article admitted into the record and the
18 remaining portion not or do you --

19 MR. RYAN: I'm okay with that, Your Honor.

20 THE COURT: Okay.

21 MR. VON LEHE: Your Honor, as long as the article is
22 not being viewed as evidence for the Department
23 of Revenue to put forward --

24 THE COURT: Well, I limited his cross-examination in
25 that regard earlier and will limit the admission

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1 of that exhibit under the same caveat.

2 MR. VON LEHE: Thank you, Your Honor. On those
3 grounds, we would agree to the admission of it.

4 THE COURT: Okay. Those two are admitted.

5 MR. RYAN: Thank you, Your Honor.

6 (Respondent's Exhibit Numbers One and Two were
7 admitted into evidence.)

8 MR. RYAN: Well, I'm not going to call anymore
9 witnesses at this time, Your Honor. I'm not
10 going to rest in that --

11 THE COURT: You reserve your right to --

12 MR. RYAN: To address Dr. Pomp with a potential
13 expert and bring him before this Court.

14 THE COURT: Okay.

15 MR. RYAN: That being the case, I would ask that --
16 I'm not going to give a closing if it's
17 permitted by Your Honor, and I'd rather give a
18 proposed order. I understand that Mr. von Lehe
19 would like to give a closing.

20 THE COURT: All right. Is that correct?

21 MR. VON LEHE: Your Honor, certainly I would like to
22 give a brief closing statement. If Your Honor
23 would like to have, and I hope you do, if you
24 would like to ask us to do proposed orders,
25 certainly we do want to do that.

1 THE COURT: Well, I want proposed orders to be given
2 to me 30 days from the date the record is
3 closed, which that isn't today. Or 30 days from
4 the day the transcript is made available to you,
5 that being -- I always say the date the
6 transcript is placed in your hands without any
7 dilatory actions on your part. Now, Mr. Ryan,
8 how many days do you need to make your
9 determination about whether to seek to present
10 additional evidence?

11 MR. RYAN: I think I can make that determination in
12 a week, Your Honor.

13 THE COURT: Okay. So in about a week let's just have
14 a conference call.

15 MR. VON LEHE: Yes. Good. Thank you, Your Honor.
16 So that would mean that in about a week we'll
17 find out if he wants to call an expert witness,
18 and then that will either close or not close the
19 case?

20 THE COURT: Yes, sir.

21 MR. VON LEHE: After which a transcript will be done?

22 THE COURT: If it's closed.

23 MR. VON LEHE: If it is closed.

24 THE COURT: If it's left open for him to present
25 additional evidence, I would give him the time

1 frame to obtain that evidence. Because you said
2 a week to make the determination, right?

3 MR. RYAN: Yes.

4 THE COURT: Time frame to obtain that evidence, which
5 I assume we would do a de bene esse type
6 deposition, if that was -- or do you envision
7 coming back to this Court and presenting that
8 testimony?

9 MR. RYAN: De bene esse is fine with me, Your Honor.

10 THE COURT: Okay. Well, let's just address that when
11 and if we need to. All right.

12 MR. VON LEHE: Very well, Your Honor. I would like
13 to make a -- I'll try to make it a brief closing
14 statement.

15 CLOSING STATEMENT - BY MR. VON LEHE:

16 MR. VON LEHE: We've talked about a lot of things the
17 last two days and nexus is one of them. It is
18 our belief that, insofar as RAC Texas is
19 concerned, that nexus has not been established
20 by the Department of Revenue because of the fact
21 that it has a customer in this state. There
22 have been possibly some factual differences
23 between us as to whether or not they have any
24 other activities here, but certainly I believe
25 you will find that the law will say that the

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1 mere fact that you have customers in a state and
 2 that you have -- and that you go into a state or
 3 purposefully don't go into the state, you
 4 perform your activities out of the state for
 5 purposes of those customers located in the
 6 state, that this does not grant nexus for
 7 purposes of taxation. We think that the primary
 8 case on that is the Geoffrey case in which there
 9 was economic nexus established because of the
 10 assistance of this intellectual property and the
 11 trademarks and trade names that were licensed
 12 here. RAC Texas simply doesn't have that. We
 13 would see that as a first point insofar as RAC
 14 Texas --
 15 THE COURT: So you think Geoffrey is your primary
 16 case, you don't think Lockwood's --
 17 MR. VON LEHE: Lockwood is coming next, Your Honor.
 18 THE COURT: Oh, okay.
 19 MR. VON LEHE: First, with regard to nexus, we
 20 believe Geoffrey is our primary case.
 21 THE COURT: Okay.
 22 MR. VON LEHE: And other cases that we will cite to
 23 you or have cited to you. Insofar as the
 24 sourcing of receipts are concerned, if in fact
 25 RAC Texas --

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1 THE COURT: Oh, that's right.
 2 MR. VON LEHE: -- is subject to tax here, there will
 3 be no tax because of the sourcing of the
 4 receipts. And the Lockwood Greene case, yes, we
 5 do believe that is our primary case. That case
 6 saying that receipts are to be sourced to the
 7 place of activity. Obviously there are two
 8 views on this as to whether or not -- or the
 9 court wouldn't have even entertained them in
 10 Lockwood Greene, but the question of whether or
 11 not should receipts be sourced to where the
 12 customers are or should they sourced to where
 13 the activities take place, and Lockwood Greene
 14 says source them to where the activities take
 15 place. Now, I think it's quite possible, Your
 16 Honor, if you were to decide that RAC Texas
 17 would have nexus in South Carolina but had no
 18 income or a minuscule income, because the test
 19 that was used in Lockwood Greene was a payroll
 20 test. And so if one were to take the
 21 payroll of RAC Texas in Texas and compare it to
 22 whatever payroll has been alleged to take place
 23 here because of some activities that the
 24 management agreement alleged, and alleged, as I
 25 understand it in the earlier arguments from the

1 Department, that some of that is being paid for
 2 for what's done here, we disagree with that, but
 3 some of it is, you're going to find that to be
 4 a minuscule part. So if you apply the payroll
 5 test to that or payroll in Texas to total
 6 payroll, you're going to end up with no, or
 7 practically no tax for RAC Texas. So we do
 8 submit that Lockwood Greene is the controlling
 9 authority insofar as whether or not that entity
 10 is subject to taxation. Insofar as the
 11 assessment itself which has been proposed
 12 against this entity, against RAC Texas, it's
 13 based on a faulty method of accounting. If they
 14 wanted to have a method to tax RAC Texas, they
 15 should have used one that had some relevance to
 16 what RAC Texas is alleged to be doing in this
 17 state, meaning they're alleging that this
 18 Management Services Agreement ought to be
 19 sourced here. But the method they used does
 20 not, with any degree of accuracy, source it to
 21 South Carolina because it makes no effort to
 22 measure the income of the stores in South
 23 Carolina. And the Management Services Agreement
 24 fee is based on income. So without knowing or
 25 having any idea what the income would be in

1 South Carolina, a method of taking the store
 2 operations divided by -- the store sales divided
 3 by total sales with nothing in there about cost
 4 and just taking a percentage of the total
 5 management fee, it's completely hit on this
 6 proposition. And there's no way of knowing
 7 whether or not it comes up with a reasonable
 8 estimate or not. Now, if they are able to show
 9 that the formula, by telling you that look, this
 10 formula is no good because it's got the stores
 11 in it in Texas, if they're able to do that, they
 12 still have the burden not only of showing that,
 13 they've got the burden of coming forward and
 14 showing that the formula they're applying is
 15 reasonable. And there's nothing reasonable
 16 about applying a formula in which you don't know
 17 whether or not it has any application to what
 18 you're trying to measure.
 19 THE COURT: And you get at that argument through your
 20 burden shifting when you change the formula?
 21 MR. VON LEHE: Yes, I do. Your Honor, I believe when
 22 you change the formula you've got to -- you then
 23 have the burden not only to show that what the
 24 ordinary formula does being wrong, but you've
 25 got to come forward and show what you have done

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1 and what they have done is right, or at least
 2 reasonable, at least reasonable. Equitable is
 3 the language used in the statute. Again,
 4 there's been quite a bit of discussion about
 5 taxing these gross receipts. We put in our
 6 testimony, and I think that the books and
 7 records, the person that knows the books and
 8 records best to this entity are the people that
 9 work with the books and records of this entity,
 10 and Mr. Tollack knows those books and records.
 11 And he says it would be very difficult, he
 12 doesn't keep his books and records that way, to
 13 show what expenses are associated with these
 14 management fees, and he doesn't. That's not the
 15 way they keep their books and records. What the
 16 Department of Revenue has asked them to do is
 17 something that is, at best, burdensome; at
 18 worst, can't be done. So we think that putting
 19 the burden on the taxpayer to do something like
 20 that and saying well, if you can't do that,
 21 we're just going to tax you on the entire gross
 22 receipts is wrong. And my judgment, as I think
 23 I've argued earlier, what should have been done
 24 is if they didn't like the deduction that was
 25 taking place at RAC East, they should have just

1 that, because we think look, the oil wells are
 2 out of state, that's got to be in the
 3 denominator of the apportionment formula, the
 4 refinery is out of state, that's got to be in
 5 the denominator of the apportionment formula,
 6 and we can't say look, we are just going to tax
 7 what you're doing here, meaning these gasoline
 8 stations. And the Exxon case says that,
 9 squarely on point makes that statement. So to
 10 think where you have a business which is unitary
 11 in nature, and hopefully we've supplied
 12 testimony to show that it is. I know of no
 13 concrete testimony that does not show where
 14 these businesses are unitary, where the
 15 management fee contributes to the stores in
 16 Texas and the stores in Texas contributes to the
 17 perfection and improvement of the management,
 18 and when you go to RAC West where the trademarks
 19 and copyrights, which are owned by that entity,
 20 contribute to the stores that are in that
 21 entity, stores in that entity in turn contribute
 22 to those trademarks and copyrights, that is the
 23 essence of a unitary business. The Department
 24 of Revenue's got a regulation on it which we
 25 discussed today with the agent. It says you

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1 disallowed the deduction. Instead they accepted
 2 the RAC East audit report, did not make an
 3 adjustment against it. That would have been the
 4 thing to do. And I'm not certain, I'd have to
 5 look back at the statute, but the agent's
 6 testimony along those lines would indicate that
 7 that would be the ordinary thing to do. Your
 8 Honor, again, this thing about a unitary
 9 business, whether somebody likes a unitary
 10 business, doesn't like a unitary business, does
 11 not like to use the terminology, etcetera,
 12 that's not really relevant for this Court. That
 13 which is relevant for this Court is whether or
 14 not the South Carolina tax law recognizes a
 15 unitary business and what it does about it. And
 16 our law in the Exxon case and two or three other
 17 cases which we will show you, but that is the
 18 clearest example where you look at a unitary
 19 business, it produces oil, it refines oil, then
 20 it sells gasoline. When you look at that
 21 unitary business, you can't just say, look, all
 22 you've got in South Carolina is gasoline
 23 stations and so we're going to tax those
 24 gasoline stations. We don't like the overall
 25 income to company, we don't like that. And for

1 split them up when they're unrelated. These
 2 just aren't unrelated, so I believe the
 3 Department's own regulation prevents the
 4 splitting up of a unitary business, along with
 5 our Exxon case and our Supreme Court decision.
 6 Your Honor, I would turn very briefly now to RAC
 7 West. We talked about it, the fact that it's
 8 sort of a Geoffrey case, except that Geoffrey
 9 has not been followed here because in Geoffrey
 10 they took the trademarks in South Carolina
 11 producing royalties. Said, okay, if we take
 12 those royalties and divide them by the total
 13 receipts of Geoffrey, multiply it against
 14 Geoffrey's net income, in both of these audits,
 15 the net income of these corporations has been
 16 disregarded. The Department of Revenue's method
 17 does not care about, is not concerned with would
 18 be a better way of putting it, is not concerned
 19 with the net income of either one of these
 20 corporations. They didn't look at that. They
 21 simply applied an alternate method, I would call
 22 it, in one case taxing gross --
 23 THE COURT: Well they can't look at net income if you
 24 don't give them your expenses, can they?
 25 MR. VON LEHE: Well, yes, Your Honor, what we've done

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1 is we were given -- we have given them the net
 2 income of the companies. We gave them that.
 3 THE COURT: Okay.
 4 MR. VON LEHE: They rejected that. They don't want
 5 that. They don't want to tax a part of the net
 6 income of the pie example. They don't want to
 7 tax a part of the net income of the company.
 8 They want to take an income element out of there
 9 and tax only that. So certainly they did have
 10 the net income of the two companies available to
 11 them, one filed it and the other one gave it to
 12 them. So they have a net income, but they
 13 didn't want to use it because of the alternate
 14 method. I want to say one last word, a couple
 15 of them, about the Carmax case. The Carmax case
 16 we believe is distinguishable. As you said,
 17 you're not bound by the case, I understand that,
 18 but nevertheless, I know you will read it. I'd
 19 like to point out with regard to that it is
 20 distinguishable, but we're distinguishable in
 21 that so far as RAC West is concerned. I think
 22 in RAC Texas, it has very little similarities to
 23 Carmax. RAC West does have some similarities to
 24 the case, but the differences being that in
 25 Carmax, the court said look, we're going to look

1 MR. VON LEHE: Very good.
 2 THE COURT: If you want to take what's in your brief
 3 and stick it in the proposed order, that's fine.
 4 I just, I would like the proposed orders to be
 5 complete.
 6 MR. VON LEHE: Yes. Very well, Your Honor. But
 7 there'd be no need for final briefs plus
 8 proposed orders?
 9 THE COURT: No, that's what I'm getting at. I'd like
 10 them to be complete.
 11 MR. VON LEHE: What's in that proposed order would
 12 mean those are the arguments being made today?
 13 THE COURT: Yes.
 14 MR. VON LEHE: Thank you, Your Honor. There are some
 15 constitutional issues, Your Honor, which we'll
 16 discuss in the proposed order, basically nexus.
 17 We've already talked about that. We do not
 18 believe, as I told you a moment ago, with regard
 19 to RAC West, we don't believe that the tax
 20 liability that's been proposed to them is in any
 21 way reasonably related to the activities of the
 22 entity in South Carolina, which is a
 23 constitutional, rises to a constitutional issue.
 24 So -- and Your Honor, you also wanted from us,
 25 I believe you wanted us to brief, perhaps, the

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1 at the unitary business and we're going to say
 2 it has a range, and they said that the range is
 3 very low in Carmax. We believe the range in RAC
 4 West is very high. So first of all, of course,
 5 we don't think Carmax is correct, but we also
 6 believe that it's not necessary that if one does
 7 think the Carmax case is correct, it is not
 8 necessary to rule the same way with regard to
 9 RAC West. There's some constitutional issues,
 10 which we'll mention in our proposed order. I
 11 would like to ask you this general question. We
 12 filed a preliminary brief with the Court. I
 13 don't know if the Department of Revenue has
 14 filed a brief or not, I assume not.
 15 MR. RYAN: We have not, Your Honor.
 16 MR. VON LEHE: But we'll both be filing proposed
 17 orders with you. Now, in those proposed orders,
 18 I am going to assume that what's placed in those
 19 proposed orders would be the same as the matter
 20 being argued before the Court?
 21 THE COURT: Say that again.
 22 MR. VON LEHE: Would a proposed order take the place
 23 of a final brief insofar as what is being argued
 24 before the Court?
 25 THE COURT: I would prefer it to be that way, yes.

1 question of whether or not a combined return is
 2 before the Court?
 3 THE COURT: Correct.
 4 MR. VON LEHE: Separately. And how would you like to
 5 have that briefed?
 6 MR. RYAN: May I interject briefly, Your Honor? If
 7 we could address that at next week's call when
 8 we talk about the expert, that will give me time
 9 to talk with my director and deputy director and
 10 see if that's something they want me to pursue
 11 any further than I already have or take it --
 12 MR. VON LEHE: Very good. Very good if that suits
 13 the Court.
 14 THE COURT: I would say in a separate section if we
 15 get there, how about that?
 16 MR. VON LEHE: Very good, Your Honor.
 17 MS. GEER: Your Honor, we talked with Mr. Ryan
 18 earlier. Because this -- well, I guess we can
 19 submit, we might as well submit it now. In case
 20 this issue comes up with the combined reporting,
 21 one thing that would be at issue would be what
 22 was said in the prehearing statements that are
 23 filed at the start of a case as to what the
 24 issues are, and Mr. Ryan didn't have any
 25 objection to us putting those into the record.

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1 THE COURT: Well, why don't we address that if indeed
 2 it's going to be an issue. You're here now so
 3 you just assume --
 4 MS. GEER: I just assume.
 5 THE COURT: Okay. I understand that. Go ahead.
 6 MR. VON LEHE: No objection to it?
 7 MR. RYAN: No objection to preparing a statement,
 8 Your Honor.
 9 MS. GEER: Your Honor, the other thing we're talking
 10 about is that we still have to decide what is
 11 going in the Pomp reports and what is not. So
 12 perhaps we can talk about that in the next week
 13 and also address that at the status conference.
 14 THE COURT: Well, the record is not closed yet.
 15 MS. GEER: That's right.
 16 THE COURT: So you're free to do that.
 17 MS. GEER: Okay.
 18 THE COURT: Are you going to have that marked?
 19 MS. GEER: What I was going to do, if it's okay with
 20 Your Honor, is I had a new index created and was
 21 going to put them at the end of the exhibit
 22 notebook --
 23 THE COURT: Okay.
 24 MS. GEER: -- so they'd just be additional tabs.
 25 THE COURT: Okay. All right.

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1 MR. RYAN: Just to be clear, Your Honor, while we're
 2 doing that, I don't know if we've actually ever
 3 moved these documents in. So could we --
 4 THE COURT: I'm pretty sure One is.
 5 MR. RYAN: It's in? Okay.
 6 THE COURT: And I just called it Petitioner's One
 7 with tabs, so by her inserting tabs right now,
 8 it keeps the record clean. I will tell you, Mr.
 9 von Lehe, all your arguments are in play for me
 10 except the argument about the corporation's
 11 inability to calculate their expenses. That is
 12 one I have a lot of trouble buying. That
 13 doesn't mean you can't argue it in your proposed
 14 order, but I will tell you that if I were you,
 15 I would put my efforts elsewhere.
 16 MR. VON LEHE: Thank you, Your Honor. Thank you for
 17 that, I would call it advice.
 18 THE COURT: Yes.
 19 MR. VON LEHE: But I would like to say on that
 20 subject, the only testimony in the record that
 21 I'm aware of is that it would be difficult, if
 22 not impossible, the only testimony with regard
 23 to anyone who has worked with these books and
 24 records --
 25 THE COURT: I think the testimony, there may have been

1 contrary testimony by Dr. Harrison, but I'm not
 2 for sure.
 3 MR. VON LEHE: But he's never seen -- he knows nothing
 4 about the company books and records.
 5 THE COURT: Well, that's true. But he said in
 6 general --
 7 MR. VON LEHE: He says there's no firsthand knowledge.
 8 THE COURT: Yeah.
 9 MR. VON LEHE: Anything that he might say has got to
 10 be a matter of, as he said, has got to be a
 11 matter of his general knowledge. I'll put it
 12 like this, Your Honor, I am an accountant, this
 13 isn't testimony, this is just my thoughts. I am
 14 an accountant, I've been there, I am a CPA. I
 15 just can't imagine a company keeping costs on
 16 these management services. It's just something
 17 that would never occur to me for any reason to
 18 do that.
 19 THE COURT: Okay. Well, I'll hear your -- let's wait
 20 first our conference call and we decide where
 21 we're going to move and then I'll get your
 22 proposed orders.
 23 MR. VON LEHE: Thank you, Your Honor.
 24 THE COURT: But thank you for your time.
 25 MR. VON LEHE: Thank you for yours, Your Honor.

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1 (There being nothing further, the hearing was
 2 adjourned for the day at 5:11 p.m.)

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ROA 0298

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State of South Carolina
Department of Revenue

301 Gervais Street, P.O. Box 125, Columbia, South Carolina, 29214

March 12, 2008

Rent A Center West Inc.
5501 Headquarters 2nd Fl
Plano, TX 75024

Attn: Teri Kelly
Tax Manager

Tax Type :Corp. Income/License
Periods :12-31-03/05
File # :21056112-2
Response Date :June 12, 2008
Audit # :00/36/6388

Gentlemen:

The audit of the above referenced tax return(s) has been completed by the Field Services Division of the South Carolina Department of Revenue. Enclosed is a "Report of Field Audit" (AS-54) which explains our "Proposed Assessment".

If you agree with the changes detailed in the enclosed report, the balance shown to be due on Form AS-54 should be remitted to this office within thirty (30) days from the date of this letter, to avoid additional interest and penalties, if applicable. Please include a copy of the AS-54 with your check to insure proper processing.

If you agree with the Division's adjustments but are unable to make full payment at this time, please complete the enclosed Waiver of Restriction on Assessment (SC 870) and return it to this office within thirty (30) days from the date of this letter. Upon receipt of this document, a "Final Assessment" will be issued.

If you disagree with any of the adjustments of tax, interest, or penalties that have been proposed by the Division, a written protest must be submitted to this office by the response date stated above.

If you do not respond to this letter by the response date stated above, the Division will issue the "Final Assessment" and begin collection action.

Should you have any questions, please do not hesitate to call me at the number listed below.

Yours very truly,

S.C. DEPARTMENT OF REVENUE
LAW & COMPLIANCE



Tim Donovan - Supervisor Non Resident Auditors
(803)898-5619
(803)898-5825 (fax)

/ds
Enclosure.

Form Letter AS-54-PA (Rev. 8/95)

ROA 0340

**SOUTH CAROLINA DEPARTMENT OF REVENUE
REPORT OF FIELD AUDIT: INCOME TAX & LICENSE FEE**

TAXPAYER: Rent-A-Center West, Inc
ADDRESS: 5501 Headquarters
Plano, Texas 75024

FEI #: 48-1156618
FILE #: 21056112-2
PERIOD: 12/03-12/05
DATE: 1/9/08
AUDITOR: SOUTHARD
DENNIS

INTEREST COMPUTED TO: APRIL 15, 2008

INCOME TAX:				
PERIOD ENDED:	INCOME TAX	INTEREST	PENALTY	TOTALS
12/31/03	\$44,887	\$14,016	\$11,222	\$70,125
12/31/04	46,607	11,748	11,652	70,007
12/31/05	53,477	9,322	13,369	76,168
TOTALS	\$144,971	\$35,086	\$36,243	\$216,300

LICENSE FEE:				
PERIOD ENDED:	LICENSE FEE	INTEREST	PENALTY	TOTALS
12/31/04	\$0	\$0	\$0	\$0
12/31/05	0	0	0	0
12/31/06	0	0	0	0
TOTALS	\$0	\$0	\$0	\$0

SUMMARY:	TAX	INTEREST	PENALTY	TOTALS
INCOME TAX	\$144,971	\$35,086	\$36,243	\$216,300
LICENSE FEE	0	0	0	0
TOTALS	\$144,971	\$35,086	\$36,243	\$216,300

**SOUTH CAROLINA DEPARTMENT OF REVENUE
RECOMPUTATION OF NET INCOME & TAX**

TAXPAYER: Rent-A-Center West, Inc
FILE #: 21058112-2
PERIOD: 12/03-12/05

SCHEDULE: A
AUDITOR: SOUTHARD
DENNIS
DATE: 1/9/08

PERIOD ENDED:

12/31/2003 12/31/2004 12/31/2005

**APPORTIONABLE INCOME PER RETURN:
ADJUSTMENTS:**

	6,533,058	18,721,980	(17,958,070)
a) Zero balance apportionable income	(6,533,058)	(18,721,980)	17,958,070
b) Reference Schedule "B1&B2" Rent-A-Center East	904,348	951,180	945,478
b) Reference Schedule "B3&B4" RAC RR	0	0	56,078
b) Reference Schedule "B5&B6" Rainbow Rentals	0	0	87,983

APPORTIONMENT INCOME AS ADJUSTED
SC APPORTIONMENT RATIO-Per Sch B
SC PROPORTION
ALLOCABLE TO SC
SC NET INCOME
SC NOL
TAXABLE NET INCOME
TAX RATE
TAX DUE
TAX CREDIT
BALANCE
TAX PREVIOUSLY PAID
UNDERPAYMENT (OVERPAYMENT)

904,348	951,180	1,089,538	0
100%	100%	100%	
904,348	951,180	1,089,538	0
0	0	0	
904,348	951,180	1,089,538	0
0	0		
904,348	951,180	1,089,538	0
5%	5%	5%	5%
45,217	47,558	53,477	0
0	0	0	
45,217	47,558	53,477	0
(330)	(951)	0	
44,887	48,807	53,477	0

EXPLANATION OF ADJUSTMENTS:

a) Taxpayer has no income in the state of South Carolina other than royalty income that is generated by the operations of Rent-A-Center East, Rent-A-Center Texas LP, Rainbow Rentals and RAC RR. All expenses shown on the US1120 of taxpayer did not occur within the state of South Carolina nor did they bear any relationship to royalty income and should not be considered in the calculation of apportionable income to South Carolina. The above apportionable income includes sales of tangible personal property, rental income, interest, capital gains and 4797 gains with expenses applicable to those activities and operations that are completely outside the state of South Carolina. Auditors had to start with only South Carolina business activity income as calculated on Schedules "B1-B6". In the above case only royalty income is generated in South Carolina based on the above entities business activities. If taxpayer can prove that any expense of Rent-A-Center West was directly related to the production of royalty income, that expense will be examined and the audit adjusted if necessary.

b) The apportionable income above was generated exclusively within the state of South Carolina.

Please reference Schedule "B1-B6" for the calculations. Those dollar amounts above represent royalty

**SOUTH CAROLINA DEPARTMENT OF REVENUE
RECOMPUTATION OF NET INCOME & TAX**

TAXPAYER: Rent-A-Center West, Inc
FILE # : 21058112-2
PERIOD: 12/03-12/05

SCHEDULE: A
AUDITOR: SOUTHARD
DENNIS
DATE: 1/9/08

Income earned within the state of South Carolina. SC Code of Laws Section 12-6-2320, allows the employment of any reasonable method to effectuate an equitable allocation and apportionment of the taxpayer's income.

SC Code Section 12-6-2320-Allocation and Apportionment of Taxpayer's Income When Provisions Unfairly Represent Taxpayer's Business Activity;

(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 allocation and apportionment of the taxpayer's income.

CONCLUSION: Since the taxpayer's only business activity in South Carolina is the receipt of royalty income, pursuant to SC Code Section 12-6-2320, separate accounting is required on the royalty receipts. This method more fairly represents this taxpayer's activity in South Carolina. Therefore, the denominator used to compute the apportionment for the taxpayer is adjusted to reflect only royalty receipts.

**SOUTH CAROLINA DEPARTMENT OF REVENUE
RECOMPUTATION OF THE GROSS RECEIPTS RATIO**

TAXPAYER: Rent-A-Center West, Inc
FILE #: 21056112-2
PERIOD: 12/03-12/05

SCHEDULE: B1
AUDITOR: SOUTHARD
DENNIS
DATE: 1/8/08

RENT-A-CENTER EAST, INC
PERIOD ENDED:
Royalty Expense per US1120
ADJUSTMENTS:

12/31/2003	12/31/2004	12/31/2005
47,911,720	48,228,943	47,528,802

Gross Rental Income per US1120
ADJUSTMENTS:

47,911,720	48,228,943	47,528,802	0
1,487,227,885	1,457,824,914	1,415,504,741	

1,487,227,885	1,457,824,914	1,415,504,741	0
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ROYALTY EXPENSE RATE

3.2855%	3.3081%	3.3577%	#DIV/0!
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EXPLANATION:

The purpose of this schedule is to determine the royalty expense rate attributable to South Carolina operations of Rent-A-Center East, Inc.

**SOUTH CAROLINA DEPARTMENT OF REVENUE
RECOMPUTATION OF THE GROSS RECEIPTS RATIO**

TAXPAYER: Rent-A-Center West, Inc
FILE # : 21058112-2
PERIOD: 12/03-12/05

SCHEDULE: B2
AUDITOR: SOUTHARD
DENNIS
DATE: 1/9/08

RENT-A-CENTER EAST, INC
PERIOD ENDED:
South Carolina Sales per SC1120
ADJUSTMENTS:

12/31/2003	12/31/2004	12/31/2005
27,894,054	28,752,480	28,158,500

SC RECEIPTS AS ADJUSTED

27,894,054	28,752,480	28,158,500	0
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ADJUSTMENTS:

ROYALTY EXPENSE RATE

3.2655%	3.3081%	3.3577%	0
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ROYALTY INCOME CONTRIBUTED BY SC

904,349	951,180	945,478	0
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EXPLANATION:

The purpose of this schedule is to determine the royalty income attributable to South Carolina operations of Rent-A-Center East, Inc.

**SOUTH CAROLINA DEPARTMENT OF REVENUE
RECOMPUTATION OF THE GROSS RECEIPTS RATIO**

TAXPAYER: Rent-A-Center West, Inc
FILE #: 21058112-2
PERIOD: 12/03-12/05

SCHEDULE: 83
AUDITOR: SOUTHARD
DENNIS
DATE: 1/9/08

RAC RR, Inc
PERIOD ENDED:
Royalty Expense per US1120
ADJUSTMENTS:

12/31/2004	12/31/2005
0	1,097,388

Gross Rental Income per US1120
ADJUSTMENTS:

0	1,097,388	0	0
0	33,021,079		

ROYALTY EXPENSE RATE

0	33,021,079	0	0
0.0000%	3.3233%	#DIV/0!	#DIV/0!

EXPLANATION:

The purpose of this schedule is to determine the royalty expense rate attributable to South Carolina operations of RAC RR, Inc.

**SOUTH CAROLINA DEPARTMENT OF REVENUE
RECOMPUTATION OF THE GROSS RECEIPTS RATIO**

TAXPAYER: Rent-A-Center West, Inc
FILE # : 21056112-2
PERIOD: 12/03-12/05

SCHEDULE: B4
AUDITOR: SOUTHARD
DENNIS
DATE: 1/8/08

RAC RR, Inc
PERIOD ENDED:
South Carolina Sales per SC1120
ADJUSTMENTS:

	12/31/2004	12/31/2005
	1,360,322	1,687,423

SC RECEIPTS AS ADJUSTED

1,360,322	1,687,423	0	0
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ADJUSTMENTS:

ROYALTY EXPENSE RATE

0.0000%	3.3235%	0
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ROYALTY INCOME CONTRIBUTED BY SC

0	56,075	#VALUE!	0
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EXPLANATION:

The purpose of this schedule is to determine the royalty income attributable to South Carolina operations of RAC RR, Inc.

**SOUTH CAROLINA DEPARTMENT OF REVENUE
RECOMPUTATION OF THE GROSS RECEIPTS RATIO**

TAXPAYER: Rent-A-Center West, Inc
FILE # : 21058112-2
PERIOD: 12/03-12/05

SCHEDULE: B5
AUDITOR: SOUTHARD
DENNIS
DATE: 1/8/08

Rainbow Rentals

PERIOD ENDED:

Royalty Expense per US1120

ADJUSTMENTS:

12/31/2004	12/31/2005
0	2,286,953

Gross Rental Income per US1120

ADJUSTMENTS:

0	2,286,953	0	0
0	70,140,840		

ROYALTY EXPENSE RATE

0	70,140,840	0	0
0.0000%	3.2320%	#DIV/0!	#DIV/0!

EXPLANATION:

The purpose of this schedule is to determine the royalty expense rate attributable to South Carolina operations of Rainbow Rentals.

**SOUTH CAROLINA DEPARTMENT OF REVENUE
RECOMPUTATION OF THE GROSS RECEIPTS RATIO**

TAXPAYER: Rent-A-Center West, Inc
FILE # : 21058112-2
PERIOD: 12/03-12/05

SCHEDULE: B6
AUDITOR: SOUTHARD
DENNIS
DATE: 1/9/08

Rainbow Rentals

PERIOD ENDED:

South Carolina Sales per SC1120

ADJUSTMENTS:

12/31/2004	12/31/2005
0	2,103,422

SC RECEIPTS AS ADJUSTED

0	2,103,422	0	0
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ADJUSTMENTS:

ROYALTY EXPENSE RATE

0.0000%	3.2320%	0
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ROYALTY INCOME CONTRIBUTED BY SC

0	87,983	#VALUE!	0
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EXPLANATION:

The purpose of this schedule is to determine the royalty income attributable to South Carolina operations of Rainbow Rentals.

**SOUTH CAROLINA DEPARTMENT OF REVENUE
RECOMPUTATION OF LICENSE FEE**

TAXPAYER: Rent-A-Center West, Inc
FILE # : 21058112-2
PERIOD: 12/04-12/08

SCHEDULE: C
AUDITOR: SOUTHARD
DENNIS
DATE: 1/9/08

PERIOD ENDED:	12/31/04	12/31/05	12/31/06	
TOTAL CAPITAL & PD. IN SURPLUS	0	0	0	
SC APPORTIONMENT RATIO-Per Sch "B"	3.2855%	3.3081%	3.3577%	
SC PROPORTION	0	0	0	0
LICENSE FEE RATE	0.001	0.001	0.001	0.001
LICENSE FEE DUE	0	0	0	0
ADDL. LICENSE FEE (12-20-50)	15	15	15	15
TOTAL LICENSE FEE (\$25 MIN.)	25	25	25	0
LESS: LICENSE FEE PAID	-25	-25	-25	
TAX CREDITS				
UNDERPAYMENT (OVERPAYMENT)	0	0	0	0

EXPLANATION:

LICENSE FEE IS BASED ON CAPITAL STOCK AND "PAID IN SURPLUS" PER SECTION 12-20-50 (PREVIOUSLY 12-19-70) SC CODE OF LAWS. SC PROPORTION OF CAPITAL STOCK AND PAID IN SURPLUS IS DETERMINED INACCORDANCE WITH THE RATIOS PRESCRIBED FOR THE PURPOSED OF THE INCOME TAX PER SECTION 12-20-80 (PREVIOUSLY 12-19-80) SC CODE OF LAWS.

1039



STATE OF SOUTH CAROLINA
DEPARTMENT OF REVENUE
Protest Pursuant to Revenue Procedures Act
S.C. Code Ann. §12-60-10, et seq.

C-245
(Rev. 10/10/07)
6177

Section I: Taxpayer IdentificationTaxpayer Name (s): RENT-A-CENTER WEST, INC.

(Please type or print)

Address: 5501 HEADQUARTERS, 2ND FLOORCity: PLANOState: TEXASZip Code: 75024Telephone: (972) 801-1331Period (s) Covered: PERIODS ENDED 12/31/03 THROUGH 12/31/05

Type (s) of Tax (es) or matter. Check all that apply:

- | | | |
|--|--|---|
| ☒ Corporate Income Tax | ☐ Deed Recording Fee | ☐ Employer Withholding Tax |
| ☐ Individual Income Tax | ☐ Liquor by the Drink Tax | ☐ Motor Fuel Tax |
| ☐ Partnership Income Tax | ☐ Regulatory Violation | ☐ Sales and Use Tax |
| ☐ Other (Specify) _____ | | |

Identification Number (Social Security Number, License Number, File Number, etc.):

FEI NUMBER: 48-1156618; FILE NUMBER: 21056112-2**Section II: Department of Revenue Document to be Attached**

Please attach a copy of the Department of Revenue document or notice you received which led to the filing of this protest.

Section III: Reason for Protest

State all the reasons you disagree, including a statement of facts supporting your position and the law or other authority upon which you rely. (If the amount of proposed assessment is less than \$2,500 you need not provide your legal authority unless you are a partnership, "S" corporation, an exempt organization or an employee plan and the proposed tax is imposed by Chapters 6, 11, or 13 of Title 12.) The law or other authority supporting your position must be furnished on all regulatory violations. Add additional sheets if necessary.

SEE ATTACHMENT TO APPLICATION FOR APPEAL - FORM C-245

(over)

61771028

Taxpayer's Signature _____ Date _____

Spouse's Signature _____ Date _____

Business Entity Name (if applicable) RENT-A-CENTER WEST, INC.

By Michael W. McLaughlin Title _____
Signature of Owner/Partner/Officer/LLC Member

Michael W. McLaughlin Date 6/3/08
Print Name

INSTRUCTIONS

The purpose of this form is to reduce to writing those facts and issues with which you disagree. If more space is needed, additional sheets may accompany this form. A protest may be filed by letter rather than using this form; however, all of the information required by this form must be included in the letter and you must comply with the requirements concerning signatures. If you file a joint income tax return, both you and your spouse must sign. If the protest is for a corporation, it must include the corporation's name followed by the signature and title of the corporate officer authorized to sign. If you have any questions concerning this matter, please call the telephone number on the notice or document with which you disagree. Please return document to the Department of Revenue address shown on the notice or document with which you disagree.

Social Security Privacy Act Disclosure

It is mandatory that you provide your social security number on this tax form. 42 U.S.C 405(c)(2)(C)(i) permits a state to use an individual's social security number as means of identification in administration of any tax. SC Regulation 117-201 mandates that any person required to make a return to the SC Department of Revenue shall provide identifying numbers, as prescribed, for securing proper identification. Your social security number is used for identification purposes.

The Family Privacy Protection Act

Under the Family Privacy Protection Act, the collection of personal information from citizens by the Department of Revenue is limited to the information necessary for the Department to fulfill its statutory duties. In most instances, once this information is collected by the Department, it is protected by law from public disclosure. In those situations where public disclosure is not prohibited, the Family Privacy Protection Act prevents such information from being used by third parties for commercial solicitation purposes.

61772026

ATTACHMENT TO APPLICATION FOR APPEAL - FORM C-245.

Rent-A-Center West, Inc.

File: 21056112-2

Corporate Income Tax

Audit No. 00/36/6388

Taxable Periods Ended 12/31/03 through 12/31/005

This Application for Appeal is being filed in response to the March 12, 2008 Report of Field Audit issued by the Field Services Division ("Division") of the South Carolina Department of Revenue ("Department") which asserts a Proposed Assessment against Rent-A-Center West, Inc. ("RAC West") in the amount of \$216,300.00, consisting of corporate income tax in the amount of \$144,971.00, interest in the amount of \$35,086.00 and penalty in the amount of \$36,243.00, for tax years ending December 31, 2003 through December 31, 2005 (the "Periods in Issue"). (A copy of the Report of Field Audit is attached as Exhibit A.) Attached (as Exhibit B) is a Power of Attorney authorizing our representation of RAC West in this matter.

Facts

Rent-A-Center, Inc. ("Rent-A-Center") is a corporation organized under the laws of Delaware. Its principal place of business and commercial domicile are in Texas. Rent-A-Center operates, through its affiliates, retail stores that rent and sell tangible personal property under flexible rental arrangements that allow the customer to purchase the merchandise at the end of the rental agreement.

Rent-A-Center East, Inc. ("RAC East") is a corporation organized under the laws of Delaware. Its principal place of business and commercial domicile are in Texas.

RAC East is a subsidiary of Rent-A-Center and is the legal entity that owns and operates retail stores located in various states, including South Carolina.

RAC West is a corporation organized under the laws of Delaware. Its principal place of business and commercial domicile are in Texas. RAC West is a subsidiary of RAC East that owns and operates retail stores located in various states, but it has no stores in South Carolina. It also owns, develops, licenses and protects the "Rent-A-Center" trademarks, tradenames, and service marks ("Intellectual Property").

RAC West licensed the Intellectual Property that it owns to RAC East and other affiliates. The license agreements between RAC West and RAC East and the other affiliates were executed by RAC West outside of South Carolina.

During the Periods in Issue, RAC West timely filed South Carolina corporate income tax returns and apportioned its income using the standard South Carolina three factor apportionment formula. RAC West included in the numerator of the sales factor of the apportionment formula the revenue generated by the licensing of its Intellectual Property in South Carolina based on RAC East's South Carolina apportionment factor. RAC West did not have any payroll or property in South Carolina.

On audit, the Division rejected RAC West's computation of its South Carolina apportionable income and recalculated RAC West's South Carolina income using separate accounting and disallowing any deductions related to the production of RAC West's South Carolina royalty income. In effect, the Division calculated RAC West's

South Carolina tax liability based on RAC West's gross receipts from the licensing of the Intellectual Property as separately allocated to South Carolina.

Reasons for the Appeal

RAC West objects to the following adjustments proposed by the Division:

A. The alleged use of separate accounting to calculate RAC West's South Carolina corporate income tax when in fact no separate accounting of income has been attempted by the department.

B. The computation of RAC West's alleged tax liability based on gross receipts instead of South Carolina taxable income.

C. The assessment of penalties against RAC West; and

D. All other adverse adjustments that result in the imposition of any additional corporate income tax on RAC West.

A. **The Use of Separate Accounting is Inappropriate.** For years prior to 2006, companies engaged in the following activities were required to use a three factor apportionment formula with a double weighted sales factor: (1) manufacturing, collecting, buying, assembling, or processing goods and materials; or (2) selling, distributing, or dealing in tangible personal property. S.C. CODE ANN. § 12-6-2250. The Department may only use an alternative apportionment method, such as separate accounting, if the statutorily mandated method does not fairly represent the extent of the taxpayer's business activity in the state and the use of the alternative method is

reasonable. S.C. CODE ANN. § 120-6-2320. The Department's use of an alternative apportionment method in regard to RAC West was in error because the statutory method fairly represents the extent of RAC West's business activity in the state and the alternative method is unreasonable.

For the Periods in Issue, the principal business of RAC West was dealing in tangible personal property and thus it was required to use the three factor apportionment formula set out in S.C. CODE ANN. § 12-6-2250 during the Periods in Issue. In order to determine the amount of its sales in South Carolina for purposes of the sales factor it multiplied its royalty income by RAC East's South Carolina apportionment factor. It included this amount in the numerator of its South Carolina apportionment formula. Such a calculation reasonably reflects the amount of royalty income RAC West earned in South Carolina.

On audit, the Division's Field Audit Report has asserted that RAC West's South Carolina tax must instead be computed based on separate accounting because "pursuant to SC Code Section 12-6-2320, separate accounting is required on the royalty receipts." However, nowhere does this section require the use of separate accounting for royalty receipts. The statute only allows the use of an alternative apportionment formula where the standard formula does not accurately reflect the taxpayer's income and the use of the alternative formula is reasonable.

The Field Audit Report does not explain why the use of an alternative apportionment method is necessary or reasonable and merely concludes that separate accounting "more fairly represent's the taxpayer's activity in South Carolina" without further justification or explanation. In addition, while S.C. CODE ANN. § 12-6-2320 and South Carolina case

law are silent on who has the burden of proof in regard to the use of an alternative apportionment formula, other states that have adopted the Uniform Division of Income for Tax Purposes Act's alternative apportionment provision, which is identical to the South Carolina provision, require the party seeking an alternative apportionment method to show by clear and convincing evidence that the standard formula is not a fair representation and that its proposed alternative is reasonable. See, The Limited Stores, Inc. v. Franchise Tax Board, 152 Cal. App. 4th 1491 (Cal. Ct. App. 2007); Union Pacific Corp. v. Tax Commission, 139 Idaho 573 (2004); St. Johnsbury Trucking Co. v. New Hampshire, 118 N.H. 209 (1978); Donald M. Drake Co. v. Dept. of Revenue, 263 Ore. 26 (1972). Based on these cases, the Division should bear the burden of proof as it is the party that is seeking the alternative apportionment method. The Division, however, has failed to explain why the use of an alternative method is necessary or reasonable and thus has failed to meet its burden of proof in regard to the use of separate accounting for RAC West's royalty income.

In addition, the use of separate accounting pursuant to S.C. CODE ANN. § 12-6-2320 results in a tax liability that is distortive, is out of all appropriate proportion to, and does not fairly represent, the business, if any, conducted by RAC West in South Carolina. Accordingly the use of separate accounting is unconstitutional. Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159 (1983); Hans Rees's Sons, Inc. v. North Carolina, 283 U.S. 123 (1931).

B. Tax Liability Should Not be Computed Based on Gross Receipts. The South Carolina corporate income tax is imposed annually at a rate of 5% on the South Carolina taxable income of every corporation transacting, conducting or doing business within the

state or having income within the state. S.C. CODE ANN. § 12-6-530. A corporation's South Carolina taxable income is the corporation's federal taxable income with certain modifications as provided under the South Carolina Income Tax Act. S.C. CODE ANN. § 12-6-580.

On audit, the Division incorrectly asserted that RAC West had no expenses related to the production of its South Carolina royalty income. RAC West incurred ordinary and necessary business expenses related to the production of its royalty income which it properly deducted under IRC Section 162 in computing its federal taxable income. The Division paradoxically asserts that none of RAC West's expenses can be attributed to South Carolina business income while maintaining that a portion of RAC West's income *must* be attributed to South Carolina business activity. Under the Department's position, there is no matching of gross income (receipts) with the expense that generated that income. This is contrary to the matching principal of income and expense dictated by the South Carolina court of appeals in Dalton v. South Carolina Tax Commission, 367 S.E2d 459 (S.C. App. 1988). If RAC West was earning substantial revenue from business activity in South Carolina, as the Division asserts, it is unreasonable for the Division to assume that RAC West incurred no expenses in earning that income. In addition, South Carolina law provides no modification to federal taxable income that would allow the Division to disallow deductions that were properly taken in calculating federal taxable income, on which the South Carolina tax is based. By ignoring the deductions that are necessary in order to determine federal taxable income, the Department has proposed a gross receipts tax, not an income tax. The South Carolina tax law imposes an income tax, not a gross receipts tax. Such a tax is wholly unauthorized under South Carolina law.

C. **Penalties.** The Field Audit Report asserts penalties against RAC West for the Periods in Issue. The Field Audit Report does not state the basis for the imposition of penalties, nor does it provide any statutory support for such imposition. However, whatever basis the Division alleges for the imposition of penalties, RAC West believes that such penalties should be waived because RAC West properly apportioned its income pursuant to the statutory apportionment formula under S.C. CODE ANN. §12-6-2250. Under S.C. CODE ANN. §12-54-160 the Department can waive penalties. The Department has stated that it will waive penalties where there was reasonable cause for the underpayment and the taxpayer exercised ordinary business care and prudence. See Revenue Procedural Bulletin 02-5 (October 4, 2002).

Reasonable cause exists for any deficiency that may be found to be due because RAC West's exercised ordinary business prudence in filing its returns based on the statutory apportionment provisions set out in S.C. CODE ANN. §12-6-2250. In fact RAC West could not have filed its returns using the separate accounting method that the Department has asserted because S.C. CODE ANN. § 12-6-2320 does not allow taxpayers to file their returns using an alternative apportionment formula such as separate accounting. Therefore, even if it is ultimately determined that any deficiency exists, which RAC West denies, the penalties asserted in the Report of Field Audit should be waived under S.C. CODE ANN. §12-54-160 because there was a reasonable cause for the deficiency.

In addition, it appears that the Division has imposed a substantial understatement penalty. S.C. CODE ANN. § 12-54-155(a) imposes a substantial underpayment penalty equal to 25 percent of any underpayment attributable to the understatement. However,

"understatement" does not include understatement attributable to "the tax treatment of any item by the taxpayer if there is or was substantial authority for such treatment...."

S.C. CODE ANN. § 12-54-155(b)(2)(B)(A)(i). As discussed above, RAC West correctly calculated its South Carolina corporate income tax liability using the statutorily mandated apportionment formula set out in S.C. CODE ANN. §12-6-2250. Therefore, there is substantial authority for the RAC West's use of that apportionment formula. Assertion of a substantial underpayment penalty is therefore improper and such penalty should be waived.

Conclusion

The Division erred in: (1) using an alternative apportionment method in computing the alleged tax due and owing under the corporate income tax; (2) using gross receipts to determine the alleged tax liability due and owing instead of South Carolina taxable income; (3) asserting penalties against RAC West; and (4) asserting all other adverse adjustments that result in the imposition of any additional corporate income tax on RAC West.

RAC West reserves the right to present further information concerning its protest of the Report of Field Audit at or prior to the conference in this matter.

Based on the foregoing, RAC West respectfully requests a redetermination of the Proposed Assessment.

816574

THO

STATE OF SOUTH CAROLINA

SC 1120

C CORPORATION

INCOME TAX RETURN

Return is due on or before the 15th day of the 3rd month following the close of the taxable year.

(Rev. 8/26/03)
3091

FILE #

INCOME TAX PERIOD ENDING 12/31/2003

LICENSE FEE PERIOD ENDING 12/31/2004

FED EI # 48-1156618

NAME

Rent-A-Center West, Inc.

MAILING ADDRESS 5501 Headquarters Drive

Check if ☐ Consolidated Return

Total Gross Receipts.

Total cost of depreciable personal property in SC.

30,654,681

0.00

CITY Plano

STATE TX

ZIP CODE 75024

Change of

Address

Accounting Period

Mail this return to: SCDOR, Corporation Return, Columbia, SC 29214-0100

If Filing a Final Return, See Instructions for Further Information.

☐ Merged☐ Reorganized☐ Dissolved☐ WithdrawnPART I
INCOME TAX LIABILITY

1. Federal Taxable Income per Federal Form 1120 or 1120A 1. -12,626,035
2. Net Adjustment from line 12, Schedule A and B 2. 18,929,941
3. Total Net Income as Reconciled (line 1 plus or minus line 2) 3. 6,303,906
4. If Multi-state Corporation, enter amount from line 6, Schedule G; otherwise, enter amount from line 3. 4. 12,721
5. LESS: South Carolina net operating loss carryover, if applicable 5.
6. South Carolina Net Income subject to tax (line 4 less line 5) 6. 12,721
7. TAX: Multiply amount on line 6 by .05 (5.0%) 7. 636
8. Less tax deferred on income from foreign trade receipts (see instructions) 8.
9. Balance (line 7 less line 8) 9. 636
10. Credit Carryover (line 7, Schedule C) Non-refundable credits (line 5, Schedule C) 10.
11. Balance of tax (line 9 less line 10). Enter the difference but not less than zero 11. 636
12. Interest on DISC-deferred tax liability; or Foreign Trade Deferred Tax Liability 12.
13. Total tax and/or interest (add lines 11 and 12) 13. 636
14. Payments: (a) Tax Withheld (see instructions) (b) Paid by Declaration
- (c) Paid with Tentative Return 330 (d) Credit from Line 29b
15. Total Payments (add lines 14a through 14d) 15. 330
16. Balance of Tax and/or Interest Due (line 13 less line 15) 16. 306
17. Interest Due Penalty Due (See penalty and interest instructions.) Enter Total 17.
18. TOTAL INCOME TAX, Interest and Penalty Due (add lines 16 and 17) BALANCE DUE 18. 306
19. OVERPAYMENT (line 15 less line 13) To be applied as follows:

AS AMENDED

COMPUTATION

PART II
COMPUTATION OF LICENSE FEE

- (a) Estimated Tax (b) License Fee (c) Refunded
20. Total Capital And Paid in Surplus (Multi-State Corporations See Schedule E) 20.
21. FEE DUE - Line 20 x .001, plus \$15.00 (Fee cannot be less than \$25.00 per taxpayer) 21. 25
22. LESS: Applicable Credits against License Fee (attach SC1120-TC) 22.
23. Balance (line 21 less line 22) 23. 25
24. Payments: (a) Paid with Tentative Return 25 (b) Credit from line 19b
25. Total Payments (add line 24(a) and (b)) 25. 25
26. Balance of Fee Due (line 23 less line 25) 26.
27. Interest Due Penalty Due (See penalty and interest instructions.) Enter Total 27.
28. TOTAL LICENSE FEE, Interest and Penalty Due (add lines 26 and 27) BALANCE DUE 28.
29. OVERPAYMENT (line 25 less line 23) To be applied as follows:
- (a) Estimated Tax (b) Income Tax (c) Refunded
30. GRAND TOTAL: INCOME TAX and LICENSE FEE DUE (add lines 18 and 28) EFT 30. 306

Please
Sign
Here

I, the undersigned, a principal officer of the corporation for which this return is made declare that this return, including accompanying Annual Report, statements and schedules, has been examined by me and is to the best of my knowledge and belief, a true and complete return.

Signature of officer

Date

VP Tax

972-801-1844

Title

Telephone Number

I authorize the Director of the Department of Revenue or delegate to discuss this return, attachments and related tax matters with the preparer.

Yes ☐No ☐

Preparer's Printed Name

Preparer's
signature

Date

Check if
self-employed ☐

Preparer's telephone number

Use Only

Firm's name (or
yours if self-employed)
and address

EI #

ZIP Code

304911 4000

ROA 0361

SCHEDULE A AND B**ADDITIONS TO FEDERAL NET INCOME**

1. Taxes on or Measured By Income	1.	3,872,181
2. Federal Net Operating Loss	2.	
Depreciation Adjustment	3.	15,066,437
	4.	
5. Other Additions (attach schedule)	5.	
6. Total Additions (add lines 1 through 5)	6.	18,938,618

DEDUCTIONS FROM FEDERAL NET INCOME

7. Interest On Obligations Of The U.S.	7.	
8. Federal Job Credit	8.	8,677
9.	9.	
10. Other Deductions (attach schedule)	10.	
11. Total Deductions (add lines 7 through 10)	11.	8,677
12. Net Adjustment (line 6 less line 11) Also enter on line 2, Part 1, SC1120	12.	18,929,941

SCHEDULE C**SUMMARY OF CREDITS (FROM SC1120-TC)**

1. Credit Carryover From Previous Year's SC1120, Schedule C (NOTE: Should agree to SC1120-TC Column A, line 22)	1.	
2. Enter Total Credits from SC1120-TC, Column B, line 22. SC1120-TC must be attached to return.	2.	
3. Total Credits (add lines 1 and 2)	3.	
4. Tax (line 9, Part 1, SC1120)	4.	636
5. Lesser of line 3 or 4 (enter on line 10, Part 1, SC1120) (NOTE: Should agree to SC1120-TC, Column C, line 22)	5.	
6. Enter Credits Lost Due to Statute (NOTE: Should agree to SC1120-TC, Column D, line 22)	6.	
7. Credit Carryover (line 3 less lines 5 and 6) (NOTE: Should agree to SC1120-TC, Column E, line 22)	7.	

SCHEDULE D**ANNUAL REPORT TO BE COMPLETED BY ALL CORPORATIONS**

1. Name Rent-A-Center West, Inc.

2. Incorporated under the laws of the State of Delaware

3. Location of the Registered Office of the Corporation in the State of South Carolina is _____
In the City of _____ Registered Agent at such address is _____

4. Location of principal office (street address) 5501 HEADQUARTERS DRIVE, Plano, TX 75024
Nature of principal business in SC RENT TO OWN

5. The total number of authorized shares of capital stock, itemized by class and series, if any, within each class is as follows:
NUMBER OF SHARES: 1000 CLASS: Common SERIES: N/A

6. The total number of issued and outstanding shares of capital stock itemized by class and series, if any, within each class is as follows:
NUMBER OF SHARES: 1000 CLASS: Common SERIES: N/A

7. The names and business addresses of the directors (or individuals functioning as directors) and principal officers in the Corporation are:
(If additional space is necessary, attach separate schedule).

NAME	BUSINESS ADDRESS AND OFFICE
See Statement 1	

8. Date Incorporated 10/11/1994 Date commenced business in the State of South Carolina was _____

9. Date of this report _____ Fed EI # 48-1156618

10. If Foreign Corporation, the date qualified to do business in the State of South Carolina is _____

11. Was the name of the Corporation changed during the year? NO Give old name _____

12. The Corporation's books are in the care of Hugh Tollack
Located at (street address) 5501 HEADQUARTERS DRIVE, PLANO, TX 75024

13. If filing consolidated, complete and attach Schedule J for each Corporation included in the consolidation.

14. The total amount of stated capital per balance sheet is:

A. Total paid in Capital Stock (cannot be a negative amount)	\$	0.00
B. Total paid in Capital Surplus (cannot be a negative amount)	\$	0.00
C. Total amount of stated Capital (cannot be a negative amount)	\$	0.00

Street	City	State
dit Location: 5501 HEADQUARTERS DRIVE, PLANO, TX 75024		
Audit Contact: HUGH TOLLACK	Telephone Number: 972-801-1100	
County or Counties in SC Where Property is Located:		

THO
3/24/92 2:00

ATTACHED COMPLETED COPY OF FEDERAL RETURN.

ROA 0362

SCHEDULES E, F, G, AND H ARE TO BE COMPLETED BY MULTI-STATE CORPORATIONS**SCHEDULE E COMPUTATION FOR LICENSE FEE - MULTI-STATE CORPORATIONS**

Total Capital and Paid-in-Surplus at end of Year

\$

SC PROPORTION: (line 1 X ratio from Schedule H-1, H-2 or H-3, as appropriate) Also enter on line 20, Part II

\$

SCHEDULE F INCOME SUBJECT TO DIRECT ALLOCATION

	Gross Amounts 1	Less: Related Expenses 2	Net Amounts Allocated Directly to SC and Other States 3	Net Amounts Allocated Directly to SC 4	Payrolls to be Excluded from Payroll Factor 5	Property to be Excluded from Property Factor 6
1. Interest not connected with business						
2. Dividends received						
3. Rents						
4. Gains/losses on real property						
5. Gains/losses on intangible pers. prop.						
6. Investment income directly allocated						
7. TOTAL INCOME DIRECTLY ALLOCATED				NONE		
8. INCOME DIRECTLY ALLOCATED TO SC						
9. TOTALS TO APPORTIONMENT FACTORS					NONE	NONE

SCHEDULE G COMPUTATION OF TAXABLE INCOME FOR CORPORATIONS CLAIMING MULTI-STATE OPERATIONS

1. Total net income as reconciled. Enter amount from line 3, Page 1	1.	6,303,906
2. Less: Income subject to direct allocation to SC and other states from Schedule F, line 7	2.	
3. Total net income subject to apportionment (line 1 less line 2)	3.	6,303,906
4. Multiply amount on line 3 by appropriate ratio from Schedule H-1, 2, or 3 and enter result here	4.	12,721
5. Add: Income subject to direct allocation to SC from Schedule F, line 8	5.	
6. Total S.C. Net Income (sum of lines 4 and 5 above) also enter on line 4, Part 1 of Page 1	6.	12,721

SCHEDULE H-1 COMPUTATION OF FOUR FACTOR APPORTIONMENT RATIO

	1. Property Within South Carolina		2. Total Property Everywhere	
	(a) Beginning Period	(b) Ending Period	(a) Beginning Period	(b) Ending Period
1. Land				
2. Buildings				
3. Machinery and Equipment				
4. Inventories				
5. Other Property				
6. Exclusions	<	>	<	>
7. TOTAL (add lines 1-5; subtract line 6)				
		1. Within SC	2. Total Everywhere	3. Ratio
8. Avg. of Beginning and Ending Period (add line 7a and b and divide by 2)				
9. Rental or Lease Value				
10. TOTAL Property Add lines 8 and 9. (Col. 1 ÷ Col. 2 and enter ratio in Col. 3)				%
11. GROSS Payroll				
12. Less: Officers Compensation and Exclusions	<	>		
13. TOTAL Payroll (Col. 1 ÷ Col. 2 and enter ratio in Col. 3)				%
14. TOTAL Sales (Col. 1 ÷ Col. 2 and enter ratio in Col. 3)				%
15. TOTAL Sales (same as line 14)				%
16. TOTAL of Ratios (add Column 3 - lines 10, 13, 14 and 15)				%
17. Arithmetical Average of Ratios				%

SCHEDULE H-2 COMPUTATION OF GROSS RECEIPTS RATIO

	1. In SC	2. Total Everywhere	3. Ratio
1. Total Gross Receipts	830,247	411,403,419	
2. Less: Exclusion (see instructions)	<	>	
3. Gross Receipts (for ratio)	830,247	411,403,419	
4. Ratio of Gross Receipts (line 3, Col. 1 ÷ line 3, Col. 2)			0.2018 %

SCHEDULE H-3 COMPUTATION OF RATIO FOR PUBLIC SERVICE CORPORATIONS

	Amount	Ratio
Total Within South Carolina		
Total for System		
3. Ratio (South Carolina ÷ Total System)		%



STATE OF SOUTH CAROLINA
'C' CORPORATION
INCOME TAX RETURN

SC1120

(Rev. 8/26/03)
3091

Return is due on or before the 15th day of the 3rd month
following the close of the taxable year.

SC FILE # _____

INCOME TAX PERIOD ENDING 12/31/2003

LICENSE FEE PERIOD ENDING 12/31/2004

FED EI # 48-1156618

NAME Rent-A-Center West, Inc.

MAILING ADDRESS 5601 Headquarters Drive

CITY Plano STATE TX ZIP CODE 75024

Change of ☐ Address ☐ Accounting Period

Mail this return to: SCDOR, Corporation Return, Columbia, SC 29214-0100

AS ORIGINALLY AMENDED

Check if ☐ Consolidated Return

Total Gross Receipts. Total cost of depreciable personal property in SC.

30,654,681

If Filing a Final Return, See Instructions for Further Information.

☐ Merged ☐ Reorganized ☐ Dissolved ☐ Withdrawn

PART I
COMPUTATION OF INCOME TAX LIABILITY

1. Federal Taxable Income per Federal Form 1120 or 1120A.....	1.	(12,626,035)
2. Net Adjustment from line 12, Schedule A and B.....	2.	18,929,941
3. Total Net Income as Reconciled (line 1 plus or minus line 2).....	3.	6,303,906
4. If Multi-state Corporation, enter amount from line 6, Schedule G; otherwise, enter amount from line 3.	4.	6,361
5. LESS: South Carolina net operating loss carryover, if applicable.....	5.	
6. South Carolina Net Income subject to tax (line 4 less line 5).....	6.	6,361
7. TAX: Multiply amount on line 6 by .05 (5.0%).....	7.	318
8. Less tax deferred on income from foreign trade receipts (see instructions).....	8.	
9. Balance (line 7 less line 8).....	9.	318
10. Credit Carryover (line 7, Schedule C) ☐ Non-refundable credits (line 5, Schedule C).....	10.	<
11. Balance of tax (line 9 less line 10). Enter the difference but not less than zero.....	11.	318
12. Interest on DISC-deferred tax liability.....; or Foreign Trade Deferred Tax Liability.....	12.	
13. Total tax and/or interest (add lines 11 and 12).....	13.	318
14. Payments: (a) Tax Withheld (see instructions) ☐ (b) Paid by Declaration ☐		
(c) Paid with Tentative Return ☐ 330 (d) Credit from Line 29b ☐		
15. Total Payments (add lines 14a through 14d).....	15.	330
16. Balance of Tax and/or Interest Due (line 13 less line 15).....	16.	0
17. Interest Due ☐ Penalty Due ☐ (See penalty and interest instructions.) Enter Total.....	17.	0
18. TOTAL INCOME TAX, Interest and Penalty Due (add lines 16 and 17).....	18.	0
19. OVERPAYMENT (line 15 less line 13).....	19.	0
(a) Estimated Tax ☐ 12 (b) License Fee ☐ SC1120 (c) Refunded ☐		

PART II
COMPUTATION OF LICENSE FEE

20. Total Capital And Paid in Surplus (Multi-State Corporations See Schedule E).....	20.	0
21. FEE DUE - Line 20 x .001, plus \$15.00 (Fee cannot be less than \$25.00 per taxpayer).....	21.	25
22. LESS: Applicable Credits against License Fee (attach SC1120-TC).....	22.	
23. Balance (line 21 less line 22).....	23.	25
24. Payments: (a) Paid with Tentative Return ☐ 25 (b) Credit from line 19b ☐		
25. Total Payments (add line 24(a) and (b)).....	25.	25
26. Balance of Fee Due (line 23 less line 25).....	26.	0
27. Interest Due ☐ Penalty Due ☐ (See penalty and interest instructions.) Enter Total.....	27.	0
28. TOTAL LICENSE FEE, Interest and Penalty Due (add lines 26 and 27).....	28.	0
29. OVERPAYMENT (line 25 less line 23).....	29.	0
(a) Estimated Tax ☐ (b) Income Tax ☐ (c) Refunded ☐		
30. GRAND TOTAL: INCOME TAX and LICENSE FEE DUE (add lines 18 and 28).....	30.	0

I, the undersigned, a principal officer of the corporation for which this return is made declare that this return, including accompanying Annual Report, statements and schedules, has been examined by me and is to the best of my knowledge and belief, a true and complete return.

Please Sign Here Ricardo Cardon Signature of officer Date 1/17/09 VP Tax Title (972) 801-1100 Telephone Number

I authorize the Director of the Department of Revenue or delegate to discuss this return, attachments and related tax matters with the preparer. Yes ☐ No ☐ Preparer's Printed Name

Paid Preparer's signature Date Check if self-employed ☐ Preparer's telephone number
Preparer's Firm's name for Use Only yours if self-employed) and address EI # ZIP Code

Data Tech

ROA 0364

SC1120

Page 2

SCHEDULE A AND B

ADDITIONS TO FEDERAL NET INCOME

1. Taxes on or Measured By Income.....	1.	3,872,181
2. Federal Net Operating Loss.....	2.	
3. Depreciation Adjustment.....	3.	15,066,437
4.	4.	
5. Other Additions (attach schedule).....	5.	
6. Total Additions (add lines 1 through 5).....	6.	18,938,618

DEDUCTIONS FROM FEDERAL NET INCOME

7. Interest On Obligations Of The U.S.....	7.	
8. Federal Job Credit.....	8.	8,677
9.	9.	
10. Other Deductions (attach schedule).....	10.	
11. Total Deductions (add lines 7 through 10).....	11.	8,677
12. Net Adjustment (line 6 less line 11) Also enter on line 2, Part 1, SC1120.....	12.	18,929,941

SCHEDULE C

SUMMARY OF CREDITS (FROM SC1120-TC)

1. Credit Carryover From Previous Year's SC1120, Schedule C (NOTE: Should agree to SC1120-TC Column A, line 22) ...	1.	
2. Enter Total Credits from SC1120-TC, Column B, line 22. SC1120-TC must be attached to return.	2.	
3. Total Credits (add lines 1 and 2).....	3.	
4. Tax (line 9, Part 1, SC1120).....	4.	318
5. Lesser of line 3 or 4 (enter on line 10, Part 1, SC1120) (NOTE: Should agree to SC1120-TC, Column C, line 22.) ..	5.	
6. Enter Credits Lost Due to Statute (NOTE: Should agree to SC1120-TC, Column D, line 22.) ..	6.	
7. Credit Carryover (line 3 less line 5 and 6) (NOTE: Should agree to SC1120-TC, Column E, line 22.) ..	7.	

SCHEDULE D

ANNUAL REPORT TO BE COMPLETED BY ALL CORPORATIONS

- Name Rent-A-Center West, Inc.
- Incorporated under the laws of the State of DELAWARE
- Location of the Registered Office of the Corporation in the State of South Carolina is _____
In the City of _____ Registered Agent at such address is _____
- Location of principal office (street address) 5501 Headquarters Drive
Nature of principal business in SC Rent To Own
- The total number of authorized shares of capital stock, itemized by class and series, if any, within each class is as follows:
NUMBER OF SHARES: 1,000 CLASS: Common SERIES: N/A
- The total number of issued and outstanding shares of capital stock itemized by class and series, if any, within each class is as follows:
NUMBER OF SHARES: 1,000 CLASS: Common SERIES: N/A
- The names and business addresses of the directors (or individuals functioning as directors) and principal officers in the Corporation are:
(If additional space is necessary, attach separate schedule).

NAME

BUSINESS ADDRESS AND OFFICE

See Statement 1

- Date Incorporated 10/11/94 Date commenced business in the State of South Carolina was _____
- Date of this report _____ Fed EI # 48-1156618
- If Foreign Corporation, the date qualified to do business in the State of South Carolina is _____
- Was the name of the Corporation changed during the year? _____ Give old name _____
- The Corporation's books are in the care of Hugh Tollack
Located at (street address) 5501 Headquarters Drive
- If filing consolidated, complete and attach Schedule J for each Corporation included in the consolidation.
- The total amount of stated capital per balance sheet is:
 - Total paid in Capital Stock (cannot be a negative amount) \$ 0
 - Total paid in Capital Surplus (cannot be a negative amount) \$ 0
 - Total amount of stated Capital (cannot be a negative amount) \$ 0

Street	City	State
Audit Location: <u>5501 Headquarters Drive, Plano, TX 75024</u>		
Audit Contact: <u>Hugh Tollack</u>	Telephone Number: <u>(972) 801-1100</u>	
County or Counties in SC Where Property is Located: _____		

Data Tech

ATTACH COMPLETED COPY OF FEDERAL RETURN.

ROA 0365

SC1120

SCHEDULES E, F, G, AND H ARE TO BE COMPLETED BY MULTI-STATE CORPORATIONS**SCHEDULE E COMPUTATION FOR LICENSE FEE - MULTI-STATE CORPORATIONS**

1. Total Capital and Paid-In-Surplus at end of Year \$ _____
2. SC PROPORTION: (line 1 X ratio from Schedule H -1, H -2 or H -3, as appropriate) Also enter on line 20, Part II \$ _____

SCHEDULE F INCOME SUBJECT TO DIRECT ALLOCATION

	Gross Amounts 1	Less: Related Expenses 2	Net Amounts Allocated Direct to SC and Other States 3	Net Amounts Allocated Directly to SC 4	Payrolls to be Excluded from Payroll Factor 5	Property to be Excluded from Property Factor 6
1. Interest not connected with business						
2. Dividends received						
3. Rents						
4. Gains/losses on real property						
5. Gains/losses on intangible pers. prop.						
6. Investment income directly allocated						
7. TOTAL INCOME DIRECTLY ALLOCATED						
8. INCOME DIRECTLY ALLOCATED TO SC				0		
9. TOTALS TO APPORTIONMENT FACTORS					0	0

SCHEDULE G COMPUTATION OF TAXABLE INCOME FOR CORPORATIONS CLAIMING MULTI-STATE OPERATIONS

1. Total net income as reconciled. Enter amount from line 3, Page 1 1. 6,303,906
2. Less: Income subject to direct allocation to SC and other states from Schedule F, line 7 2.
3. Total net income subject to apportionment (line 1 less line 2) 3. 6,303,906
4. Multiply amount on line 3 by appropriate ratio from Schedule H-1, 2, or 3 and enter result here 4. 6,361
5. Add: Income subject to direct allocation to SC from Schedule F, line 8 5.
6. Total S.C. Net Income (sum of lines 4 and 5 above) also enter on line 4, Part 1 of Page 1 6. 6,361

SCHEDULE H - 1 COMPUTATION OF FOUR FACTOR APPORTIONMENT RATIO

	1. Property Within South Carolina		2. Total Property Everywhere	
	(a) Beginning Period	(b) Ending Period	(a) Beginning Period	(b) Ending Period
1. Land				
2. Buildings				
3. Machinery and Equipment				
4. Inventories				
5. Other Property			209,666,946	226,292,429
6. Exclusions	< >	< >	< >	< >
7. TOTAL (add lines 1-5; subtract line 6)	0	0	209,666,946	226,292,429
8. Avg. of Beginning and Ending Period (add line 7a and b and divide by 2)			217,979,687	
9. Rental or Lease Value			200,765,853	
10. TOTAL Property Add lines 8 and 9. (Col. 1 ÷ Col. 2 and enter ratio in Col. 3)		0	418,745,540	0.0000 %
11. GROSS Payroll		0	100,479,220	
12. Less: Officers Compensation and Exclusions	< >	0 >	< >	0 >
13. TOTAL Payroll (Col. 1 ÷ Col. 2 and enter ratio in Col. 3)		0	100,479,220	0.0000 %
14. TOTAL Sales (Col. 1 ÷ Col. 2 and enter ratio in Col. 3)		830,247	411,403,419	0.2018 %
15. TOTAL Sales (same as line 14)		830,247	411,403,419	0.2018 %
16. TOTAL of Ratios (add Column 3 - lines 10, 13, 14 and 15)				0.4036 %
17. Arithmetical Average of Ratios				0.1009 %

SCHEDULE H - 2 COMPUTATION OF GROSS RECEIPTS RATIO

	1. In SC	2. Total Everywhere	3. Ratio
1. Total Gross Receipts			
2. Less: Exclusion (see instructions)	< >	< >	
3. Gross Receipts (for ratio)			
4. Ratio of Gross Receipts (line 3, Col. 1 ÷ line 3, Col. 2)			0.0000 %

SCHEDULE H - 3 COMPUTATION OF RATIO FOR PUBLIC SERVICE CORPORATIONS

	Amount	Ratio
1. Total Within South Carolina		
2. Total for System		
3. Ratio (South Carolina ÷ Total System)		0.0000 %

Rent-A-Center, Inc. 5501 Headquarters Dr. Plano TX 75024 1-800-275-2696

Date: 7/11/11 No. 41851739

SC DEPARTMENT OF REVENUE AND T. CORPORATE INCOME TAX COLUMBIA SC 29214-0006 UNITED STATES (12485)

INVOICE#		DATE	Gross	Discount	Net Amount	INVOICE#		DATE	Gross	Discount	Net Amount
070711-RW000		07/07/11	306.00	0.00	306.00						
JC/JM*** RAC SC 03 RTN											

THO

STATE OF SOUTH CAROLINA
'C' CORPORATION
INCOME TAX RETURNReturn is due on or before the 15th day of the 3rd month
following the close of the taxable year.Mail this return to:
SC DEPARTMENT OF REVENUE
Corporation Return
Columbia, SC 29214-0100

SC 1120

(Rev. 8/10/04)
3091

FILE #

INCOME TAX PERIOD ENDING 12/31/2004

LICENSE FEE PERIOD ENDING 12/31/2005

FED EI # 48-1156618

NAME

Rent-A-Center West, Inc.

MAILING ADDRESS 5501 Headquarters Drive

CITY Plano STATE TX ZIP CODE 75024

Change of ☐ Address ☐ Accounting PeriodA COMPLETE COPY OF FEDERAL RETURN MUST BE
ATTACHED TO THIS RETURN.

County or Counties in SC Where Property is Located:

NONE

City Audit Location State
5501 HEADQUARTERS DRIVE, PLANO, TX 75024
Audit Contact Telephone Number
Hugh Tollack 972-801-1100Check if ☐ Consolidated ReturnTotal Gross Receipts. Total cost of depreciable personal property in SC.
33,386,541 0

If Filing a Final Return, See Instructions for Further Information.

☐ Merged ☐ Reorganized ☐ Dissolved ☐ WithdrawnPART I
INCOME TAX LIABILITY

1. Federal Taxable Income per Federal Form 1120 or 1120A	1. 35,538,525
2. Net Adjustment from line 12, Schedule A and B	2. -15,697,725
3. Total Net Income as Reconciled (line 1 plus or minus line 2)	3. 19,840,800
4. If Multi-state Corporation, enter amount from line 6, Schedule G; otherwise, enter amount from line 3.	4. 40,317
5. LESS: South Carolina net operating loss carryover, if applicable	5.
6. South Carolina Net Income subject to tax (line 4 less line 5)	6. 40,317
7. TAX: Multiply amount on line 6 by .05 (5.0%)	7. 2,016
8. Less tax deferred on income from foreign trade receipts (see instructions)	8.
9. Balance (line 7 less line 8)	9. 2,016
10. Credit Carryover (line 7, Schedule C) ☐ Non-refundable credits (line 5, Schedule C) ☐	10.
11. Balance of tax (line 9 less line 10). Enter the difference but not less than zero	11. 2,016
12. Interest on DISC deferred tax liability; or Foreign Trade Deferred Tax Liability	12.
13. Total tax and/or interest (add lines 11 and 12)	13. 2,016
14. Payments: (a) Tax Withheld (see instructions) (b) Paid by Declaration (c) Paid with Tentative Return 996 (d) Credit from Line 29b	
15. Total Payments (add lines 14a through 14d) (\$951 from original Form SC1120 plus \$45 from 2004 amended Form SC1120)	15. 996
16. Balance of Tax and/or Interest Due (line 13 less line 15)	16. 1,020
17. Interest Due Penalty Due (See penalty and interest instructions.) Enter Total	17.
18. TOTAL INCOME TAX, Interest and Penalty Due (add lines 16 and 17) BALANCE DUE	18. 1,020
19. OVERPAYMENT (line 15 less line 13) To be applied as follows:	
(a) Estimated Tax (b) License Fee (c) Refunded	

AS AMENDED

PART II
COMPUTATION OF LICENSE FEE

20. Total Capital And Paid in Surplus (Multi-State Corporations See Schedule E)	20.
21. FEE DUE - Line 20 x .001, plus \$15.00 (Fee cannot be less than \$25.00 per taxpayer)	21. 25
22. LESS: Applicable Credits against License Fee (attach SC1120-TC)	22.
23. Balance (line 21 less line 22)	23. 25
24. Payments: (a) Paid with Tentative Return 25 (b) Credit from line 19b	
25. Total Payments (add line 24(a) and (b))	25. 25
26. Balance of Fee Due (line 23 less line 25)	26. None
27. Interest Due Penalty Due (See penalty and interest instructions.) Enter Total	27. None
28. TOTAL LICENSE FEE, Interest and Penalty Due (add lines 26 and 27) BALANCE DUE	28.
29. OVERPAYMENT (line 25 less line 23) To be applied as follows:	
(a) Estimated Tax (b) Income Tax (c) Refunded	
30. GRAND TOTAL: INCOME TAX and LICENSE FEE DUE (add lines 18 and 28) EFT ☐	30. 1,020

Please
Sign
Here

I, the undersigned, a principal officer of the corporation for which this return is made declare that this return, including accompanying Annual Report, statements and schedules, has been examined by me and is to the best of my knowledge and belief, a true and complete return.

Signature of officer

Date

Title

Telephone Number

I authorize the Director of the Department of Revenue or delegate to discuss this return, attachments and related tax matters with the preparer.

Yes ☐ No ☐

Preparer's Printed Name

Preparer's
signature

Date

Check if
self-employed ☐

Preparer's telephone number

Use Only

Firm's name (or
yours if self-employed)
and address

EI #

ZIP Code

SCHEDULE A AND B

ADDITIONS TO FEDERAL TAXABLE INCOME

1. Taxes on or Measured By Income 1. -1,371,229
Federal Net Operating Loss 2. _____
3. _____
4. _____
5. Other Additions (attach schedule) 5. _____
6. Total Additions (add lines 1 through 5) 6. -1,371,229

DEDUCTIONS FROM FEDERAL TAXABLE INCOME

7. Interest On Obligations Of The U.S. 7. _____
8. Federal Jobs Credit 8. 5,481
9. Bonus Depreciation 9. 14,321,015
10. Other Deductions (attach schedule) 10. _____
11. Total Deductions (add lines 7 through 10) 11. 14,326,496
12. Net Adjustment (line 6 less line 11) Also enter on line 2, Part 1, SC1120 12. -15,697,725

SCHEDULE C

SUMMARY OF CREDITS (FROM SC1120-TC)

1. Credit Carryover From Previous Year's SC1120, Schedule C (NOTE: Should agree to SC1120-TC Column A, line 25), ... 1. _____
2. Enter Total Credits from SC1120-TC, Column B, line 25. SC1120-TC must be attached to return. 2. _____
3. Total Credits (add lines 1 and 2) 3. _____
4. Tax (line 9, Part 1, SC1120) 4. 2,016
5. Lesser of line 3 or 4 (enter on line 10, Part 1, SC1120) (NOTE: Should agree to SC1120-TC, Column C, line 25.), ... 5. _____
6. Enter Credits Lost Due to Statute (NOTE: Should agree to SC1120-TC, Column D, line 25.) 6. _____
7. Credit Carryover (line 3 less lines 5 and 6) (NOTE: Should agree to SC1120-TC, Column E, line 25.), ... 7. _____

SCHEDULE D

ANNUAL REPORT TO BE COMPLETED BY ALL CORPORATIONS

1. Name Rent-A-Center West, Inc.
2. Incorporated under the laws of the State of DELAWARE
3. Location of the Registered Office of the Corporation in the State of South Carolina is _____
In the City of _____ Registered Agent at such address is _____
Location of principal office (street address) See Statement 1
Nature of principal business in SC Rent To Own
5. The total number of authorized shares of capital stock, itemized by class and series, if any, within each class is as follows:
NUMBER OF SHARES: 1000 CLASS: COMMON SERIES: N/A
6. The total number of issued and outstanding shares of capital stock itemized by class and series, if any, within each class is as follows:
NUMBER OF SHARES: 1000 CLASS: COMMON SERIES: N/A
7. The names and business addresses of the directors (or individuals functioning as directors) and principal officers in the Corporation are:
(If additional space is necessary, attach separate schedule).

NAME	BUSINESS ADDRESS AND OFFICE
MARK E. SPEESE	5501 Headquarters Drive, Plano, TX 75024
MITCHELL E. FADEL	5501 Headquarters Drive, Plano, TX 75024
ROBERT D. DAVIS	5501 Headquarters Drive, Plano, TX 75024
CHRISTOPHER A. KORST	5501 Headquarters Drive, Plano, TX 75024

8. Date Incorporated 10/11/1994 Date commenced business in the State of South Carolina was _____
9. Date of this report _____ Fed EI # 48-1156618
10. If Foreign Corporation, the date qualified to do business in the State of South Carolina is _____
11. Was the name of the Corporation changed during the year? NO Give old name _____
12. The Corporation's books are in the care of Hugh Tollack
Located at (street address) See Statement 1
13. If filing consolidated, complete and attach Schedule J for each Corporation included in the consolidation.
14. The total amount of stated capital per balance sheet is:
A. Total paid in Capital Stock (cannot be a negative amount) \$ _____
B. Total paid in Capital Surplus (cannot be a negative amount) \$ _____
C. Total amount of stated Capital (cannot be a negative amount) \$ _____

SCHEDULES E, F, G, AND H ARE TO BE COMPLETED BY MULTI-STATE CORPORATIONS**SCHEDULE E COMPUTATION FOR LICENSE FEE - MULTI-STATE CORPORATIONS**

Total Capital and Paid-In-Surplus at end of Year

\$

SC PROPORTION: (line 1 X ratio from Schedule H-1, H-2 or H-3, as appropriate) Also enter on line 20, Part II

\$

SCHEDULE F INCOME SUBJECT TO DIRECT ALLOCATION

	Gross Amounts 1	Less: Related Expenses 2	Net Amounts Allocated Direct to SC and Other States 3	Net Amounts Allocated Directly to SC 4	Payrolls to be Excluded from Payroll Factor 5	Property to be Excluded from Property Factor 6
1. Interest not connected with business						
2. Dividends received						
3. Rents						
4. Gains/losses on real property						
5. Gains/losses on intangible pers. prop.						
6. Investment income directly allocated						
7. TOTAL INCOME DIRECTLY ALLOCATED						
8. INCOME DIRECTLY ALLOCATED TO SC						
9. TOTALS TO APPORTIONMENT FACTORS						

SCHEDULE G COMPUTATION OF TAXABLE INCOME FOR CORPORATIONS CLAIMING MULTI-STATE OPERATIONS

1. Total net Income as reconciled. Enter amount from line 3, Page 1	1.	19,840,800
2. Less: Income subject to direct allocation to SC and other states from Schedule F, line 7	2.	
3. Total net income subject to apportionment (line 1 less line 2)	3.	19,840,800
4. Multiply amount on line 3 by appropriate ratio from Schedule H-1, 2, or 3 and enter result here	4.	40,317
5. Add: Income subject to direct allocation to SC from Schedule F, line 8	5.	
6. Total S.C. Net Income (sum of lines 4 and 5 above) also enter on line 4, Part 1 of Page 1	6.	40,317

SCHEDULE H-1 COMPUTATION OF FOUR FACTOR APPORTIONMENT RATIO

	1. Property Within South Carolina		2. Total Property Everywhere	
	(a) Beginning Period	(b) Ending Period	(a) Beginning Period	(b) Ending Period
1. Land				
Buildings				
3. Machinery and Equipment				
4. Inventories				
5. Other Property				
6. Exclusions	<	<	<	<
7. TOTAL (add lines 1-5; subtract line 6)				
	1. Within SC		2. Total Everywhere	3. Ratio
8. Avg. of Beginning and Ending Period (add line 7a and b and divide by 2)				
9. Rental or Lease Value				
10. TOTAL Property (Add lines 8 and 9. (Col. 1 ÷ Col. 2 and enter ratio in Col. 3)				%
11. GROSS Payroll		0		
12. Less: Officers' Compensation and Exclusions	<	<	>	
13. TOTAL Payroll (Col. 1 ÷ Col. 2 and enter ratio in Col. 3)				%
14. TOTAL Sales (Col. 1 ÷ Col. 2 and enter ratio in Col. 3)				%
15. TOTAL Sales (same as line 14)				%
16. TOTAL of Ratios (add Column 3 - lines 10, 13, 14 and 15)				%
17. Arithmetical Average of Ratios				%

SCHEDULE H-2 COMPUTATION OF GROSS RECEIPTS RATIO

	1. In SC	2. Total Everywhere	3. Ratio
1. Total Gross Receipts	861,437	424,004,077	
2. Less: Exclusion (see instructions)	<	<	>
3. Gross Receipts (for ratio)	861,437	424,004,077	
4. Ratio of Gross Receipts (line 3, Col. 1 ÷ line 3, Col. 2)			0.2032 %

SCHEDULE H-3 COMPUTATION OF RATIO FOR PUBLIC SERVICE CORPORATIONS

	Amount	Ratio
1. Total Within South Carolina		
Total for System		
3. Ratio (South Carolina ÷ Total System)		%

THO		STATE OF SOUTH CAROLINA C CORPORATION INCOME TAX RETURN		Mail this return to: SC DEPARTMENT OF REVENUE Corporation Return Columbia, SC 29214-0100		SC 1120 (Rev. 8/10/04) 3091	
Return is due on or before the 15th day of the 3rd month following the close of the taxable year.				A COMPLETE COPY OF FEDERAL RETURN MUST BE ATTACHED TO THIS RETURN.			
SC FILE # <u>AS ORIGINALLY AMENDED</u>				County or Counties in SC Where Property is Located:			
INCOME TAX PERIOD ENDING <u>12/31/2004</u>				NONE			
LICENSE FEE PERIOD ENDING <u>12/31/2005</u>				City _____ Audit Location _____ State _____			
FED EI # <u>48-1156618</u>				5501 HEADQUARTERS DRIVE, PLANO, TX 75024			
NAME <u>Rent-A-Center West, Inc.</u>				Audit Contact _____ Telephone Number _____			
				HUGH TOLLACK 972-801-1100			
MAILING ADDRESS <u>5501 Headquarters Drive</u>				Check if ☐ Consolidated Return			
CITY <u>Plano</u> STATE <u>TX</u> ZIP CODE <u>75024</u>				Total Gross Receipts _____ Total cost of depreciable personal property in SC. _____			
Change of ☐ Address ☐ Accounting Period ☐				33,386,541. NONE			
				If Filing a Final Return, See Instructions for Further Information.			
				☐ Merged ☐ Reorganized ☐ Dissolved ☐ Withdrawn			
PART I COMPUTATION OF INCOME TAX LIABILITY		1. Federal Taxable Income per Federal Form 1120 or 1120A		35,538,525.			
		2. Net Adjustment from line 12, Schedule A and B		-15,697,725.			
		3. Total Net Income as Reconciled (line 1 plus or minus line 2)		19,840,800.			
		4. If Multi-state Corporation, enter amount from line 6, Schedule G; otherwise, enter amount from line 3.		20,158.			
		5. LESS: South Carolina net operating loss carryover, if applicable					
		6. South Carolina Net Income subject to tax (line 4 less line 5)		20,158.			
		7. TAX: Multiply amount on line 6 by .05 (5.0%)		1,008.			
		8. Less tax deferred on income from foreign trade receipts (see instructions)					
		9. Balance (line 7 less line 8)		1,008.			
		10. Credit Carryover (line 7, Schedule C) ☐ Non-refundable credits (line 5, Schedule C) ☐		1,008.			
		11. Balance of tax (line 9 less line 10). Enter the difference but not less than zero		1,008.			
		12. Interest on DISC-deferred tax liability _____; or Foreign Trade Deferred Tax Liability _____					
		13. Total tax and/or interest (add lines 11 and 12)		1,008.			
		14. Payments: (a) Tax Withheld (see instructions) ☐ (b) Paid by Declaration ☐					
		(c) Paid with Tentative Return ☐ 963. (d) Credit from Line 29b ☐					
		15. Total Payments (add lines 14a through 14d) _____ \$951 From 2004 original Form SC1120 plus \$12 from 2003 amended Form SC1120		963.			
		16. Balance of Tax and/or Interest Due (line 13 less line 15)		45.			
		17. Interest Due ☐ Penalty Due ☐ (See penalty and interest instructions.) Enter Total ☐		45.			
		18. TOTAL INCOME TAX, Interest and Penalty Due (add lines 16 and 17)		BALANCE DUE 45.			
19. OVERPAYMENT (line 15 less line 13) _____ To be applied as follows: _____							
(a) Estimated Tax ☐ (b) License Fee ☐ (c) Refunded ☐							
PART II COMPUTATION OF LICENSE FEE		20. Total Capital And Paid In Surplus (Multi-State Corporations See Schedule E)		25.			
		21. FEE DUE - Line 20 x .001, plus \$15.00 (Fee cannot be less than \$25.00 per taxpayer)		25.			
		22. LESS: Applicable Credits against License Fee (attach SC1120-TC)					
		23. Balance (line 21 less line 22)		25.			
		24. Payments: (a) Paid with Tentative Return ☐ 25. (b) Credit from line 19b ☐					
		25. Total Payments (add line 24(a) and (b))		25.			
		26. Balance of Fee Due (line 23 less line 25)		NONE			
		27. Interest Due ☐ Penalty Due ☐ (See penalty and interest instructions.) Enter Total ☐					
		28. TOTAL LICENSE FEE, Interest and Penalty Due (add lines 26 and 27)		BALANCE DUE 28.			
		29. OVERPAYMENT (line 25 less line 23) _____ To be applied as follows: _____					
(a) Estimated Tax ☐ (b) Income Tax ☐ (c) Refunded ☐							
30. GRAND TOTAL INCOME TAX AND LICENSE FEE DUE (add lines 18 and 28)		EFT ☐ 45.					
I, the undersigned, a principal officer of the corporation for which this return is made declare that this return, including accompanying Annual Report, statements and schedules, has been examined by me and is to the best of my knowledge and belief, a true and complete return.							
Please Sign Here		Signature of officer <u>[Signature]</u>		Date <u>11/10/09</u>		VP TAX	
I authorize the Director of the Department of Revenue or delegate to discuss this return, attachments and related tax matters with the preparer.				Yes ☐ No ☐		Preparer's Printed Name _____ Telephone Number _____	
Paid Preparer's Use Only		Preparer's signature _____		Date _____		Check if self-employed ☐	
		Firm's name (or yours if self-employed) _____		EI# _____		Preparer's telephone number _____	
		address _____		ZIP Code _____			
4D911 2.000 000080 12/23/2008 11:00:22 V2005.071 48-1156618 2							

ROA 0372

SCHEDULE A AND B

ADDITIONS TO FEDERAL TAXABLE INCOME

1. Taxes on or Measured By Income	1.	-1,371,229.
2. Federal Net Operating Loss	2.	
3.	3.	
4.	4.	
5. Other Additions (attach schedule)	5.	
6. Total Additions (add lines 1 through 5)	6.	-1,371,229.

DEDUCTIONS FROM FEDERAL TAXABLE INCOME

7. Interest On Obligations Of The U.S.	7.	
8. Federal Jobs Credit	8.	5,481.
9. Amortization Adjustment	9.	14,321,015.
10. Other Deductions (attach schedule)	10.	
11. Total Deductions (add lines 7 through 10)	11.	14,326,496.
12. Net Adjustment (line 6 less line 11) Also enter on line 2, Part 1, SC1120	12.	-15,697,725.

SCHEDULE C

SUMMARY OF CREDITS (FROM SC1120-TC)

1. Credit Carryover From Previous Year's SC1120, Schedule C (NOTE: Should agree to SC1120-TC Column A, line 25).	1.	
2. Enter Total Credits from SC1120-TC, Column B, line 25. SC1120-TC must be attached to return.	2.	
3. Total Credits (add lines 1 and 2)	3.	
4. Tax (line 9, Part 1, SC1120)	4.	1,008.
5. Lesser of line 3 or 4 (enter on line 10, Part 1, SC1120) (NOTE: Should agree to SC1120-TC, Column C, line 25.)	5.	
6. Enter Credits Lost Due to Statute (NOTE: Should agree to SC1120-TC, Column D, line 25.)	6.	
7. Credit Carryover (line 3 less lines 5 and 6) (NOTE: Should agree to SC1120-TC, Column E, line 25.)	7.	

SCHEDULE D

ANNUAL REPORT TO BE COMPLETED BY ALL CORPORATIONS

1. Name	
2. Incorporated under the laws of the State of <u>Delaware</u>	
3. Location of the Registered Office of the Corporation in the State of South Carolina is In the City of _____ Registered Agent at such address is _____	
4. Location of principal office (street address) <u>See Statement 1</u> Nature of principal business in SC <u>Rent To Own</u>	
5. The total number of authorized shares of capital stock, itemized by class and series, if any, within each class is as follows: NUMBER OF SHARES: <u>1,000</u> CLASS: <u>Common</u> SERIES: <u>N/A</u>	
6. The total number of issued and outstanding shares of capital stock itemized by class and series, if any, within each class is as follows: NUMBER OF SHARES: <u>1,000</u> CLASS: <u>Common</u> SERIES: <u>N/A</u>	
7. The names and business addresses of the directors (or individuals functioning as directors) and principal officers in the Corporation are: (If additional space is necessary, attach separate schedule).	
NAME	BUSINESS ADDRESS AND OFFICE
<u>MARK E. SPEESE</u>	<u>5501 Headquarters Drive, Plano, TX 75024</u>
<u>MITCHELL E. FADEL</u>	<u>5501 Headquarters Drive, Plano, TX 75024</u>
<u>ROBERT D. DAVIS</u>	<u>5501 Headquarters Drive, Plano, TX 75024</u>
<u>CHRISTOPHER A. KORST</u>	<u>5501 Headquarters Drive, Plano, TX 75024</u>

8. Date Incorporated <u>10/11/2004</u>	Date commenced business in the State of South Carolina was _____
9. Date of this report _____	Fed Et # <u>48-1156618</u>
10. If Foreign Corporation, the date qualified to do business in the State of South Carolina is _____	
11. Was the name of the Corporation changed during the year? <u>NO</u>	Give old name _____
12. The Corporation's books are in the care of <u>HUGH TOLLACK</u> Located at (street address) <u>See Statement 1</u>	
13. If filing consolidated, complete and attach Schedule J for each Corporation included in the consolidation.	
14. The total amount of stated capital per balance sheet is:	
A. Total paid in Capital Stock (cannot be a negative amount)	\$ _____
B. Total paid in Capital Surplus (cannot be a negative amount)	\$ _____
C. Total amount of stated Capital (cannot be a negative amount)	\$ _____

SCHEDULES E, F, G, AND H ARE TO BE COMPLETED BY MULTI-STATE CORPORATIONS

SCHEDULE E COMPUTATION FOR LICENSE FEE - MULTI-STATE CORPORATIONS

1. Total Capital and Paid-in-Surplus at end of Year \$ _____
2. SC PROPORTION: (line 1 X ratio from Schedule H-1, H-2 or H-3, as appropriate) Also enter on line 20, Part II \$ _____

SCHEDULE F INCOME SUBJECT TO DIRECT ALLOCATION

	Gross Amounts 1	Less: Related Expenses 2	Net Amounts Allocated Direct to SC and Other States 3	Net Amounts Allocated Directly to SC 4	Payrolls to be Excluded from Payroll Factor 5	Property to be Excluded from Property Factor 6
1. Interest not connected with business						
2. Dividends received						
3. Rents						
4. Gains/losses on real property						
5. Gains/losses on intangible pers. prop.						
6. Investment Income directly allocated						
7. TOTAL INCOME DIRECTLY ALLOCATED						
8. INCOME DIRECTLY ALLOCATED TO SC						
9. TOTALS TO APPORTIONMENT FACTORS						

SCHEDULE G COMPUTATION OF TAXABLE INCOME FOR CORPORATIONS CLAIMING MULTI-STATE OPERATIONS

1. Total net income as reconciled. Enter amount from line 3, Page 1 1. 19,840,800.
2. Less: Income subject to direct allocation to SC and other states from Schedule F, line 7 2.
3. Total net income subject to apportionment (line 1 less line 2) 3. 19,840,800.
4. Multiply amount on line 3 by appropriate ratio from Schedule H-1, 2, or 3 and enter result here 4. 20,158.
5. Add: Income subject to direct allocation to SC from Schedule F, line 8 5.
6. Total S.C. Net Income (sum of lines 4 and 5 above) also enter on line 4, Part 1 of Page 1 6. 20,158.

SCHEDULE H-1 COMPUTATION OF FOUR FACTOR APPORTIONMENT RATIO

	1. Property Within South Carolina		2. Total Property Everywhere	
	(a) Beginning Period	(b) Ending Period	(a) Beginning Period	(b) Ending Period
1. Land				
2. Buildings				
3. Machinery and Equipment				
4. Inventories				
5. Other Property			2,262,292,429.	238,695,588.
6. Exclusions	<	>	<	>
7. TOTAL (add lines 1-5; subtract line 6)			2,262,292,429.	238,695,588.
		1. Within SC	2. Total Everywhere	3. Ratio
8. Avg. of Beginning and Ending Period (add line 7a and b and divide by 2)			232,494,009.	
9. Rental or Lease Value			222,250,609.	
10. TOTAL Property Add lines 8 and 9. (Col. 1 ÷ Col. 2 and enter ratio in Col. 3)			454,744,618.	NONE %
11. GROSS Payroll			96,656,885.	
12. Less: Officers Compensation and Exclusions	<	>	<	>
13. TOTAL Payroll (Col. 1 ÷ Col. 2 and enter ratio in Col. 3)			96,656,885.	NONE %
14. TOTAL Sales (Col. 1 ÷ Col. 2 and enter ratio in Col. 3)		861,437.	424,004,077.	0.2032 %
15. TOTAL Sales (same as line 14)		861,437.	424,004,077.	0.2032 %
16. TOTAL of Ratios (add Column 3 - lines 10, 13, 14 and 15)				0.4064 %
17. Arithmetical Average of Ratios				0.1016 %

SCHEDULE H-2 COMPUTATION OF GROSS RECEIPTS RATIO

	1. In SC	2. Total Everywhere	3. Ratio
1. Total Gross Receipts			
2. Less: Exclusion (see instructions)	<	>	
3. Gross Receipts (for ratio)			
4. Ratio of Gross Receipts (line 3, Col. 1 ÷ line 3, Col. 2)			%

SCHEDULE H-3 COMPUTATION OF RATIO FOR PUBLIC SERVICE CORPORATIONS

	Amount	Ratio
1. Total Within South Carolina		
2. Total for System		
3. Ratio (South Carolina ÷ Total System)		%

Rent-A-Center, Inc. 5501 Headquarters Dr. Plano TX 75024 1-800-275-2696

Date: 7/11/11 No. 41855573

SC DEPARTMENT OF REVENUE AND T. CORPORATE INCOME TAX COLUMBIA SC 29214-0006 UNITED STATES (12485)

INVOICE#	DATE	Gross	Discount	Net Amount	INVOICE#	DATE	Gross	Discount	Net Amount
070711-RW000A	07/07/11	1,020.00	0.00	1,020.00					
JG/JM*** RACW SC 04 RTN									

THO

State of South Carolina
'C' CORPORATION INCOME TAX RETURN

SC 1120

(Rev. 8/18/05)
3091Return is due on or before the 15th day of the 3rd month following the close of the taxable year.
Mail return to: SC DEPARTMENT OF REVENUE, Corporation Return, Columbia SC 29214-0100

FILE #

Mailed 7/11/2011
USPS tracking#: 7010 2780 0001 7066 4797A COMPLETE COPY OF FEDERAL RETURN MUST BE
ATTACHED TO THIS RETURN.

INCOME TAX PERIOD ENDING 12/31/2005

LICENSE FEE PERIOD ENDING 12/31/2006

FED EI # 48-1156618

NAME

Rent-A-Center West, Inc.

MAILING ADDRESS 5501 Headquarters Drive

CITY Plano STATE TX ZIP CODE 75024

Change of ☐ Address ☐ Accounting Period

County or Counties in SC Where Property is Located:

NONE

City

Audit Location

State

5501 HEADQUARTERS DRIVE, PLANO, TX 75024

Audit Contact

Telephone Number

HUGH TOLLACK

972-801-1100

Check if ☐ Consolidated Return

Total Gross Receipts.

Total cost of depreciable personal property in SC.

36,027,127.00

0.00

If Filing a Final Return, See Instructions for Further Information.

☐ Merged☐ Reorganized☐ Dissolved☐ WithdrawnPART I
INCOME TAX LIABILITY

1. Federal Taxable Income per Federal Form 1120 or 1120A 1. -7,599,812.00
2. Net Adjustment from line 12, Schedule A and B 2. -2,306,170.00
3. Total Net Income as Reconciled (line 1 plus or minus line 2) 3. -9,905,982.00
4. If Multi-state Corporation, enter amount from line 6, Schedule G; otherwise, enter amount from line 3 4. -19,624.00
5. LESS: South Carolina net operating loss carryover, if applicable 5.
6. South Carolina Net Income subject to tax (line 4 less line 5) 6. -19,624.00
7. TAX: Multiply amount on line 6 by .05 (5.0%) 7. NONE
8. Less tax deferred on income from foreign trade receipts (see instructions) 8.
9. Balance (line 7 less line 8) 9. NONE
10. Credit Carryover (line 7, Schedule C) ☐ Non-refundable credits (line 5, Schedule C) 10. <
11. Balance of tax (line 9 less line 10). Enter the difference but not less than zero 11. NONE
12. Interest on DISC-deferred tax liability ; or Foreign Trade Deferred Tax Liability 12.
13. Total tax and/or interest (add lines 11 and 12) 13. NONE
14. Payments: (a) Tax Withheld (see instructions) ☐ (b) Paid by Declaration ☐
- (c) Paid with Tentative Return ☐ (d) Credit from Line 29b ☐
- Refundable Credits: (e) Ammonia Additive ☐ (f) Milk Credit ☐
15. Total Payments and Refundable Credits (add lines 14a through 14f) 15.
16. Balance of Tax and/or Interest Due (line 13 less line 15) 16. NONE
17. Interest Due ☐ Penalty Due ☐ (See penalty and interest instructions.) Enter Total. 17.
18. TOTAL INCOME TAX, Interest and Penalty Due (add lines 16 and 17) BALANCE DUE 18. NONE
19. OVERPAYMENT (line 15 less line 13) To be applied as follows: 19.
- (a) Estimated Tax ☐ (b) License Fee ☐ (c) Refunded ☐

COMPUTAT.

PART II
COMPUTATION OF LICENSE FEE

20. Total Capital And Paid in Surplus (Multi-State Corporations See Schedule E) 20.
21. FEE DUE - Line 20 x .001, plus \$15.00 (Fee cannot be less than \$25.00 per taxpayer) 21. 25.00
22. LESS: Applicable Credits against License Fee (attach SC1120-TC) 22.
23. Balance (line 21 less line 22) 23. 25.00
24. Payments: (a) Paid with Tentative Return ☐ 25.00 (b) Credit from line 19b ☐
25. Total Payments (add line 24(a) and (b)) 25. 25.00
26. Balance of Fee Due (line 23 less line 25) 26. NONE
27. Interest Due ☐ Penalty Due ☐ (See penalty and interest instructions.) Enter Total. 27.
28. TOTAL LICENSE FEE, Interest and Penalty Due (add lines 26 and 27) BALANCE DUE 28.
29. OVERPAYMENT (line 25 less line 23) To be applied as follows: 29.
- (a) Estimated Tax ☐ (b) Income Tax ☐ (c) Refunded ☐
30. GRAND TOTAL: INCOME TAX and LICENSE FEE DUE (add lines 18 and 28) EFT ☐ 30. NONE

Please
Sign
Here

I, the undersigned, a principal officer of the corporation for which this return is made declare that this return, including accompanying Annual Report, statements and schedules, has been examined by me and is to the best of my knowledge and belief, a true and complete return.

Signature of officer

Date

VP TAX

972-801-1844

Title

Telephone Number

I authorize the Director of the Department of Revenue or delegate to discuss this return, attachments and related tax matters with the preparer.

Yes ☐ No ☐

Preparer's Printed Name

Preparer's
signature

Date

Check if
self-employed ☐

Preparer's telephone number

Use Only

Firm's name (or
yours if self-employed)
and address

EI #

ZIP Code

504811 1000

ROA 0377

SCHEDULE A AND B

ADDITIONS TO FEDERAL TAXABLE INCOME

1. Taxes on or Measured By Income 1. -2,268,939.00
Federal Net Operating Loss 2. _____
3. _____
4. _____ 4. _____
5. Other Additions (attach schedule) 5. _____
6. Total Additions (add lines 1 through 5) 6. -2,268,939.00

DEDUCTIONS FROM FEDERAL TAXABLE INCOME

7. Interest On Obligations Of The U.S. 7. _____
8. FEDERAL JOBS CREDIT 8. 37,231.00
9. _____ 9. _____
10. Other Deductions (attach schedule) 10. _____
11. Total Deductions (add lines 7 through 10) 11. 37,231.00
12. Net Adjustment (line 6 less line 11) Also enter on line 2, Part 1, SC1120 12. -2,306,170.00

SCHEDULE C

SUMMARY OF CREDITS (FROM SC1120-TC)

1. Credit Carryover From Previous Year's SC1120, Schedule C (NOTE: Should agree to SC1120-TC Column A, line 27) 1. _____
2. Enter Total Credits from SC1120-TC, Column B, line 27. SC1120-TC must be attached to return. 2. _____
3. Total Credits (add lines 1 and 2) 3. _____
4. Tax (line 9, Part 1, SC1120) 4. NONE
5. Lesser of line 3 or 4 (enter on line 10, Part 1, SC1120) (NOTE: Should agree to SC1120-TC, Column C, line 27.) 5. _____
6. Enter Credits Lost Due to Statute (NOTE: Should agree to SC1120-TC, Column D, line 27.) 6. _____
7. Credit Carryover (line 3 less lines 5 and 6) (NOTE: Should agree to SC1120-TC, Column E, line 27.) 7. _____

SCHEDULE D

ANNUAL REPORT TO BE COMPLETED BY ALL CORPORATIONS

1. Name RENT-A-CENTER WEST, INC.
2. Incorporated under the laws of the State of DELAWARE
3. Location of the Registered Office of the Corporation in the State of South Carolina is _____
In the City of _____ Registered Agent at such address is _____
Location of principal office (street address) SEE STATEMENT 1
Nature of principal business in SC NONE
The total number of authorized shares of capital stock, itemized by class and series, if any, within each class is as follows:
NUMBER OF SHARES: 1,000 CLASS: COMMON SERIES: N/A
6. The total number of issued and outstanding shares of capital stock itemized by class and series, if any, within each class is as follows:
NUMBER OF SHARES: 1,000 CLASS: COMMON SERIES: N/A
7. The names and business addresses of the directors (or individuals functioning as directors) and principal officers in the Corporation are:
(If additional space is necessary, attach separate schedule).

NAME	BUSINESS ADDRESS AND OFFICE
MARK E. SPEESE	5501 HEADQUARTERS DRIVE, PLANO, TX 75024
MITCHELL E. FADEL	5501 HEADQUARTERS DRIVE, PLANO, TX 75024
ROBERT D. DAVIS	5501 HEADQUARTERS DRIVE, PLANO, TX 75024
CHRISTOPHER A. KORST	5501 HEADQUARTERS DRIVE, PLANO, TX 75024

8. Date Incorporated 10/11/1994 Date commenced business in the State of South Carolina was _____
9. Date of this report 06/30/2006 Fed EI # 48-1156618
10. If Foreign Corporation, the date qualified to do business in the State of South Carolina is _____
11. Was the name of the Corporation changed during the year? NO Give old name _____
12. The Corporation's books are in the care of HUGH TOLLACK
Located at (street address) SEE STATEMENT 1
13. If filing consolidated, complete and attach Schedule J for each Corporation included in the consolidation.
14. The total amount of stated capital per balance sheet is:
A. Total paid in Capital Stock (cannot be a negative amount) \$ _____
B. Total paid in Capital Surplus (cannot be a negative amount) \$ _____
C. Total amount of stated Capital (cannot be a negative amount) \$ _____

SCHEDULES E, F, G, AND H ARE TO BE COMPLETED BY MULTI-STATE CORPORATIONS**SCHEDULE E COMPUTATION FOR LICENSE FEE - MULTI-STATE CORPORATIONS**

Total Capital and Paid-in-Surplus at end of Year

\$

SC PROPORTION: (line 1 X ratio from Schedule H-1, H-2 or H-3, as appropriate) Also enter on line 20, Part II

\$

SCHEDULE F INCOME SUBJECT TO DIRECT ALLOCATION

	Gross Amounts 1	Less: Related Expenses 2	Net Amounts Allocated Direct to SC and Other States 3	Net Amounts Allocated Directly to SC 4	Payrolls to be Excluded from Payroll Factor 5	Property to be Excluded from Property Factor 6
1. Interest not connected with business						
2. Dividends received						
3. Rents						
4. Gains/losses on real property						
5. Gains/losses on intangible pers. prop.						
6. Investment income directly allocated						
7. TOTAL INCOME DIRECTLY ALLOCATED						
8. INCOME DIRECTLY ALLOCATED TO SC						
9. TOTALS TO APPORTIONMENT FACTORS						

SCHEDULE G COMPUTATION OF TAXABLE INCOME FOR CORPORATIONS CLAIMING MULTI-STATE OPERATIONS

1. Total net income as reconciled. Enter amount from line 3, Page 1	1.	-9,905,982.00
2. Less: Income subject to direct allocation to SC and other states from Schedule F, line 7	2.	
3. Total net income subject to apportionment (line 1 less line 2)	3.	-9,905,982.00
4. Multiply amount on line 3 by appropriate ratio from Schedule H-1, 2, or 3 and enter result here	4.	-19,624.00
5. Add: Income subject to direct allocation to SC from Schedule F, line 8	5.	
6. Total S.C. Net Income (sum of lines 4 and 5 above) also enter on line 4, Part 1 of Page 1	6.	-19,624.00

SCHEDULE H-1 COMPUTATION OF FOUR FACTOR APPORTIONMENT RATIO

	1. Property Within South Carolina		2. Total Property Everywhere	
	(a) Beginning Period	(b) Ending Period	(a) Beginning Period	(b) Ending Period
1. Land				
2. Buildings				
3. Machinery and Equipment				
4. Inventories				
5. Other Property				
6. Exclusions	<	>	<	>
7. TOTAL (add lines 1-5; subtract line 6)				
		1. Within SC	2. Total Everywhere	3. Ratio
8. Avg. of Beginning and Ending Period (add line 7a and b and divide by 2)				
9. Rental or Lease Value				
10. TOTAL Property Add lines 8 and 9. (Col. 1 ÷ Col. 2 and enter ratio in Col. 3)				%
11. GROSS Payroll				
12. Less: Officers Compensation and Exclusions	<	>	<	>
13. TOTAL Payroll (Col. 1 ÷ Col. 2 and enter ratio in Col. 3)				%
14. TOTAL Sales (Col. 1 ÷ Col. 2 and enter ratio in Col. 3)				%
15. TOTAL Sales (same as line 14)				%
16. TOTAL of Ratios (add Column 3 - lines 10, 13, 14 and 15)				%
17. Arithmetical Average of Ratios				%

SCHEDULE H-2 COMPUTATION OF GROSS RECEIPTS RATIO

	1. In SC	2. Total Everywhere	3. Ratio
1. Total Gross Receipts	844,348.13	426,296,541.00	
2. Less: Exclusion (see instructions)	<	>	
3. Gross Receipts (for ratio)	844,348.13	426,296,541.00	
4. Ratio of Gross Receipts (line 3, Col. 1 ÷ line 3, Col. 2)			0.1981 %

SCHEDULE H-3 COMPUTATION OF RATIO FOR PUBLIC SERVICE CORPORATIONS

	Amount	Ratio
Total Within South Carolina		
Total for System		
3. Ratio (South Carolina ÷ Total System)		%

THO		State of South Carolina 'C' CORPORATION INCOME TAX RETURN Return is due on or before the 15th day of the 3rd month following the close of the taxable year. Mail return to: SC DEPARTMENT OF REVENUE, Corporation Return, Columbia SC 29214-0100		SC 1120 (Rev. 8/18/05) 3091	
SC FILE #		AS ORIGINALLY AMENDED			
INCOME TAX PERIOD ENDING		12/31/2005			
LICENSE FEE PERIOD ENDING		12/31/2006			
FED EI #		48-1156618			
NAME		Rent-A-Center West, Inc.			
MAILING ADDRESS		5501 Headquarters Drive			
CITY		Plano STATE TX ZIP CODE 75024			
Change of		☐ Address ☐ Accounting Period			
A COMPLETE COPY OF FEDERAL RETURN MUST BE ATTACHED TO THIS RETURN.		County or Counties in SC Where Property is Located: NONE			
City		Audit Location		State	
5501 HEADQUARTERS DRIVE, PLANO, TX 75024					
Audit Contact		Telephone Number			
HUGH TOLLACK		972-801-1100			
Check if ☐ Consolidated Return					
Total Gross Receipts		Total cost of depreciable personal property in SC.			
36,027,127.00		NONE			
If Filing a Final Return, See Instructions for Further Information.					
☐ Merged ☐ Reorganized ☐ Dissolved ☐ Withdrawn					
PART I COMPUTATION OF INCOME TAX LIABILITY	1. Federal Taxable Income per Federal Form 1120 or 1120A	1. -7,599,812.00			
	2. Net Adjustment from line 12, Schedule A and B	2. -2,306,170.00			
	3. Total Net Income as Reconciled (line 1 plus or minus line 2)	3. -9,905,982.00			
	4. If Multi-state Corporation, enter amount from line 6, Schedule G; otherwise, enter amount from line 3.	4. -9,817.00			
	5. LESS: South Carolina net operating loss carryover, if applicable	5.			
	6. South Carolina Net Income subject to tax (line 4 less line 5)	6. -9,817.00			
	7. TAX: Multiply amount on line 6 by .05 (5.0%)	7. NONE			
	8. Less tax deferred on income from foreign trade receipts (see instructions)	8.			
	9. Balance (line 7 less line 8)	9. NONE			
	10. Credit Carryover (line 7, Schedule C) ☐ Non-refundable credits (line 5, Schedule C) ☐	10.			
	11. Balance of tax (line 9 less line 10). Enter the difference but not less than zero	11. NONE			
	12. Interest on DISC-deferred tax liability; or Foreign Trade Deferred Tax Liability	12.			
	13. Total tax and/or interest (add lines 11 and 12)	13. NONE			
	14. Payments: (a) Tax Withheld (see instructions) ☐ (b) Paid by Declaration ☐				
	(c) Paid with Tentative Return ☐ (d) Credit from Line 29b ☐				
	Refundable Credits: (e) Ammonia Additive ☐ (f) Milk Credit ☐				
	15. Total Payments and Refundable Credits (add lines 14a through 14f)	15.			
	16. Balance of Tax and/or Interest Due (line 13 less line 15)	16. NONE			
	17. Interest Due ☐ Penalty Due ☐ (See penalty and interest instructions.) Enter Total	17.			
18. TOTAL INCOME TAX, Interest and Penalty Due (add lines 16 and 17)	18. NONE				
19. OVERPAYMENT (line 15 less line 13) To be applied as follows:					
(a) Estimated Tax ☐ (b) License Fee ☐ (c) Refunded ☐					
PART II COMPUTATION OF LICENSE FEE	20. Total Capital And Paid in Surplus (Multi-State Corporations See Schedule E)	20.			
	21. FEE DUE - Line 20 x .001, plus \$15.00 (Fee cannot be less than \$25.00 per taxpayer)	21. 25.00			
	22. LESS: Applicable Credits against License Fee (attach SC1120-TC)	22.			
	23. Balance (line 21 less line 22)	23. 25.00			
	24. Payments: (a) Paid with Tentative Return ☐ 25.00 (b) Credit from line 19b ☐				
	25. Total Payments (add line 24(a) and (b))	25. 25.00			
	26. Balance of Fee Due (line 23 less line 25)	26. NONE			
	27. Interest Due ☐ Penalty Due ☐ (See penalty and interest instructions.) Enter Total	27.			
	28. TOTAL LICENSE FEE, Interest and Penalty Due (add lines 26 and 27)	28.			
	29. OVERPAYMENT (line 25 less line 23) To be applied as follows:				
	(a) Estimated Tax ☐ (b) Income Tax ☐ (c) Refunded ☐				
30. GRAND TOTAL: INCOME TAX and LICENSE FEE DUE (add lines 18 and 28)	30. EFT ☐ NONE				
I, the undersigned a principal officer of the corporation for which this return is made declare that this return, including accompanying Annual Report, statements and schedules, has been examined by me and is to the best of my knowledge and belief, a true and complete return.					
Please Sign Here		Signature of officer		Date	
		VP Tax		972-801-110	
		Title		Telephone Number	
I authorize the Director of the Department of Revenue or delegate to discuss this return, attachments and related tax matters with the preparer.		Yes ☐ No ☐		Preparer's Printed Name	
Paid Preparer's signature		Date		Preparer's telephone number	
Firm's name (or yours if self-employed) and address		Check if self-employed ☐		E1#	
				ZIP Code	

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SCHEDULE A AND B

ADDITIONS TO FEDERAL TAXABLE INCOME

1. Taxes on or Measured By Income	1.	-2,268,939.00
2. Federal Net Operating Loss	2.	
3.	3.	
4.	4.	
5. Other Additions (attach schedule)	5.	
6. Total Additions (add lines 1 through 5)	6.	-2,268,939.00

DEDUCTIONS FROM FEDERAL TAXABLE INCOME

7. Interest On Obligations Of The U.S.	7.	
8. Federal Jobs Credit	8.	37,231.00
9.	9.	
10. Other Deductions (attach schedule)	10.	
11. Total Deductions (add lines 7 through 10)	11.	37,231.00
12. Net Adjustment (line 6 less line 11) Also enter on line 2, Part 1, SC1120	12.	-2,306,170.00

SCHEDULE C

SUMMARY OF CREDITS (FROM SC1120-TC)

1. Credit Carryover From Previous Year's SC1120, Schedule C (NOTE: Should agree to SC1120-TC Column A, line 27).	1.	
2. Enter Total Credits from SC1120-TC, Column B, line 27. SC1120-TC must be attached to return.	2.	
3. Total Credits (add lines 1 and 2)	3.	
4. Tax (line 9, Part 1, SC1120)	4.	NONE
5. Lesser of line 3 or 4 (enter on line 10, Part 1, SC1120) (NOTE: Should agree to SC1120-TC, Column C, line 27.)	5.	
6. Enter Credits Lost Due to Statute (NOTE: Should agree to SC1120-TC, Column D, line 27.)	6.	
7. Credit Carryover (line 3 less lines 5 and 6) (NOTE: Should agree to SC1120-TC, Column E, line 27.)	7.	

SCHEDULE D

ANNUAL REPORT TO BE COMPLETED BY ALL CORPORATIONS

1. Name <u>Rent-A-Center West, Inc.</u>	
2. Incorporated under the laws of the State of <u>DELAWARE</u>	
3. Location of the Registered Office of the Corporation in the State of South Carolina is In the City of _____ Registered Agent at such address is _____	
4. Location of principal office (street address) <u>See Statement 1</u> Nature of principal business in SC <u>NONE</u>	
5. The total number of authorized shares of capital stock, itemized by class and series, if any, within each class is as follows: NUMBER OF SHARES: <u>1,000.</u> CLASS: <u>COMMON</u> SERIES: <u>N/A</u>	
6. The total number of issued and outstanding shares of capital stock itemized by class and series, if any, within each class is as follows: NUMBER OF SHARES: <u>1,000.</u> CLASS: <u>COMMON</u> SERIES: <u>N/A</u>	

7. The names and business addresses of the directors (or individuals functioning as directors) and principal officers in the Corporation are:
(If additional space is necessary, attach separate schedule).

NAME	BUSINESS ADDRESS AND OFFICE
<u>MARK E. SPEESE</u>	<u>5501 HEADQUARTERS DRIVE, PLANO, TX 75024</u>
<u>MITCHELL E. FADEL</u>	<u>5501 HEADQUARTERS DRIVE, PLANO, TX 75024</u>
<u>ROBERT D. DAVIS</u>	<u>5501 HEADQUARTERS DRIVE, PLANO, TX 75024</u>
<u>CHRISTOPHER A. KORST</u>	<u>5501 HEADQUARTERS DRIVE, PLANO, TX 75024</u>

8. Date Incorporated <u>10/11/1994</u>	Date commenced business in the State of South Carolina was _____
9. Date of this report <u>06/30/2006</u>	Fed EI # <u>48-1156618</u>
10. If Foreign Corporation, the date qualified to do business in the State of South Carolina is _____	
11. Was the name of the Corporation changed during the year? <u>NO</u> Give old name _____	
12. The Corporation's books are in the care of <u>HUGH TOLLACK</u> Located at (street address) <u>See Statement 1</u>	
13. If filing consolidated, complete and attach Schedule J for each Corporation included in the consolidation.	
14. The total amount of stated capital per balance sheet is:	
A. Total paid in Capital Stock (cannot be a negative amount)	\$ _____
B. Total paid in Capital Surplus (cannot be a negative amount)	\$ _____
C. Total amount of stated Capital (cannot be a negative amount)	\$ _____

SCHEDULES E, F, G, AND H ARE TO BE COMPLETED BY MULTI-STATE CORPORATIONS**SCHEDULE E COMPUTATION FOR LICENSE FEE - MULTI-STATE CORPORATIONS**

1. Total Capital and Paid-in-Surplus at end of Year \$ _____
2. SC PROPORTION: (line 1 X ratio from Schedule H-1, H-2 or H-3, as appropriate) Also enter on line 20, Part II \$ _____

SCHEDULE F INCOME SUBJECT TO DIRECT ALLOCATION

	Gross Amounts 1	Less: Related Expenses 2	Net Amounts Allocated Direct to SC and Other States 3	Net Amounts Allocated Directly to SC 4	Payrolls to be Excluded from Payroll Factor 5	Property to be Excluded from Property Factor 6
1. Interest not connected with business						
2. Dividends received						
3. Rents						
4. Gains/losses on real property						
5. Gains/losses on intangible pers. prop.						
6. Investment income directly allocated						
7. TOTAL INCOME DIRECTLY ALLOCATED						
8. INCOME DIRECTLY ALLOCATED TO SC						
9. TOTALS TO APPORTIONMENT FACTORS						

SCHEDULE G COMPUTATION OF TAXABLE INCOME FOR CORPORATIONS CLAIMING MULTI-STATE OPERATIONS

1. Total net income as reconciled. Enter amount from line 3, Page 1 1. -9,905,982.00
2. Less: Income subject to direct allocation to SC and other states from Schedule F, line 7 2.
3. Total net income subject to apportionment (line 1 less line 2) 3. -9,905,982.00
4. Multiply amount on line 3 by appropriate ratio from Schedule H-1, 2, or 3 and enter result here 4. -9,817.00
5. Add: Income subject to direct allocation to SC from Schedule F, line 8 5.
6. Total S.C. Net Income (sum of lines 4 and 5 above) also enter on line 4, Part 1 of Page 1 6. -9,817.00

SCHEDULE H-1 COMPUTATION OF FOUR FACTOR APPORTIONMENT RATIO

	1. Property Within South Carolina		2. Total Property Everywhere	
	(a) Beginning Period	(b) Ending Period	(a) Beginning Period	(b) Ending Period
1. Land				
2. Buildings				
3. Machinery and Equipment		NONE		
4. Inventories				
5. Other Property			238,695,588.00	234,765,517.00
6. Exclusions	< >	< >	< >	< >
7. TOTAL (add lines 1-5; subtract line 6)		NONE	238,695,588.00	234,765,517.00
		1. Within SC	2. Total Everywhere	3. Ratio
8. Avg. of Beginning and Ending Period (add line 7a and b and divide by 2)		NONE	236,730,552.50	
9. Rental or Lease Value			233,115,376.00	
10. TOTAL Property Add lines 8 and 9. (Col. 1 ÷ Col. 2 and enter ratio in Col. 3)		NONE	469,845,928.50	NONE %
11. GROSS Payroll			93,067,064.00	
12. Less: Officers Compensation and Exclusions	< >	< >		
13. TOTAL Payroll (Col. 1 ÷ Col. 2 and enter ratio in Col. 3)			93,067,064.00	NONE %
14. TOTAL Sales (Col. 1 ÷ Col. 2 and enter ratio in Col. 3)		844,348.13	426,296,541.00	0.1981 %
15. TOTAL Sales (same as line 14)		844,348.13	426,296,541.00	0.1981 %
16. TOTAL of Ratios (add Column 3 - lines 10, 13, 14 and 15)				0.3962 %
17. Arithmetical Average of Ratios				0.0991 %

SCHEDULE H-2 COMPUTATION OF GROSS RECEIPTS RATIO

	1. In SC	2. Total Everywhere	3. Ratio
1. Total Gross Receipts			
2. Less: Exclusion (see instructions)	< >	< >	
3. Gross Receipts (for ratio)			
4. Ratio of Gross Receipts (line 3, Col. 1 ÷ line 3, Col. 2)			%

SCHEDULE H-3 COMPUTATION OF RATIO FOR PUBLIC SERVICE CORPORATIONS

	Amount	Ratio
1. Total Within South Carolina		
2. Total for System		
3. Ratio (South Carolina ÷ Total System)		%

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TRADEMARK LICENSE AGREEMENT

THIS TRADEMARK LICENSE AGREEMENT ("Agreement") is entered into on the 31 day of December, 2002, by and between Rent-A-Center West, Inc. ("Licensor"), a Delaware corporation having a principal place of business at 5700 Tennyson Parkway, 3rd Floor, Plano, Texas 75024 and Rent-A-Center East, Inc. ("Licensee"), a Delaware corporation (hereafter, Licensor and Licensee will be individually referred to as "Party" and collectively as the "Parties").

WITNESSETH:

A. Licensor is the owner and holder of the trademark rights in and to a certain trademarks and service marks (hereinafter collectively referred to as the "Trademarks"), including, but not limited to, those identified on Exhibit A attached hereto and including any and all trademarks presently owned or hereafter acquired by Licensor.

B. The Trademarks embody substantial goodwill and enjoy favorable public recognition and Licensor's rights therein constitute valuable assets of Licensor.

C. Licensee desires the right to use the Trademarks in the Territory (as hereinafter defined) and Licensor is willing to grant a license allowing Licensee to do so, on the terms and conditions hereinafter provided.

NOW, THEREFORE, in consideration of the premises and the mutual agreements, covenants and provisions contained herein, the sufficiency of which are hereby acknowledged and confessed, the Parties agree as follows:

1. Definitions: In this Agreement:

(a) "Net Sales" shall mean gross sales of the Licensed Services by Licensee, less returns actually received, normal trade discounts and allowances usually granted, provided, however, that the amount of normal trade discounts and allowances credited against gross sales by Licensee for purposes of this Agreement shall not exceed an amount equal to Five (5%) Percent of gross sales in any year of this Agreement.

(b) "Licensed Service" or "Licensed Services" shall mean rental service(s) featuring home appliances, furniture, home furnishings, computer equipment, and home entertainment products such as televisions, camcorders, home theater equipment, stereos, video cassette recorders, DVD players, and video game consoles.

(c) "Parent" shall mean a Person which, directly or through one or more Subsidiaries, owns or controls a Subsidiary.

(d) "Subsidiary" shall mean, as to any individual, partnership, firm, association, trust, firm, corporation or other entity ("Person") (i) any corporation or other entity more than 50% of the voting stock or beneficial interest of any class, or the power to elect a majority of the directors or trustees is owned or held by such Person, or one or more

Subsidiaries of such Person, and (ii) any partnership, association, trust, or other entity in which such Person and one or more Subsidiaries of such Person has more than a 50% equity interest at the time.

(e) The "Territory" comprises the United States of America and any other countries in which Licensee does business during the term of this Agreement.

2. License Grant. Licensor grants to Licensee, and Licensee accepts, a non-exclusive license with rights to use and exploit the Trademarks, in the Territory during the term of this Agreement.

3. Quality Control of Trademarks. Upon request, Licensee shall provide Licensor with samples of all literature, brochures, signs, and advertising material prepared by Licensee bearing the Trademarks, for quality control purposes. Licensor shall also have the right, during reasonable business hours and upon reasonable notice to inspect Licensee's operations of Licensee's services that are promoted under the Trademarks. When using the Trademarks under this Agreement, Licensee undertakes to comply substantially with all laws pertaining to trademarks enforced at any time in the Territory.

4. Ownership of Trademark. Licensee acknowledges that Licensor has sole and exclusive ownership of all right, title and interest in and to the Trademarks and any registrations that have been issued or may be issued thereon, and Licensee agrees that it will not at any time do or cause to be done any act or thing contesting or in any way impairing or tending to impair any part of such right, title and interest, including applying for trademarks in the Licensee's name for any word or mark which is the same or likely to be confusingly similar to the Trademarks. Licensee further acknowledges, represents, and warrants that it has not acquired, and shall not acquire (whether by operation of law, this Agreement, or otherwise), any right, title, interest, or ownership (collectively "Ownership") in or to the Trademarks or any part thereof. Licensee recognizes the value of the goodwill associated with the Trademarks and acknowledges that all rights therein belong exclusively to Licensor as owner of the Trademarks and further acknowledges that the Trademarks have acquired secondary meaning in the mind of the public. In connection with the use of the Trademarks, Licensee shall not in any manner represent that it has any Ownership in the Trademarks or registration thereof, and all parties acknowledge that any and all use by Licensee of the Trademarks, including all goodwill, shall inure to the benefit of Licensor. Upon termination of this Agreement in the manner provided herein, Licensee will cease and desist from all use of the Trademarks in any way, and it will deliver to Licensor, or its duly authorized representatives, all material and papers upon which the Trademarks appear, and furthermore, Licensee will not at any time adopt or use without Licensor's prior consent, any word or mark which is likely to be similar to or confusing with the Trademarks.

5. Indemnity. Licensor assumes no liability to Licensee or to any third parties with respect to services provided by Licensee under the Trademarks, and Licensee shall indemnify and hold harmless Licensor against any losses incurred arising from any claims of any third parties against Licensor based upon the sale of Licensee's services in connection the Trademarks.

6. Termination.

(a) Either Party may terminate this Agreement, with or without cause, upon notice of intention to terminate within thirty (30) days thereof.

(b) In case either Party breaches any provision of this Agreement, the other Party may immediately give notice of intention to terminate within thirty (30) days thereof, and, unless the breaching Party notifies the other of a correction of such breach within such period, this Agreement shall automatically terminate at the expiration of the thirty (30) day period.

(c) Licensee may terminate this Agreement upon the filing by or against Licensor of a petition in bankruptcy or judicial or administrative declaration of insolvency, by giving notice to Licensor of intention to terminate. Licensor may terminate this Agreement by giving notice thereof to Licensee in the event of government expropriation of any of the assets of Licensee which relate to the activities of Licensee contemplated by the present Agreement. In any of the foregoing events, such termination shall be effective immediately.

(d) Termination of this Agreement for any reason shall not affect (i) obligations which have accrued as of the date of termination, and (ii) those obligations which, from the context hereof, are intended to survive termination of this Agreement.

(e) Any waiver by either Party of a breach of any term or condition of this Agreement shall not be considered as a waiver of any subsequent breach of the same or any other term or condition thereof.

7. Royalties. Licensee shall pay to Licensor and account for a royalty of 5% of Net Sales of Licensed Services for each calendar quarter, payable within thirty (30) days of the close of each calendar quarter.

8. Force Majeure. Neither Party shall be in default hereunder by reason of its delay in the performance of or failure to perform any of its obligations herein if such delay or failure is caused by strikes, acts of God or the public enemy, riots, incendiaries, interference by civil and military authorities, compliance with governmental laws, rules and regulations, delays in transit or delivery, inability to secure necessary governmental priorities for materials, or any fault beyond its control or without its fault or negligence.

9. Partnership; Agency. The Parties specifically intend that this Agreement does not constitute a partnership, joint venture or commercial agency agreement and no partnership, joint venture or commercial agency is intended and Licensee does not pretend to receive any payments or profits derived from this Agreement other than the profits to be realized from its sale of the Licensed Services.

10. Assignments; Licenses; Sublicenses. Licensee shall not assign or delegate any rights or obligations under this Agreement without the prior written consent of Licensor, except that Licensee may assign or delegate any rights or obligations under this Agreement to any Parent or Subsidiary without the consent of Licensor. Licensor may assign or delegate any rights or

obligations it has under this Agreement only upon thirty (30) days prior written notice to Licensee. Licensee shall have the right to grant sublicenses according to the terms of this Agreement, with the prior written consent of Licensor, which consent shall not be unreasonably withheld. The terms and conditions of this Agreement are binding upon and inure to the benefit of Licensee and Licensor and their respective Subsidiaries, Parents, successors, permitted assigns, if any, and licensees, if applicable.

11. Third Parties. Except as set forth or referred to herein, nothing in this Agreement is intended or shall be construed to confer upon or give to any party other than the Parties hereto and their successors and assigns any rights or remedies under or by reason of this Agreement.

12. Notices. Any notices required or permitted to be given under this Agreement shall be deemed sufficiently given if in writing hand delivered with receipt acknowledged, or mailed by certified or registered mail postage prepaid, or mailed by a nationally recognized overnight delivery service addressed to the Party to be notified at its address shown below, or to such other person or at such other address as may be furnished in writing to the other Party hereto.

If to Licensor: Rent-A-Center West, Inc.
5700 Tennyson Parkway, 3rd Floor
Plano, Texas 75024

If to Licensee: Rent-A-Center East, Inc.
5700 Tennyson Parkway, 3rd Floor
Plano, Texas 75024

13. Entire Agreement. This Agreement encompasses the entire agreement and understanding between the Parties hereto with respect to the subject matter hereof and supersedes all other prior agreements and undertakings, both written and oral, among the Parties with respect to the subject matter hereof, and shall be governed, construed and enforced in accordance with the laws of the State of Texas and the United States of America.

14. Severability. If any of the provisions of this Agreement are determined to be invalid or unenforceable, such invalidity or unenforceability will not invalidate or render unenforceable the remainder of this Agreement, but rather the entire Agreement will be construed as if not containing the particular invalid or unenforceable provision or provisions, and the rights and obligations of the Parties hereto shall be construed and enforced accordingly. The Parties hereto acknowledge that if any provision of this Agreement is determined to be invalid or unenforceable, it is their desire and intention that such provision be reformed and construed in such manner that it will, to the maximum extent practicable, be deemed to be valid and enforceable.

IN WITNESS WHEREOF, the undersigned have caused their duly authorized representatives to execute this Agreement effective as of the date above and in the capacities shown below.

LICENSOR:

Rent-A-Center West, Inc.

By: 
Mark E. Speese
President

LICENSEE:

Rent-A-Center East, Inc.

By: 
Mark E. Speese
Chairman of the Board and Chief Executive Officer

ROA 0388

AMENDMENT NO. 1 TO TRADEMARK LICENSE AGREEMENT

THIS AMENDMENT NO. 1 TO TRADEMARK LICENSE AGREEMENT ("Amendment") is entered into as of the 31st day of December, 2004, by and between Rent-A-Center West, Inc. ("Licensor"), a Delaware corporation having a principal place of business at 5700 Tennyson Parkway, Plano, Texas 75024, and Rent-A-Center East, Inc. ("Licensee"), a Delaware corporation (hereafter, Licensor and Licensee will be individually referred to as "Party" and collectively as the "Parties").

WITNESSETH:

A. Licensor and Licensee have entered into that certain Trademark License Agreement dated December 31, 2002 ("Agreement"), pursuant to which Licensor granted to Licensee a license to use the Trademarks (as defined in the Agreement).

B. The Parties desire to amend the Agreement on the terms and conditions hereinafter provided.

NOW, THEREFORE, in consideration of the premises and the mutual agreements, covenants and provisions contained herein, the sufficiency of which are hereby acknowledged and confessed, the Parties agree as follows:

1. Definitions. Capitalized terms used herein without definition shall be as defined in the Agreement.

2. Amendment to Section 7. Section 7 of the Agreement is hereby amended and restated to read in its entirety as follows:

7. Royalties. Licensee shall pay to Licensor and account for a royalty in such amount as may be mutually determined by Licensor and Licensee. The initial royalty hereunder shall be 3% of Net Sales of Licensed Services. The royalty shall be accounted for in book entry form on a quarterly basis in accordance with the regular accounting practices of Licensor and Licensee as in effect from time to time.

3. Effective Date of Amendment. The Amendment shall be effective as of the date of the Agreement and shall be applied retroactively for all periods during which the Agreement has been in effect.

4. Effect of Amendment. Except as amended hereby, the Agreement shall remain in full force and effect.

5. Governing Law. THIS AMENDMENT SHALL BE GOVERNED BY AND CONSTRUED IN ACCORDANCE WITH THE SUBSTANTIVE LAWS OF THE STATE OF TEXAS.

IN WITNESS WHEREOF, the undersigned have caused their duly authorized representatives to execute this Amendment effective as of the date above and in the capacities shown below.

LICENSOR:

Rent-A-Center West, Inc.

By:


Mark E. Speese
President

LICENSEE:

Rent-A-Center East, Inc.

By:


Mark E. Speese
President

Management Services Agreement

This Management Services Agreement (this "*Agreement*") is effective as of the 31st day of December, 2002, by and between Rent-A-Center East, Inc., a Delaware corporation having its principal offices at 5700 Tennyson Parkway, Third Floor, Plano, Texas 75024 (the "*Company*"), and Rent-A-Center Texas, L.P., a Texas limited partnership having its principal offices at 5700 Tennyson Parkway, Third Floor, Plano, Texas 75024 (the "*Management Consultant*").

RECITALS:

WHEREAS, the Company desires to retain the Management Consultant to perform certain services for the Company subject to the terms and conditions of this Agreement; and

WHEREAS, the Management Consultant desires to be retained by the Company to provide such services.

AGREEMENT

NOW, THEREFORE, in consideration of the premises, the mutual covenants herein contained and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows:

1. **Management Duties.**

(a) Upon the request of the Company, the Management Consultant shall provide any requested services to the Company. Such services may include, but shall not be limited to:

- (i) information technology services and clerical support;
- (ii) general accounting services in conformity with good commercial practice;
- (iii) payroll services for the Company;
- (iv) general human resource services for the Company, including, but not limited to, the hiring of employees by the Company, termination of Company employees and the management of the Company's benefit plans;
- (v) maintenance of insurance policies for which the Company is a named or additional insured;
- (vi) maintenance of the Company's corporate records as instructed by the President of the Company;
- (vii) advertising services for the Company;

(viii) purchasing activities on behalf of the Company, including inventory requirements; and

(ix) coordination of the leasing of real property on behalf of the Company.

(b) To the extent that services are provided to the Company by a third party, all personnel necessary to provide such services will remain the employees and responsibility of such third party. Compensation and expense reimbursements payable to third parties providing services to the Company shall be the sole responsibility of the Company, and the amount of such compensation and terms of such engagement shall be determined in the sole discretion of the Company.

2. Term. The initial term of this Agreement shall be for a period of one (1) year, commencing on the date hereof. Thereafter, the term of this Agreement shall be extended automatically, without any further action by the Company or the Management Consultant, for successive one-year terms. During the term of this Agreement, the Company may terminate this Agreement for any reason upon three (3) days written notice to the Management Consultant and the Management Consultant may terminate this Agreement for any reason upon thirty (30) days written notice to the Company.

3. Compensation. As payment for the services provided hereunder, the Company shall pay a monthly fee to the Management Consultant equal to 3.3% of the Company's gross monthly revenues (the "Management Fee"). Such Management Fee shall be paid to the Management Consultant on or before the tenth (10th) day of the next succeeding month. The amount of the Management Fee shall be prorated in the event this Agreement is not in full force and effect for the entire month covered by such Management Fee.

4. Independent Contractor. In the performance of its work, duties and obligations, it is mutually understood and agreed that the Management Consultant is at all times acting and performing as an independent contractor. The Company shall neither have nor exercise any control or direction over the methods by which the Management Consultant or its employees, if any, shall perform their work and functions. The sole interest and responsibility of the Management Consultant is to assure that the services covered under this Agreement shall be performed and rendered in a commercially reasonable manner. Nothing herein contained shall be construed to limit the Management Consultant from providing similar services to other entities as long as the provision of such services does not infringe upon its ability to perform its duties under this Agreement.

5. Reimbursement of Expenses. The Company shall reimburse the Management Consultant for any reasonable out-of-pocket expenses actually paid or incurred by the Management Consultant on a monthly basis.

6. Indemnification. The Company shall indemnify, defend and forever hold harmless the Management Consultant and its officers, directors, employees, agents, successors and assigns against and in respect of any and all liability, loss, claims, cost and expense (including reasonable attorneys' costs of litigation) that may be incurred by the Company arising out of, in connection with, or that may be incurred as a result of the Management Consultant or any agent or employee of

the Management Consultant being negligent or derelict in the performance of services under this Agreement.

7. Assignment. Neither of the parties may assign or delegate this Agreement or any rights or obligations hereunder without the prior written consent of the other party. Any attempted assignment or delegation in violation of the immediately preceding sentence will be void.

8. Entire Agreement and Amendment. This Agreement contains the entire agreement of the parties relating to the subject matter hereof, and the parties hereto have made no agreements, representations or warranties relating to the subject matter of this Agreement which are not set forth herein. No amendment or modification of this Agreement shall be valid unless made in writing and signed by the parties hereto. No term or condition of this Agreement shall be deemed to have been waived except by written instrument of the party charged with such waiver.

9. Governing Law. This Agreement shall be construed and enforced in accordance with the laws of the State of Texas (exclusive of conflicts of law principles).

10. Notices. Any notice to be sent hereunder shall be either hand delivered or sent by facsimile, Federal Express or registered mail, return receipt requested, addressed to the appropriate party at:

To the Company:

Rent-A-Center East, Inc.
5700 Tennyson Parkway
Third Floor
Plano, Texas 75024
Attention: Robert D. Davis,
Senior Vice President - Finance,
Chief Financial Officer and
Treasurer

To the Management Consultant:

Rent-A-Center Texas, L.P.
5700 Tennyson Parkway
Third Floor
Plano, Texas 75024
Attention: Mark E. Speese, President

11. Survivability. If any of the provisions of this Agreement are determined to be invalid or unenforceable, such invalidity or unenforceability will not invalidate or render unenforceable the remainder of this Agreement, but rather the entire Agreement will be construed as if not containing the particular invalid or unenforceable provision or provisions, and the rights and obligations of the parties will be construed and enforced accordingly.

12. Counterparts. This Agreement may be executed simultaneously in one or more counterparts, each of which shall be deemed to be an original, but all of which together constitute one and the same instrument.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the day and year first above written.

RENT-A-CENTER EAST, INC.

By: 
Mark E. Speese
Chairman of the Board and
Chief Executive Officer

RENT-A-CENTER TEXAS, L.P.

By: Rent-A-Center East, Inc., its general partner

By: 
Mitchell B. Fadel
President and Chief Operating Officer

**Amendment No. 1 To
Management Services Agreement**

THIS AMENDMENT NO. 1 TO MANAGEMENT SERVICES AGREEMENT ("Amendment") is entered into as of the 31st day of December, 2004, by and between Rent-A-Center East, Inc., a Delaware corporation having its principal offices at 5700 Tennyson Parkway, Suite 100, Plano, Texas 75024 (the "*Company*"), and Rent-A-Center Texas, L.P., a Texas limited partnership having its principal offices at 5700 Tennyson Parkway, Suite 100, Plano, Texas 75024 (the "*Management Consultant*").

WITNESSETH:

A. The Company and the Management Consultant have entered into that certain Management Services Agreement dated December 31, 2002 ("Agreement"), pursuant to which the Company retained the Management Consultant to perform certain services for the Company.

B. The Parties desire to amend the Agreement to reflect their original intent and the business practice in effect since the date of the Agreement.

NOW, THEREFORE, in consideration of the premises and the mutual agreements, covenants and provisions contained herein, the sufficiency of which are hereby acknowledged and confessed, the Parties agree as follows:

1. Definitions. Capitalized terms used herein without definition shall be as defined in the Agreement.
2. Amendment to Section 3. Section 3 of the Agreement is hereby amended and restated to read in its entirety as follows:
 3. Compensation. As payment for the services provided hereunder, the Company shall pay a monthly fee to the Management Consultant in an amount equal to the net profit of the Company in excess of 4.5% of operating expenses, or such other amount as the Company and the Management Consultant may mutually determine (the "*Management Fee*"). Such Management Fee shall be accounted for in book entry form on a quarterly basis in accordance with the regular accounting practices of the Company and the Management Consultant as in effect from time to time. The amount of the Management Fee shall be prorated in the event this Agreement is not in full force and effect for the entire month covered by such Management Fee.
3. Effective Date of Amendment. The Amendment shall be effective as of the date of the Agreement and shall be applied retroactively for all periods during which the Agreement has been in effect.
4. Effect of Amendment. Except as amended hereby, the Agreement shall remain in full force and effect.

5. Governing Law. THIS AMENDMENT SHALL BE GOVERNED BY AND CONSTRUED IN ACCORDANCE WITH THE SUBSTANTIVE LAWS OF THE STATE OF TEXAS.

IN WITNESS WHEREOF, the undersigned have caused their duly authorized representatives to execute this Amendment effective as of the date above and in the capacities shown below.

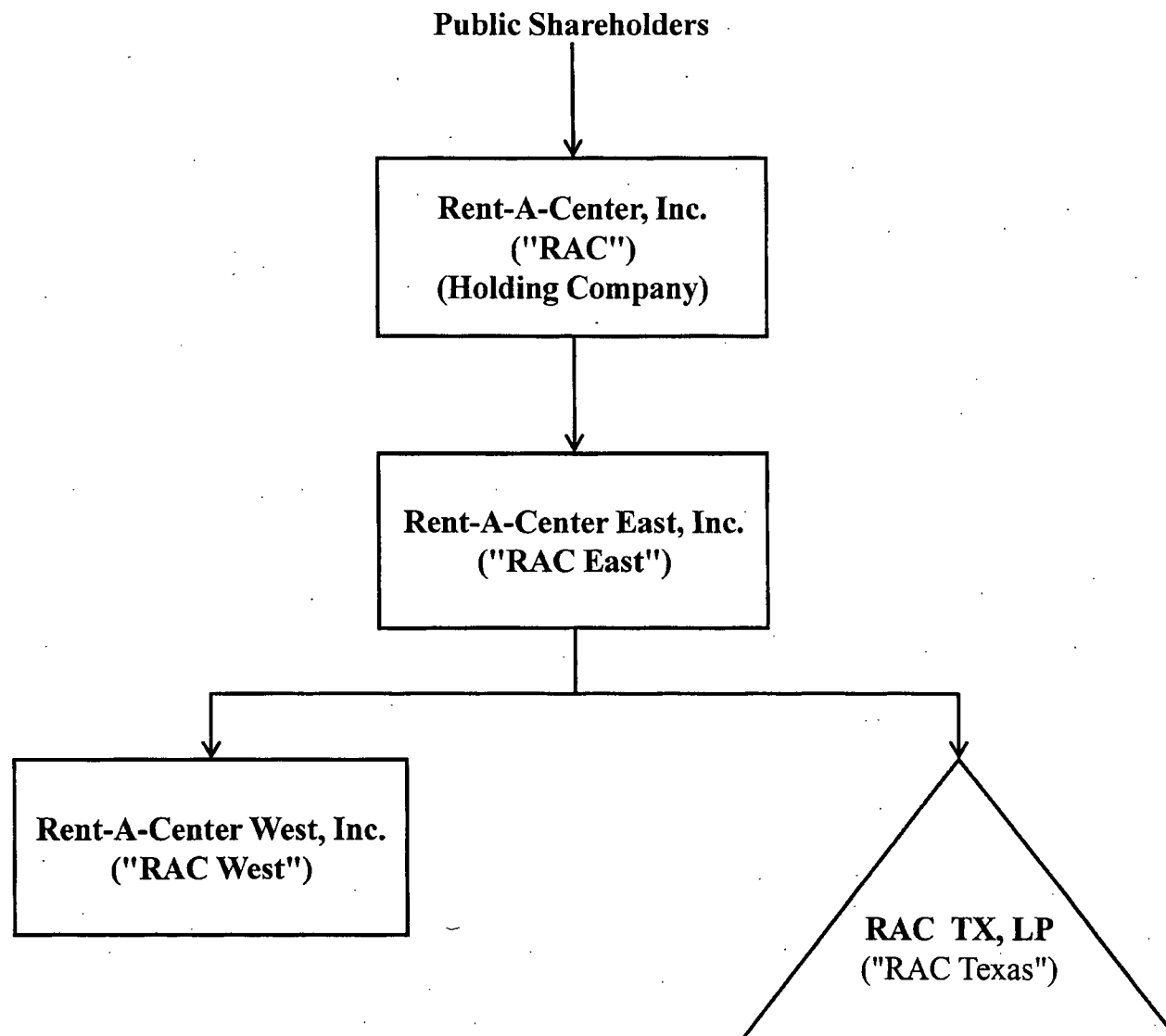
RENT-A-CENTER EAST, INC.

By: 
Mark E. Speese, President

RENT-A-CENTER TEXAS, L.P.

By: 
Mark E. Speese, Chief Executive Officer

Simplified Rent-A-Center Corporate Structure for Purposes of South Carolina Audit



EXPERT OPINION OF PROFESSOR RICHARD D. POMP
Rent-A-Center West, Inc.

I. Introduction

A. My Qualifications

I am currently the Alva P. Loisel Professor of Law at the University of Connecticut Law School, and an adjunct Professor of Law at NYU Law School in the LL.M. program.

For nearly 40 years, I have studied, lectured, taught, published, consulted, and testified on issues of taxation. I have served as a consultant to Alaska, California, Connecticut, Delaware, Hartford, Illinois, Kansas, Louisiana, Montana, New Jersey, New York, North Dakota, San Francisco, South Carolina, Tennessee, West, Utah, West Virginia, the Multistate Tax Commission, the Internal Revenue Service, the Department of Justice, the U.S. Congress, the International Monetary Fund, the World Bank, the United Nations, and numerous foreign countries.

I have been qualified and testified as an expert witness on various aspects of tax policy Alabama, Alaska, California, Colorado, Connecticut, Delaware, Illinois, Kansas, Kentucky, Louisiana, Massachusetts, Michigan, Mississippi, Montana, New Jersey, New York, New York City, North Carolina, North Dakota, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, Tennessee, West, Utah, and West Virginia. Nearly half of these approximately seventy appearances have been on behalf of the states.

My curriculum vitae, attached to this Opinion, describes my career in further detail.

B. Overview

1. Facts

Rent-A-Center West, L. P. ("RAC West") is a Delaware corporation, with its principal place of business and domicile in Texas. RAC West is a subsidiary

of RAC East. RAC East operates retail stores in South Carolina and elsewhere. These stores conduct a similar business to that of RAC West.

RAC West owns and operates 422 retail stores in the western United States, which rent and sell consumer goods such as furniture, home electronics, appliances, and computers. None of these stores is in South Carolina. RAC West also owns, develops, licenses, and protects the "Rent-A-Center" trademarks, tradenames, and service marks ("IP"). It licenses the IP to RAC East and other affiliates. For ease of presentation, RAC East will be used to refer to all the licensees.

All the license agreements were executed outside of South Carolina. Under these agreements, RAC West receives a gross royalty of 3% of the net sales of the licensee and 3% of a licensee's rental income.

The royalty was determined by a transfer pricing study conducted by one of the Big Four accounting firms. The Department Determination does not dispute that the 3% royalty is fair and reasonable. The Department Determination accepts that the royalty is a legitimate cost of doing business by the licensees and is properly deductible by them.

During the audit period at issue, 2003 through 2005, RAC West filed South Carolina corporate income tax returns. RAC West calculated its tax by first determining its total unitary income, as calculated under South Carolina law. It then apportioned its unitary income using the three factor apportionment formula. RAC West subsequently filed an amended return using the single factor formula. That formula provides for a fraction whose numerator is gross receipts from within South Carolina and whose denominator is gross receipts from everywhere. S.C. Code Ann. Sec. 12-6-2290. That formula is applied to RAC West's total unitary income.

The Department disregarded the statute. The Department taxed RAC West using a methodology known as separate accounting. Using this methodology, the Department taxed the gross royalties RAC West received from South Carolina stores. The Department ignored RAC West's income from the operation of its retail stores and ignored the gross receipts from those stores.

2. Issue in the Case

The issue in this case is whether RAC West should be taxed on an apportioned share of its unitary income as provided for by South Carolina law, or whether the Department can disregard the statutes and apply separate accounting to tax the royalties received from South Carolina stores.

The Department justified the use of separate accounting because RAC West's "*income from South Carolina* is only from intangibles yet its income from other states includes the sale of tangible personal property." Department Determination, p. 2 (emphasis added). As explained more fully below, this statement misunderstands the concept of a unitary business and how formulary apportionment works.

In a nutshell, statements like "income from South Carolina" have meaning only after the apportionment formula has been applied to a corporation's taxable income. The South Carolina apportionment formula is used to determine how much of a corporation's income should be viewed as attributable to activities taking place in the State. The result of applying the formula to a corporation's taxable income is what constitutes South Carolina income. The statement quoted above from the Department Determination is inconsistent with these principles.

3. Question Asked

I have been asked my opinion from a tax policy perspective about the appropriateness of the Department's actions in disregarding the statutory formula apportionment and substituting separate accounting.

II. Analysis

A. The Department's Taxation of RAC West is Inconsistent with the Theory of Unitary Taxation and Formulary Apportionment

From a policy perspective, this case involves one overriding issue: should RAC West be taxable on a slice of its total unitary income, which consists of its royalties and income from the stores, using formulary apportionment, or should the Department use an alternative approach known as separate accounting, and tax the royalties received from stores in South Carolina? If

the latter, should the Department offset the royalties by the expenses RAC West incurred to generate the royalties?

From a policy perspective, I find the Department's taxation of RAC West using a methodology not set forth in the statute to be improper. To understand why, a bit of background on the taxation of multistate corporations is required.

RAC West conducts a multistate unitary business. The taxable income of a multijurisdictional enterprise conducting a unitary business can be viewed as a pizza pie. A state must first determine the size of the pizza, and it must then determine its appropriate taxable slice of that pie.

The size of the pizza is determined by the unitary taxable income of the corporation. Most states, including South Carolina, incorporate the Internal Revenue Code for defining gross income, deductions, taxable income, and the like. RAC West's unitary income consists of both its royalties and the profits from its retail stores (sales plus rentals), and it is allowed to deduct all of its ordinary and necessary business expenses. The resulting amount is RAC West's taxable income.

There are two primary methodologies for resolving the second issue of determining a state's appropriate slice or share of a corporation's unitary taxable income: separate accounting and formulary apportionment. Each methodology is discussed below.

1. Separate Accounting

Historically, an early method for determining the slice of the pie, now generally fallen into disfavor except for limited circumstances, is known as separate accounting. Separate accounting is based on the premise that it is both possible and practical to isolate the taxable income of those portions of the unitary business that a multistate corporation carries on solely within a state. This approach attempts to determine how much taxable income would be earned if a distinct and independent entity conducted the corporation's unitary activities within a taxing state. Taxable income is calculated under state law for this discrete, hypothetical business. Separate accounting is an attempt to directly measure the income attributable to a state.

One of the major weaknesses in separate accounting is its failure to capture the synergies, interdependencies, functional integration, economies of scale, centralized management, unity of ownership, use and management, and flows of value that are the hallmark of a unitary business. Separate accounting does not work because in a unitary business the income is attributable to all of a corporation's activities and not to any single activity.

For example, the value of RAC West's IP is inextricably linked to the profits of its retail stores. RAC West uses the IP in its own operations. If all of its stores operated at a loss, the IP would be less valuable than if the stores were highly profitable. But the IP is used to operate the stores at a profit.

The royalty that any licensor can charge reflects the value of the IP that is being licensed. And that value, in turn, reflects the income that can be generated by using that IP. The royalty income is inextricably tied to the operation of the retail stores. There is a synergy between the operations of the stores and amount of royalty that can be charged for the IP.

RAC West is not in two discrete, separate, independent businesses: (1) owning and licensing IP, and (2) operating the retail stores. RAC West does not describe itself as being in two businesses, does not hold itself out to the public as being in two businesses, and does not manage or conduct itself as if it were in two separate, discrete, independent businesses. RAC West employs strong centralized management and oversight regarding its retail business and the IP. There is a unity of ownership, use, and management. The revenues from the royalties and the stores are commingled and used to pay the expenses of RAC West. There is no way to disaggregate RAC West into its retail operation and its IP operation. Both are integral parts of the whole. Separate accounting is inappropriate.

As another illustration of a unitary business, consider a corporation that conducts a unitary retail business of selling consumer goods. The corporation has low-volume, profitable stores in South Carolina and high-volume, break even stores outside the State. It would be improper for South Carolina to apply separate accounting and tax only the profitable stores in the State and ignore the rest of the business. Separate accounting would ignore the fact that the high-volume, out-of-state stores contribute to the profits of the South Carolina stores by allowing the unitary business to obtain a volume discount on its purchase of inventory. Indeed, the corporation might well be worse off by closing its break even stores, which

would increase its cost of inventory and lower the profits of the South Carolina stores.

Similarly, the break even store contributes to the value of the corporation's goodwill and trademarks by increasing the overall profits of the business. And that in turn, contributes to the amount of royalty that can be charged for the use of the IP. If the break even store were closed, the value of the IP would decline and so would the amount that could be charged for the use of the IP. As these examples illustrate, when there are synergies, interdependencies, and flows of value, it is wrong, from a tax policy perspective, to apply separate accounting to only a segment of the business. This was recognized at the beginning of the 20th century, when formulary apportionment developed to cure the defects in separate accounting.

2. Formulary Apportionment

Because of the problems inherent in separate accounting when applied to a unitary business, the states early on developed an alternative method--formulary apportionment--for dividing and sharing the tax base of a unitary multistate enterprise. As the name suggests, a formula is used to determine a state's slice of the multistate unitary business. The formula is applied to a corporation's taxable income. The relevant formula in this case, as provided by statute, is the single factor sales formula.

From a policy perspective, because RAC West is conducting a unitary business, South Carolina should tax an apportioned share of the corporation's entire unitary income. That net income would be calculated by starting with RAC West's gross receipts from its royalties and the operation of its retail stores (sales plus rentals), and then deducting from that amount its aggregate expenses. That resulting number--RAC West's unitary taxable income--would determine the size of the pizza, which would then be apportioned to determine South Carolina's slice.

The applicable apportionment formula set forth in the South Carolina statute divides the gross receipts received in South Carolina (i.e., the royalties attributable to South Carolina stores) by the gross receipts received from all sources (i.e., the royalties and the gross receipts from the retail stores). That resulting fraction would then be applied to the total unitary taxable income of RAC West.

The Department rejected that approach, however. Its reason for doing so is that “[i]n states other than South Carolina, the taxpayer’s business includes renting and selling tangible personal property. Therefore, the taxpayer’s gross receipts include amounts received from the renting and selling of tangible personal property, as well as the taxpayer’s royalty income. On the other hand, the taxpayer’s gross receipts from South Carolina only include royalty fees. Therefore, apportioning the taxpayer’s income in accordance with [the single factor formula] would not be accurate, as the South Carolina royalty income would be diluted by the denominator that includes not only royalty fees, but also amounts received from the sales and rentals of tangible personal property.” Department Determination, p. 6.

For this reason, instead of applying the statutory apportionment formula, the Department applied separate accounting and disregarded RAC West’s retail stores.

From a policy perspective, I am puzzled by the Department’s logic. The Department ignores that it should be taxing a slice of RAC West’s entire unitary taxable income. It should not be taxing 100% of the royalties from South Carolina stores.

Put differently, from a tax policy perspective, South Carolina should be taxing a slice of the whole pizza; that is, it should be taxing a slice of RAC West’s unitary taxable income. Its slice is determined by the apportionment formula. The South Carolina tax is the result of the interaction of the size of the pizza and South Carolina’s slice. If RAC West has a lot of retail stores outside of South Carolina that make its IP more valuable, then the pizza will grow larger, and South Carolina’s slice will grow smaller. Whether South Carolina’s tax increases or decreases, however, is an empirical question based on whether the increase in the size of the pizza offsets the smaller South Carolina slice of the pizza.

The Department’s alternative methodology fails to recognize that it is RAC West’s total unitary income that should be taxed, that is, its income from all sources, including its retail stores and its royalties. The statutory apportionment factor takes into account RAC West’s gross receipts from all sources, including its retail stores and its royalties. Because the income from the stores in RAC West is part of what is being apportioned to South Carolina, it is only appropriate as a policy matter that the gross receipts from those stores enter into determining the South Carolina apportionment factor.

To disregard both the stores and their gross receipts is to impose separate accounting in order to carve out part of the unitary business, but as explained above, this is exactly the situation where separate accounting is inapplicable. South Carolina wants the fruits of the stores, while simultaneously disregarding the fact that it was the stores that made the IP valuable and generated the royalty.

Because RAC West is a unitary business, the income it generates, whether from retail sales or rentals, or royalties, represents the total efforts of the corporation. Trifurcating its income into sales, rental, or royalties is inconsistent with the theory of a unitary business. The success of the stores helps to increase the royalty income. The purpose of the apportionment formula is to determine how much of the unitary income should be viewed as attributable to South Carolina. From a policy perspective, the Department's statement that "Petitioner's *South Carolina income* consists solely of royalty fees received from [RAC East]," Respondent's Prehearing Statement, p. 3 (emphasis added), misunderstands the nature of a unitary business and formulary apportionment. It is only after the unitary income is apportioned that we know for tax purposes what the South Carolina income is. If the apportionment formula is defective, as the Department seems to think, then the proper approach, from a tax policy perspective, is to cure that formula, not shrink the size of the pizza while increasing the slice of that pizza.

The Department's approach commits a fundamental policy error. By blindly ignoring the retail stores and taxing only the royalties, the Department is turning the clock back and imposing a form of separate accounting where it does not belong. RAC West is a unitary business for which separate accounting is inappropriate from a tax policy perspective. The royalties cannot be viewed independently from the retail stores, without which the IP would be worthless, yet that is what the Department is attempting to do.

3. RAC West is Being Taxed on a Gross Basis and not on its Taxable Income.

South Carolina has adopted a corporate income tax. The essence of an income tax is that a corporation is taxed on its net profits. Two corporations might have the same gross income, but one may have expenses well in excess of that gross income and thus operate at a loss, whereas the other may have only nominal expenses. These corporations obviously do not have the

same profits; indeed, the first one is operating at a loss. Unless their expenses are taken into account, they would be taxed the same, which is the antithesis of a tax on profits or net income.

By comparison, a sales tax ignores whether a vendor is profitable or not. If the two corporations above sold the same amount of taxable goods, each would pay or collect the same amount of sales tax. South Carolina has adopted both a sales tax and a corporate income tax.

Formulary apportionment recognizes that in a unitary business both the receipts and the expenses are part of an indivisible whole. Consequently, in determining the net income of the business, the aggregate expenses are offset against the aggregate receipts. The apportionment formula applies to the net income of the business. Just the way it is inappropriate to take apart a unitary business and tax only a subset of its activities, it is inappropriate to try to identify the expenses that generated that subset.

For example, the cost of operating the retail stores in a successful manner simultaneously increases the value of the IP, which increases the rate of the royalties. It is nearly impossible to divide those costs between the stores and the royalties.

By applying separate accounting rather than formulary apportionment, the Department is requiring RAC West to bifurcate its expenses between two indivisible sources of income: the retail stores and the royalties. RAC West has no reason to do this under GAAP, the Internal Revenue Code, or under its own internal management accounting.

III. Conclusion

RAC West is a unitary business. It is not in two discrete, independent businesses: operating its retail stores and owning and licensing its IP. RAC West does not describe itself as being in two businesses, does not hold itself out the public as being in two businesses, and does not manage or conduct itself as if it were in two separate, discrete, independent businesses.

RAC West employed strong centralized management and oversight regarding its retail business and its IP. There is a unity of ownership, use and management. The IP is an integral part of the business. The more successful the stores, the more valuable the IP, and the greater a royalty that could be

charged. There is no way to disaggregate RAC West into its retail operation and IP operations. Both are integral parts of the whole. From a policy perspective, separate accounting is inappropriate in this situation. But if separate accounting is applied, the royalties should be taxed on a net, rather than, gross basis.



Analysis of Rent-A-Center, Inc Profit Distribution

**KPMG LLP
Economic Consulting Services
February 2003**

RAC WEST 0267

ROA 0409



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EXECUTIVE SUMMARY

Rent-A-Center, Inc. ("RAC" or "the Company"), engaged the Economic Consulting Services practice ("ECS") of KPMG LLP ("KPMG") to conduct a planning study to determine arm's-length pricing for transactions between Rent-A-Center Texas L.P. ("RAC- Management") and its related parties. RAC operates retail stores that offer high quality, durable products such as home electronics, appliances, computers, and furniture and accessories under flexible rental purchase agreements that typically allow the customer to obtain ownership of the merchandise at the conclusion of an agreed rental period.

As part of the restructuring, RAC-Management will perform strategic management services and provide all value added activities (e.g., training, accounting, human resource services, legal, advertising, and marketing) to the store operating entities, Rent-A-Center East ("RAC East") and Rent-A-Center West ("RAC West"), hereafter collectively referred to as "RAC-Stores." In return, RAC-Stores will function as the operating entities, performing basic retail related functions. Furthermore, RAC West will own the intangible associated with the "Rent-A-Center" trademark, and RAC- Management and RAC East will pay RAC West a royalty for the use of the trademark.

RAC has engaged KPMG to determine an appropriate arm's-length compensation that the RAC-Stores should receive for performing the routine functions and the royalty payment that RAC-Management and RAC East should make to RAC West for using the RAC trademark.

In preparing this report, KPMG relied on the regulations and methods specified in Section 482 of the Internal Revenue Code ("IRC §482"). The basic principle that underlies IRC §482 is the "arm's-length standard." Under this standard, prices paid or received in transactions between commonly controlled entities must be consistent with prices that would have been set by two unrelated firms negotiating at arm's length. KPMG used the following approach to determine the appropriate return:

- Analyzed the distribution of functions, risks, and assets within the Company to determine how profits should be shared within the two entities;
- Selected a best method for calculating the transfer price;
- Performed a benchmarking exercise to determine the routine return that the RAC-Stores should receive for operating the retail shops; and
- Benchmarked the royalty rate that should be paid by RAC East and RAC-Management to RAC West.

Based on the above analysis, KPMG assessed that RAC-Store will be performing functions that are similar to a limited risk retailer¹. To identify the return on total cost

¹ A limited risk retailer in this context is described as an entity that only performs retail functions (i.e., displays merchandise on the shop floor, manages the store, serves customers and processes customer orders). It does not have responsibility for vendor or merchandise selection, marketing and advertising or

("ROTC") that RAC-Stores should earn for its activities, KPMG carried out a search for retailers of unbranded consumer products, which included electrical products and home furnishing. The search resulted in 19 companies that had an interquartile range of adjusted ROTC of 2.3 percent to 7.0 percent, with a median of 3.3 percent.

This is the return that RAC-Management will guarantee to RAC-Stores. As the principal risk taker, all profits in excess of this level are attributable to the risk and functions associated with strategic management services and the advertising and marketing services performed by RAC-Management and thus belong to RAC-Management.

With regard to the trademark royalty, KPMG was able to identify an internal comparable uncontrollable transaction ("CUT"). ColorTyme Inc ("ColorTyme"), the franchising subsidiary of RAC, earns royalties in the range of two percent to four percent on gross revenue, from its unrelated parties. Therefore, based on this CUT, an arm's-length royalty payment from RAC-Management and RAC East to RAC West would be in the range of two percent to four percent on gross sales.

other value added or strategic management activities. It also bears no inventory risk. Therefore, the functions performed by such a retailer bear minimal risk.

KPMG LLP

Economic Consulting Services

RAC WEST 0270

ROA 0412

1. INTRODUCTION

RAC has engaged KPMG to determine an appropriate arm's-length compensation that the RAC-Stores should receive for performing routine retail functions, and the royalty payment due by related parties to RAC West for the use of the RAC trademark.

The analysis presented in this document relies on factual and financial information provided by the management and personnel of RAC to KPMG. While KPMG believes that the information used in this study is accurate, KPMG has not independently verified the information in all cases and does not warrant its accuracy. Any change in the factual or financial information provided for this study could change the results and recommendations reached in this planning study. KPMG has also relied on the current relevant provisions of the IRC of 1986, as amended, the regulations thereunder, and judicial and administrative interpretations thereof. These provisions are subject to change or modification by subsequent legislative, regulatory, administrative, or judicial decisions. Any such changes could also have an effect on the results and recommendations presented in this report. KPMG does not assume the obligation to reflect changes in tax regulations, business practices, or any other conditions impacting the companies involved subsequent to the date of this report.

This report contains the following sections:

- Section 1: Introduction
- Section 2: Company Overview
- Section 3: Industry Analysis
- Section 4: Analysis of RAC's Functions, Risks and Assets
- Section 5: US Transfer Pricing Regulation
- Section 6: Selection of Best Method
- Section 7: Comparable Search for Retailers
- Section 8: Determination of Trademark Royalty
- Section 9: Conclusion

2. COMPANY OVERVIEW

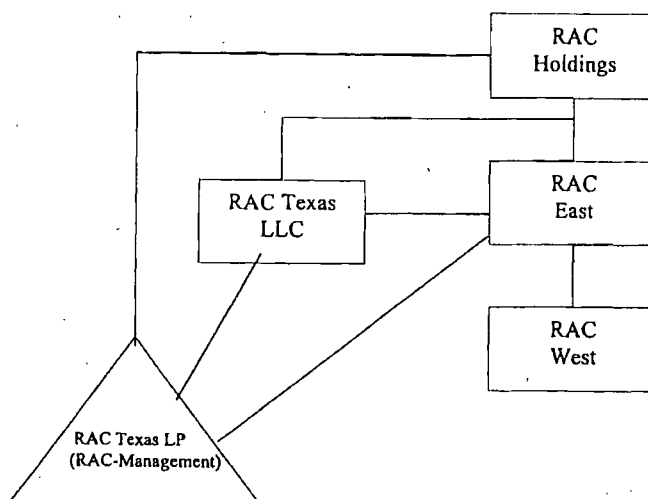
Having started with eight stores in 1986, RAC is now one of the largest domestic operator in the rent-to-own industry with more than 2,500 stores in the United States and Puerto Rico. In 2001, it operated 2623 stores, of which it owned 2281 and franchised 342. Its corporate headquarter is located in Plano, Texas, along with the headquarters of its wholly owned subsidiary, ColorTyme.

The Company's growth strategy is primarily through acquisition. For example, in May 1998, it acquired substantially all the assets of Central Rents, Inc., which operated 176 stores, for approximately \$100 million in cash. In August 1998, it acquired Thorn Americas, Inc. ("Thorn America") for approximately \$900 million in cash. Prior to this acquisition, Thorn Americas was the Company's largest competitor, operating 1,409 company-owned stores and franchising 65 stores in 49 states and the District of Columbia.

The RAC-Stores offer high quality, durable products such as home electronics, appliances, computers, and furniture and accessories under flexible rental purchase agreements ("RPAs") that typically allow the customer to obtain ownership of the merchandise at the conclusion of an agreed rental period. The RPAs are designed to appeal to a wide variety of customers by allowing them to obtain merchandise that they might otherwise be unable to obtain due to insufficient cash resources or a lack of access to credit. These agreements also cater for customers who may require the services of RAC on a temporary basis, or who simply desire to rent rather than purchase the merchandise.

Customers generally enter into weekly or monthly RPAs, which renew automatically upon receipt of each payment. RAC retains title to the merchandise during the term of the RPA. Ownership of the merchandise typically transfers to the customer if the RPA has been continuously renewed for a period of 12 to 30 months or if the customer exercises a specified early purchase option. Although the Company does not conduct a formal credit investigation of each customer, potential customers must provide store management with sufficient personal information to allow verification of residence and income. References listed by the customer are contacted to confirm the information contained in the customer's rental purchase order form. Rental payments are generally made in cash, by money order, or through debit card. Approximately 85 percent of RAC's customers pay in the store on a weekly basis.

2.1 RAC Organizational Structure



The above organizational structure illustrates the entities that are involved in inter-company transactions discussed in this report. A brief description of each entity is provided below:

- **RAC-Management:** RAC-Management performs all strategic management and related functions, for the RAC-Stores. It also manages the Texas stores, which account for 10 percent of the total sales force.

The executive management team is located at RAC-Management who co-ordinate purchasing, perform financial planning and create controls, perform employee training and have responsibility for new store site selection. The executive management team also evaluates the performance of each region, market and store, including the use of on-site reviews. All members of the executive management team receive a significant amount of their total compensation based on the profits generated by the entire company.

- **RAC East:** RAC East makes up 75 percent of the total sales force, which includes regional directors, market managers and store managers, in addition to local store staff. RAC East is the legal entity for RAC stores located on the East Coast and those situated in the middle of the country.
- **RAC West:** RAC West is owner of RAC trademarks and is the legal entity for all stores located on the West Coast and those situated in the middle of the country. RAC West stores account for 15 percent of the total regional sales force.

2.1.1 RAC-Store Management Structure

RAC-Stores (i.e., RAC West, RAC East, and Texas stores) are organized geographically with multiple levels of management. At the individual store level, each store manager is responsible for customer and credit relations, delivery and collection of merchandise, inventory management, staffing, training store personnel, and certain marketing efforts. The store manager is required to audit the idle inventory on hand and compare the audit to the Company's computer report three times a week. The market manager performs a similar audit at least once a month. In addition, the individual store managers track their daily store performance for revenue collected as compared to the projected performance of their store. Each store manager reports to a market manager within close proximity who typically oversees six to eight stores. Typically, a market manager focuses on developing the personnel in his or her market and on ensuring that all stores meet the quality, cleanliness and service standards. In addition, a market manager routinely audits numerous areas of the stores operations, including gross profit per rental agreement, petty cash, and customer order forms.

The market managers in turn, report to regional directors. Regional directors monitor the results of their entire region, with an emphasis on developing and supervising the market managers in their region. Similar to the market managers, regional directors are responsible for ensuring that store managers follow the operational guidelines, particularly those involving store presentation, collections, inventory levels, and order verification. These regional directors report to eight senior vice presidents at RAC Management.

2.2 RAC Products and Services

2.2.1 Products

RAC-Stores offer merchandise from four basic product categories, home electronics, appliances, computers and furniture and accessories.

Home electronic products include items such as televisions, DVD players, home entertainment centers, video cassette recorders, and stereos from top brand manufacturers such as Philips, Sony, JVC, Toshiba, and Mitsubishi.

The appliances offered by RAC are manufactured by Whirlpool and consist of refrigerators, washing machines, dryers, microwave ovens, freezers, and ranges.

RAC's personal computer offerings include brand names such as Dell, IBM, Compaq, and Hewlett Packard.

The furniture products include a variety of dining room, living room, and bedroom furniture made by Ashley, England, and Benchcraft. Accessories include pictures, plants, lamps and tables and are typically rented as part of a package of items, such as a complete room of furniture. Showroom displays enable customers to visualize how the product will look in their homes and provide a showcase for accessories.

The stores typically have available at any one time approximately 100 of the 150 different items offered. Although the Company seeks to ensure sufficient inventory at each store, inventory is usually limited to prescribed levels to ensure strict inventory controls. For the year ended December 31, 2001, home electronic products accounted for approximately 41 percent of store rental revenue, furniture and accessories for 32 percent, appliances 17 percent and computers for 10 percent. RAC has found that its primary seller is large screen televisions.

2.2.2 Services

The Company seeks to provide a wide variety of high quality merchandise to customers and emphasizes high-end products from brand-name manufacturers. Customers may request either new merchandise or previously rented merchandise. Previously rented merchandise is offered at the same weekly or monthly rental rate, as is offered for new merchandise, but with an opportunity to obtain ownership of the merchandise after fewer rental payments. It offers same day or 24-hour delivery and installation of its merchandise.

A minimum rental term of 18 months is generally required to obtain ownership of new merchandise. The Company estimates that 25 percent of the initial RPAs are taken to the full term of the agreement, although the average total life for each product is approximately 22 months. This includes the initial rental period, all re-rental periods, and idle time in the system. Turnover varies significantly based on the type of merchandise rented, with certain consumer electronics products, such as camcorders and video cassette recorders, generally rented for shorter periods, while appliances and furniture are generally rented for longer periods.

Table 2.1 below summarizes RAC's financial results for the period 1999 to 2001 (\$000's)

	2001	2000	1999
Revenue	1,808,528	1,601,614	1,417,167
Operating Expenses	1,571,942	1,356,984	1,227,144
Operating Profit	236,586	244,630	190,023
Operating Margin	13.1%	15.3%	13.4%
Return on Assets	13.0%	16.8%	16.0%

3. RENT-TO-OWN INDUSTRY ANALYSIS

The rent-to-own industry is relatively new to the American economy. The unique "rent-to-own" transaction sprang up in the 1960s in response to a growing consumer need for acquiring the use of household products without incurring debt or jeopardizing credit. What distinguishes rental-purchase from a retail credit sale is the term "rent". There is no interest charged to consumers, no formal credit checks involved, and customers can return the merchandise at any time. This no-obligation, no-debt feature is the cornerstone of rental-purchase. For most rent-to-own stores, replacement, repair, and delivery are included in the purchase. The current U.S. rent-to-own industry is comprised of approximately 8,000 stores, serves over three million households, and generates \$5.3 billion per year.² Typical products include furniture, electronics, major appliances, computers, and jewelry.

3.1 Competition

RAC-Stores compete with other national and regional rent-to-own businesses, as well as with rental stores that do not offer their customers a purchase option. For customers desiring to purchase merchandise for cash or on credit, it also competes with department stores, credit card companies, and discount stores. Competition is based primarily on location, product selection and availability, customer service, and rental rates and terms.

3.2 Regulation

The rent-to-own industry has come under national scrutiny, since rent-to-own operations are not covered by federal laws or by most state laws. In 1997, Rep. Joseph Kennedy, D-Mass., and 14 co-sponsors introduced the Rent-To-Own-Reform Act of 1997 (H.R. 3060). It required a full disclosure on the part of sellers about the effective interest rate, the cost of each service and item, guarantees, condition of the item (new or used), and cost if purchased outright. If the seller failed to comply, it would be in violation of the Federal Trade Commission and could be prosecuted under that law. The bill never passed, but a new effort is currently under way in Congress.

Currently, 47 states and Puerto Rico have legislation regulating rental purchase transactions. The regulation defines and clarifies the various disclosures, procedures and transaction structures related to the rent-to-own business. With some variations in individual states, most related state legislation requires the lessor to make prescribed disclosures to customers about the RPA and transaction, and provides time periods during which customers may reinstate agreements despite having failed to make a timely payment. Some state rental purchase laws prescribe grace periods for non-payment, prohibit or limit certain types of collection or other practices, and limit certain fees that may be charged. Nine states limit the total rental payments that can be charged. These limitations, however, do not become applicable in general unless the total rental payments required under agreements exceed 2.0 to 2.4 times of the disclosed cash price or the retail value.

² Source: Association of Progressive Rental Organizations

4. ANALYSIS OF RAC'S FUNCTIONS, RISK AND ASSETS

Under IRC §482, transactions between related parties should generate results consistent with those of unrelated parties conducting business at arm's length. In concert with economic theory, IRC §482 suggests that there is a positive relationship between the risk borne by a business entity and its expected returns. Furthermore, the functions performed by an entity have varied opportunity costs, and the provider of such functions needs to be rewarded according to the activities undertaken. The ability and efficiencies of these functions are also dependent on the assets (intangible or tangible) that are employed to carry out such functions.

This section discusses how the functions, risks, and assets are shared within the Company. This is an essential step, as it forms the basis for determining how profits should be distributed between the related entities.

4.1 Functions

4.1.1 Strategic Planning

Corporate strategic planning activities provide vision and direction for the firm by examining the competitive state of the industry, determining those factors that are critical to the Company's success and tailoring a strategy to fit its core competencies. Corporate strategy provides the basis for selecting lines of business, choosing organizational structure and operating procedures, analyzing and undertaking acquisitions and divestitures, and responding to competitors and to market forces.

RAC-Management is responsible for strategic planning.

4.1.2 Accounting and Controllershship

Accounting and controllership activities involve the management of a firm's day-to-day cash flows and the recording of transactions undertaken by a firm. Accountants and controllers typically manage a firm's balance sheet items such as accounts receivable, accounts payable, payroll, employee benefits, executive compensation, and intercompany payments. Depreciation and amortization of assets are also controllership issues. The operational controllership functions include the daily implementation and monitoring of accounting systems.

RAC-Management is responsible for accounting and controllership.

4.1.3 Purchasing and Merchandising

The merchandising function includes selecting merchandise, working with vendors, monitoring sales and promoting merchandise, e.g. through markdowns or special promotions. The purchasing function involves selecting and evaluating vendors, negotiating purchase items and setting quality standards for purchased merchandise.

RAC-Management determines the general product mix in the stores based on an analysis of customer rental patterns and the introduction of new products on a test basis. Individual store managers are responsible for determining the particular product selection for their store from the pre-approved product list. Store managers make specific purchasing decisions for the stores, subject to review by RAC-Management.

The Company's largest suppliers include Ashley, Whirlpool, and Philips. Generally, the Company does not enter into written contracts with its suppliers. This allows the Company flexibility to change suppliers, and its product range to meet the changing demands and preferences of its customers. The selection of suppliers is the responsibility of RAC-Management.

4.1.4 In-bound Logistics

Inbound logistics includes the activities that are required to bring the stock to the stores. This includes shipment of products to the warehouse, the handling of products at the warehouse, taking account of inventory.

RAC-Stores are located primarily in strip malls and average approximately 4,300 square feet of retail space. RAC-Management has responsibility for vendor selection, maintaining relations and negotiating prices, along with paying the vendors. The vendors ship the Company's merchandise directly to each store, where it is held for rental. As a result, the stores are able to dedicate approximately 80 percent of the store space to showroom floor, and also eliminate warehousing costs and keep a tight control over inventory. Also, by selecting products that show consistent historical demand, it reduces the number of obsolete items in the stores. However, as mentioned above, RAC-Management is responsible for selecting the overall product-mix.

RAC-Stores' inbound responsibility is limited to coordinating the delivery and display of the merchandise on the shop-floor.

4.1.5 Outbound Logistics

Outbound logistics involves activities required to deliver the products to the customer. This includes taking the order, processing the order and making the delivery.

RAC-Stores process orders using the ^{ownership?} Management Information System ("MIS") provided by RAC-Management. RAC-Management provide training and guidance to RAC-Store managers on how to process orders, e.g. what forms to complete, information on rental payment options, how to make deliveries, and operate the delivery vehicle.

RAC-Management in its training programs also stresses the importance of customer services at the delivery stage. This is because the Company believes sound customer service is important at all stages of the sales process. An efficiently completed delivery ensures customer satisfaction with the merchandise and rental program. It is believed that the customer service received at this stage may be the determining factor in whether the customer continues to rent beyond the initial agreed period. RAC offers two types of

deliveries; one is in-store, where the customer is educated on the merchandise and the merchandise is loaded into the customer's vehicle. The second option is installation and delivery to the customer's home, where the customer receives RAC quality service. Prior to making the deliveries, the deliverer maps out the days deliveries, which also includes any collections of past due accounts. This pre-planning assists to reduce delivery costs.

4.1.6 Advertising and Marketing

Advertising and marketing activities involve those activities that assist in promoting and creating awareness of the products, and thus result in increased sales and/or company market share. The adoption of unsuccessful marketing strategies and advertising campaigns can significantly risk a company's market share and brand image.

The effectiveness of the advertising and marketing campaigns contribute significantly to expand RAC's customer base and create awareness of its services. RAC-Management undertakes all strategic marketing activities. For example, the decision to use John Madden in its advertising commercials was made by RAC-Management. RAC-Management uses direct mail advertising, radio, television, and secondary print media advertisements, to emphasize such features as product and brand-name selection; prompt delivery; and the absence of initial deposits, long credit investigations, or long-term obligations. The promotions of such features assist RAC in distinguishing itself from its competitors and the centralization of the advertising and marketing function, allows the Company to benefit from economies of scale. This is especially the case as it opens more stores, as RAC-Management is able to list all stores in the same market-wide advertisement, which reduces the advertising expenses of each store in the market.

RAC-Stores follow promotional and pricing instructions that are sent to them from RAC-Management.

4.1.7 Pricing

RAC-Management determines the prices of its merchandise and selects products for special promotion. RAC-Stores have no input in the pricing of the products.

RAC does not compete on price and thus does not use promotional gimmicks, such as "lowest price" as it aims to provide customers with branded products, which are usually priced higher than unbranded products. It competes with other Rent-to-Own providers, primarily on service.

RAC-Stores normally average sales of \$65,000 a month.

4.1.8 Customer Service

Customer service and satisfaction plays an important role in the rent-to-own industry. RAC offers same day or 24-hour delivery and installation of merchandise at no additional cost to the customer. The Company provides any required service or repair without additional charge, except for damage in excess of normal wear and tear. Repair services

are provided through a national network of 22 service centers, the cost of which may be reimbursed by the vendor if the item is still under factory warranty, passing the risk of product replacement or damage onto the vendors. If the product cannot be repaired at the customer's residence, a temporary replacement is provided while the product is being repaired. The customer is fully liable for damage, loss, or destruction of the merchandise, unless the customer purchases an optional loss/damage waiver. Most of the products offered by the stores are covered by a manufacturer's warranty for varying periods, which, subject to the terms of the warranty, is transferred to the customer in the event that the customer obtains ownership.

The RAC-Store managers have daily retail operational responsibility, which involves contact with customers. Customer service includes assisting customers purchasing decisions; processing orders, assist with product delivery in addition to taking payments from customers. The standards set for customer service are the responsibility of RAC-Management. Prompt, knowledgeable, and enthusiastic service fosters customer loyalty and can differentiate RAC from its competitors.

As mentioned earlier good customer service in the retail industry is very important to achieve repeat customers. Providing good customer service is the responsibility of RAC-Stores, but it is ultimately the responsibility of RAC-Management to ensure that this is being achieved. And to build these qualities into the Company's training programs.

4.1.9 Management Information System

RAC-Management has a licensing agreement with High Touch, Inc., which provides the integrated computerized management information and control system used by the stores. Each store is equipped with a computer system utilizing point of sale ("POS") software. This system tracks individual components of revenue, each item in idle and rented inventory, total items on rent, delinquent accounts and other account information.

An activity report is generated daily, which is used by RAC-Management to analyze the operating and financial information of all its stores. Any unusual reporting is normally addressed the next business day.

In a retail environment, information technology is considered a value driver. Software such as a POS system can provide valuable information as it can be used to analyze product and customer demand changes and inventory replenishment requirements. Valuable information facilitates correct decision-making and forecasting and thus can be a source of competitive advantage. Therefore, as RAC-Management owns the license agreement any risk associated with investing in the wrong MIS lies with RAC-Management.

RAC's MIS is integrated with RAC's accounting system, which was developed by Lawson Software, Inc. This system facilitates the production of financial statements, which are distributed monthly by RAC-Management to all stores, markets, regions and the executive management team for their review.

4.1.10 Training

Training includes the development of training material, the distribution of training material, along with conducting training sessions.

RAC-Management has developed a sophisticated three-stage training model, which requires each staff to review the self-study training manuals and videos. As the Company has a general policy of recruiting from within the Company, through for example, internal promotions, these training programs are aimed at developing staff at various stages of their progress within the Company. Furthermore, these training sessions are run by internal staff, who are able to share their experience with others and have hands-on experience of how RAC operates.

The training program covers an initial two-week program addressing basic issues. This involves learning how new customers are added to the MIS system, how their accounts are set-up and how RAC manages its customer service and customer payment process. The intermediate training program focuses on other areas of the business, such as internal controls and use of computer reports. The final stage teaches account management and understanding further RAC operational issues.

The following areas are covered in the training manuals; expectation of RAC customers and customer relations, rental payments, rental selling, taking rental orders, closing the rental agreement (e.g., what information to collect from customers), vehicle safety, product delivery, product service; and account management. At the successful completion of the self-study program the Market Manager awards the staff with a certificate.

4.1.11 Franchising

ColorTyme, is RAC's nationwide franchiser of rent-to-own stores. These rent-to-own stores offer high quality durable products such as home electronics, appliances, computers, and furniture and accessories. By December 2001, ColorTyme operated 342 franchises. All but twelve of the ColorTyme franchised stores use ColorTyme's tradenames, service marks, trademarks, logos, emblems, and indicia of origin. These twelve stores are franchises acquired in the Thorn Americas acquisition and continue to use the Rent-A-Center name. All stores operate under distinctive operating procedures and standards. ColorTyme's primary source of revenue is the sale of rental merchandise to its franchisees, the franchisees in turn, offer the merchandise to the general public for rent or purchase under a rent-to-own program. As franchiser, ColorTyme receives royalties of two percent to four percent of the franchisees' monthly gross revenue and, generally, an initial fee of between \$7,500 per location for existing franchisees and up to \$25,000 per location for new franchisees.

The ColorTyme franchise agreement generally requires the franchised stores to utilize specific computer hardware and software for the purpose of recording rentals, sales and other record keeping and central functions. ColorTyme retains the right to upload and

download data, troubleshoot, and retrieve data and information from the franchised stores' computer systems.

4.1.12 Strategic Management

As mentioned earlier, RAC's growth strategy is through the acquisition of other rent-to-own stores. When RAC acquires a rent-to-own store, on average the store is operating at gross revenue per rental agreement ("APU") of around \$75. In comparison, RAC-owned stores have an average APU of \$111. This measure provides a controlled experiment to document the value that RAC's strategic management services bring to the Company's profitability. For example, the 69 stores acquired by RAC in 2000 have seen an increase in APU of \$33 to \$108 APU in 2002. Similarly, the APU of the 83 stores acquired in 2001, has increased from \$75 to \$100, an annual increase of \$25. This highlights the significant value generated through the RAC trademark and RAC's strategic management experience.

4.2 Risk

4.2.1 Market Risk

Market risk is the risk associated with the changes in demand in the market place, along with incorrect prediction of these changes. It also includes the risk associated with increased competition.

RAC-Management determines the product mix and which products need to be continued or discontinued. RAC-Management has responsibility for predicting consumer changes and demands, and designing strategies to take advantage of opportunities or avoid the threats exposed by the market.

4.2.2 Credit Risk

Credit risk is the risk associated with bad debt collection, customer default in payment.

RAC promotes the absence of formal credit checks, however, the stores are required to adhere to the customer verification steps, as outlined in RAC-Management's guidance policies. These steps are used to verify a customer's identity and income and to approve the rental agreement.

RAC's customers typically pay weekly and when they are unable to make payments, RAC encourages its customers to return the merchandise to the stores and continue with the agreement when they are next able to make the payments. In the event, that a customer does not return the equipment and/or is not able to make the payments, any legal proceedings will be managed by RAC-Management. However, RAC-Management's bad debt amount is minimal, which is a result of RAC-Managements robust screening process.

4.2.3 Inventory Risk

Inventory risk is the risk associated with storing inventory, which includes risk of holding inventory at too high a level, product obsolescence, and damage of inventory.

The vendors deliver the products directly to the stores, where they are displayed on the shop-floor, thus the amount of inventory is controlled by the store space, which reduces warehousing cost and also the chances of damage to the inventory. The risk of product obsolescence lies with RAC-Management, as it is responsible for determining the product mix.

4.2.4 Training Risk

RAC-Management's success is heavily influenced by the quality of service it provides to its customers. The standards set by RAC-Management are communicated to the staff through training sessions. Thus any risk of inefficient training material, training sessions and the intellectual property associated with developing these training is borne by RAC-Management.

4.3 Assets

4.3.1 Intangible Assets

Intangible assets include any non-financial assets developed or owned by a company, which includes internal know-how, trademarks, bank, supplier or customer relations. These assets can be of significant value to a company and can have a direct impact on the profitability and success of the firm.

The "Rent-A-Center" name is a recognized name and plays a key role in distinguishing itself from its competitors. This is extremely important in the rent-to-own industry where competitive advantage is gained through customer service rather than pricing. Thus, the Company relies heavily on positive trademark recognition as unsuccessful advertising promotions can significantly impact the Company's product demand. RAC West owns the group's trademark. RAC-Management is responsible for developing advertising and marketing strategies to create, maintain and expand the brand name for the Company. Other intellectual property, such as strategic management plans, know-how related to customer service, computer systems and software are owned by RAC-Management.

Table 4.1 below summarizes the functions, risk and assets as they are distributed within the Company.

TABLE 4.1: Summary of RAC Function, Risk and Assets

FUNCTIONS	RAC-Management	RAC-Stores	RAC West
Strategic Planning	X		
Accounting and Controllershship	X		
Purchasing and Merchandising	X		
Inbound Logistics		X	
Outbound Logistics		X	
Advertising and Marketing	X		
Pricing	X		
Customer Service	X	X	
Management Information System	X		
Training	X		
Franchise	X		
Strategic Management	X		
Risks			
Market	X		
Credit	X		
Inventory	X		
Training	X		
Assets			
Trademark			X
Other Intellectual Property	X		

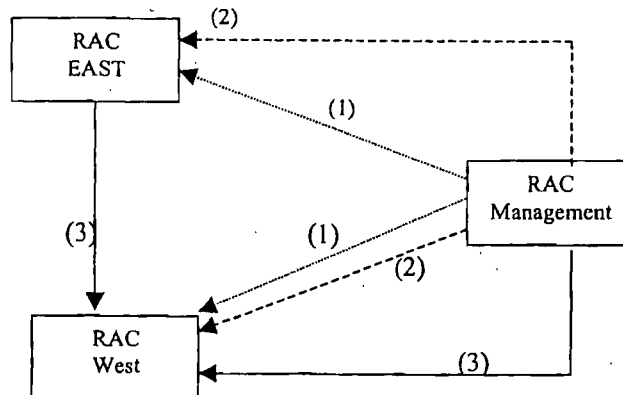
The table above highlights the fact that after the reorganization, RAC West, will become the owner and steward of the trademark and RAC-Management will conduct strategic management responsibilities, such as developing training material, legal, advertising and marketing, etc., with RAC-Stores performing routine retail functions. RAC West owns the group's trademark, for which it should earn a royalty from RAC East and RAC-Management.

This reorganization, by centralizing all the value added functions, will shift a significant amount of risk to RAC-Management. Thus, after compensating RAC-Stores for operating the retail stores and paying a royalty to RAC West for the use of the trademark, RAC-Management will retain any residual profit. In other words, RAC-Stores will earn a guaranteed return for its routine functions, irrespective of market conditions. RAC-Management's profits, due to its role as the principal risk taker, will be completely dependent upon market conditions and the success of its operations.

4.4 Summary of Inter-Company Transactions

Figure 4.1 below illustrates the inter-company transactions that are considered in this report.

Figure 4.1 : RAC's Intercompany Transactions



- (1) Management Services
- (2) Cost plus markup for retail function
- (3) Trademark Royalty

5. U.S. TRANSFER PRICING REGULATIONS

5.1 Introduction

The transfer pricing regulations supporting §482 were released by the Internal Revenue Service ("IRS") in July 1994 and were effective for tax years beginning after October 6, 1994. These regulations supersede a set finalized in 1968 and are the Treasury's implementation of statutory changes made under the Tax Reform Act of 1986.

The regulations are structured as follows:

- §1.482-1 Allocation of Income and Deductions
- §1.482-2 Determination of Taxable Income in Specific Situations
- §1.482-3 Tangible Property
- §1.482-4 Intangible Property
- §1.482-5 Comparable Profits Method
- §1.482-6 Profit Split Method
- §1.482-7 Cost Sharing
- §1.482-8 Examples

The remainder of this section will summarize key elements within the sections of the regulations that are relevant for this report.

5.2 The Arm's-Length Standard and the Best Method Rule

Under §482, related parties (i.e., under common control and therefore also referred to as "controlled") must trade at arm's length. In the U.S. regulations, as in those of other major nations, the term "arm's length" refers to the behavior that takes place in transactions between unrelated parties. The regulations, under the influence of the 1986 Act, put emphasis on the results (i.e., profits) that would have been obtained at arm's length under circumstances comparable to those of the controlled parties and establish the concept of an "arm's-length result."³ In short, imposition of the arm's-length standard is the way taxing authorities endeavor to create market conditions within a related group.

Taxpayers seeking to establish arm's-length results within the controlled group may choose from among a set of methodologies detailed in the regulations (the "specified methods") or, if the given procedures are not workable, taxpayers may apply some other means ("unspecified methods"). Selection of an arm's-length approach is guided by a set of steps collectively known as the "best method rule." The goal of the best method rule is to create the most reliable measure of an arm's-length result given the taxpayer's facts and available data. Although there is a preference in the regulations for methods employing direct evidence, no particular method is presumed (in advance of applying the

³ §1.482-1(b)(1).

best method rule) to be more inherently reliable than any other. There is also no requirement in the regulations to disprove the applicability of methods not chosen.⁴

A best method is selected by examining the degree of comparability between the controlled transactions under review and a set of uncontrolled transactions. In assessing comparability, the goal is to obtain the most reliable measure of arm's-length results in view of the controlled party's circumstances, the data at hand, and the assumptions necessary to employ the data.⁵ To determine if the comparability between controlled and uncontrolled transactions meets IRS standards, general factors to be considered for both the related-party transaction and the independent, potentially comparable one include:

- i. functions;
- ii. risks;
- iii. contractual terms;
- iv. economic conditions; and
- v. type of property or service.⁶

The regulations do not require that the controlled and uncontrolled transactions be identical along all five of these dimensions. The requirement is that they are sufficiently similar to make comparison possible; or that, if not, adjustments can be made to increase comparability; or that, in the case of irreconcilable differences, it can be demonstrated that the differences are not important under the circumstances at hand. In addition to these general comparability factors, there are others, addressed below, that are more particular to each specified method.

5.3 Applicable Methods for Transfers of Tangible Property

The §482 regulations offer five specific methods for establishing an arm's-length standard for transfers of tangible property: the Comparable Uncontrolled Price ("CUP") Method, the Resale Price Method ("RPM"), the Cost Plus Method ("CPLM"), the Comparable Profits Method ("CPM"), the Profit Split Method ("PSM").⁷ In addition to these methods, unspecified methods are available where alternatives are relatively unreliable. Each of these methods must be applied in accordance with the provisions of §1.482-1, including those provisions regarding selection of the best method, the comparability analysis, and the construction of the arm's-length range.

⁴ §1.482-1(c)(1). However, regulations offering taxpayers safe harbor exclusion from transfer pricing-related valuation misstatement penalties (under §6662(e)) require that there be included among the taxpayer's principal documents a "description of the alternative methods that were considered and an explanation of why they were not selected." §1.6662-6(d)(2)(iii).

⁵ §1.482-1(c)(2). "Accuracy" was the goal of earlier, temporary regulations. The final regulations effectively admit that requiring accuracy puts too great a burden on the rough means normally available for making arm's-length comparisons.

⁶ §1.482-1(d)(1).

⁷ These methods are described in §1.482-3(b), (c) and (d); §1.482-5; and §1.482-6.

CUP

The CUP Method looks to comparable uncontrolled transactions to estimate an arm's-length price. Such uncontrolled transactions might be observed between a controlled seller and an uncontrolled buyer, between an uncontrolled seller and a controlled buyer, or between an uncontrolled seller and an uncontrolled buyer. CUPs will usually provide the most reliable measure of arm's-length result if there are no differences between the controlled and uncontrolled transactions that would affect the price, or if there are only minor differences for which adjustments can be made. The CUP Method may be used when adjustments cannot be made, or when the differences between the controlled and uncontrolled transactions are more than minor, but the reliability of the method is reduced. Differences in products (similarity, quality, etc.), contractual terms (warranty, volume, terms, etc.), economic conditions (market level and size, geographic market, alternatives available, etc.), and intangible property associated with the sale reduce reliability of the CUP Method.⁸

RPM

The RPM looks to uncontrolled gross profit margin data to estimate an arm's-length price. The uncontrolled gross profit margin is simply gross profit divided by net sales. The arm's-length price is arrived at by multiplying the resale price by one minus the arm's-length gross profit margin. The RPM is most reliable where the reseller adds little value to the property through the use of tangible or intangible property. As with the CUP Method, the presence of uncontrolled transactions and a range of uncontrolled gross profit margins do not necessarily guarantee the RPM is the best method because differences between uncontrolled and controlled transactions may influence their gross profit margin percentages. Unless one can adjust with reasonable accuracy the uncontrolled financial information for these differences, the RPM may not be the most reliable method for a transfer pricing analysis. In applying the RPM, similarity of functions and contractual terms between the taxpayer and similar companies are relatively important, while similarity of products is less so.

CPLM

The CPLM looks to uncontrolled gross cost-plus markup data to estimate an arm's-length price. The uncontrolled gross cost-plus markup is defined as gross profit divided by cost of sales. The arm's-length price is estimated as the sum of cost of sales and marked-up cost of sales (cost of sales times one plus the arm's-length gross cost-plus markup). As with the CUP Method and the RPM, the presence of uncontrolled transactions and a range of gross cost-plus markups do not necessarily guarantee the CPLM is the best method because differences between uncontrolled and controlled transactions may influence their gross cost-plus markup percentages. Unless one can adjust with reasonable accuracy the uncontrolled financial information for these differences, the

⁸ The relevance of differences between controlled and uncontrolled information varies with methods. For example, product similarity is very important in application of the CUP Method and less important in application of the RPM.

CPLM may not be the most reliable method for a transfer pricing analysis. In applying the CPLM, similarity of product categories, trade name and trademark, plant and equipment cost structures, manufacturing and assembly complexity, engineering and testing responsibilities, research and development ("R&D") responsibilities, and operating expenses are important. This method is typically used for manufacturers and others that add significant value to their purchased inputs.

CPM

The CPM looks to uncontrolled profit data to estimate arm's-length compensation. Various profit level indicators ("PLI") are available including operating profit relative to sales and operating profit relative to assets. Generally, three years of financial data, including the tax year in question, are collected for similar firms. PLIs are calculated for each firm for each year of data; moreover, for each PLI, a three-year average is calculated for each similar company. A range is formed for each PLI that becomes the basis of identifying the arm's-length range and estimating the taxpayer's arm's-length profitability. As with other methods discussed above, the availability of raw financial data to calculate PLIs does not necessarily guarantee the CPM is the best method because differences between uncontrolled and controlled transactions may influence the PLIs. Unless one can adjust with reasonable accuracy the uncontrolled and/or controlled financial information for these differences, the CPM may not be the most reliable method for a transfer pricing analysis. In applying the CPM, similarity of plant and equipment cost structures is relatively important.

PSM

The PSM looks to each party's contributions to overall operating profit or loss as the basis to divide overall operating profit or loss. Two profit split approaches are available. The Comparable Profit Split Method ("CPSM") uses uncontrolled profit data to allocate a taxpayer's integrated operating profit or loss. Comparability criteria for this method are similar to those of the CPM. As a practical matter, identifying two (or more) uncontrolled parties similar to the two (or more) controlled taxpayers is a substantial hurdle. Necessary uncontrolled operating profit split data are generally unavailable because such data are generally consolidated over product lines, vendors (cost of sales), and customers (sales), making identification of contributors to operating profit nearly impossible. In addition, based on the comparability and best method rules discussions above, identifying similar firms for one affiliate of an integrated operation is difficult and identifying similar firms for two or (more) affiliates of an integrated operation is even more difficult.⁹

The Residual Profit Split Method uses a two-step process in allocating integrated operating profit or loss. Step one allocates operating profit (from the overall operating profit) to each target affiliate for their "routine contributions." This step may involve using another method (such as CPM) to identify such operating profit. Step two allocates

⁹ Typically, use of CUP, RPM, CPLM, and CPM involves analysis of one "tested party." The CPS Method involves two or more "tested parties."

the residual of overall operating profit to affiliates based on their contributions to profit. Contributions may be estimated by reference to the relative value of intangibles produced or the relative cost of intangibles produced. The reliability of this method is critically linked to reliability of data and assumptions made.

5.4 Applicable Methods for Transfers of Intangible Property

The regulations set forth three specified methods for examining the arm's-length nature of the intercompany use of intangible property: the Comparable Uncontrolled Transactions ("CUT") Method, the CPM, and the PSM. The CPM and PSM are as described above.

CUT

The CUT Method determines an arm's-length charge for the intercompany use of intangible property based upon the charges in comparable uncontrolled transactions. A CUT is considered to provide the most direct and reliable evidence of an arm's-length result if it involves the transfer of the same intangible under the same, or substantially the same, circumstances. If these conditions are not met, a CUT involving comparable intangible property transferred under comparable circumstances may still be used, but there is no longer a presumption that the CUT Method is the most reliable method. For two intangibles to be considered comparable, the regulations require that they be used in connection with similar products or processes within the same industry or market and that they have a similar profit potential associated with their use. Comparability also depends on similarity with respect to the contractual terms and the economic conditions under which the transfers of the intangibles take place.¹⁰

¹⁰ §1.482-4(c)(2)(iii).

6. SELECTION OF THE BEST METHOD FOR BENCHMARKING RETAILERS

The CPM was considered the best method for evaluating the transfer price for the services provided by RAC-Management to RAC-Stores. The reason for this is explained below, along with reasons for rejecting other methods.

CUP

The CUP Method looks to comparable uncontrolled transactions to estimate an arm's-length price. Such uncontrolled transactions might be observed between the controlled seller and an uncontrolled buyer, between an uncontrolled seller and the controlled buyer, or between an uncontrolled seller and an uncontrolled buyer. The presence of such transactions does not necessarily guarantee the CUP Method is usable because differences between uncontrolled and controlled transactions may influence their respective prices.

A small proportion of RAC-Stores are franchised. However, these were ruled out as comparable as the risk profile of the franchisees is not comparable to RAC-Stores. The franchise owner owns the retail outlets whereas RAC-Stores are owned by RAC-Management. The franchisee has responsibility for advertising and marketing and for promoting its own store. In comparison if a RAC store is not successful, RAC-Management would provide additional marketing and/or strategic management services to the store. Therefore, the franchisee bears a higher element of risk than RAC owned stores. For the CUP method to be applicable, the terms and conditions of the franchises and RAC-Store need to be comparable, which is not the case. KPMG eliminated the CUP as an applicable method since no comparable uncontrolled transactions are available.

CPLM

The CPLM looks to uncontrolled gross profit markup to estimate an arm's-length price, typically for a manufacturer. RAC is not a manufacturer nor does it provide additional manufacturing services, which add value to the product when it comes into inventory. Unrelated suppliers perform all of the manufacturing, assembly, and packaging services. Since the transaction at issue will not involve manufacturing, KPMG eliminated the CPLM as an applicable method.

RPM

The RPM is ordinarily used in cases involving the purchase and resale of tangible property in which the reseller has not added substantial value to the tangible goods by physically altering the goods before resale.¹¹ Similar to the CPLM, the RPM requires accurate allocation of indirect costs between the relevant business activity and the controlled taxpayer's other activities, which may affect the reliability of the analysis. In addition, the RPM requires a high degree of comparability between the taxpayer and the

¹¹ § 1.482-3(c)(1)

comparable firms in relation to the nature and level of operating expenses. The inter-company transaction between the tested parties is one of strategic management services provided by RAC-Management to RAC-Stores, thus the RPM is not an appropriate transfer pricing method in this instance.

PSM

The PSM may be used if both parties to a related-party transaction contributed to the combined operating profit (or loss) of that transaction. The PSM is normally used when both parties to a transaction contribute to the creation of intangible assets. KPMG rejected this method since RAC-Stores will simply provide the retailing functions of the products and will not house any intangible assets.

CPM

The CPM compares the operating profit of the tested party with that of similar companies that operate on an arm's-length basis. From an economic standpoint, operating profit represents a return for the investment of resources and assumption of risks. Therefore, comparability under this method is particularly dependent on resources employed and risks assumed.

The regulations identify the following acceptable measures of profitability:

- the ratio of operating profit to sales, or operating margin
- the ratio of gross profit to operating expenses, or the Berry ratio
- the ratio of operating profit to capital employed, or return on operating assets

Other profit level indicators may be used if they provide reliable measures of the income that the tested party would have earned had it dealt with controlled taxpayers at arm's length.¹²

Method Selection

KPMG selected the CPM for analyzing the provision of the retail services by RAC-Stores since it provides the most direct and reliable measure of arm's-length compensation, in the absence of reliable CUP or internal cost plus information. Comparability under both the CPLM and RPM is particularly dependent on similarity of functions performed, risks borne, and contractual terms. While functional comparability is important when considering using the CPM, "...The degree of functional comparability required to obtain a reliable result ... is generally less than that required under the resale price or cost plus methods. For example, because differences in functions performed are often reflected in operating expenses, taxpayers performing different functions may have very different gross profit margins but earn similar levels of operating profit".¹³ Because the set of

¹² § 1.482-5(b)(4)(iii).

¹³ § 1.482-5(c)(2)(ii).

broadly comparable companies includes only imperfect comparables, KPMG selected the CPM as the most reliable method available to evaluate the proposed transaction.

7. SEARCH FOR BROADLY COMPARABLE RETAIL COMPANIES

Under the CPM, the range of operating profitability that a set of independent, broadly comparable companies achieve forms the basis for a financial comparison to the operating profitability that the tested party achieves. By comparing the tested party's operating profitability to an estimated arm's-length range as measured by the financial results of the independent, broadly comparable companies, the analyst can draw conclusions regarding the arm's-length nature of the intercompany transactions in which the tested party engaged. This section summarizes the search process used to identify independent firms that provide services broadly comparable to RAC-Stores, in terms of their functions, markets, and risks.

As the aim of the search is to reward the tested party, RAC-Stores for its basic retail function; KPMG carried out a search for all retailers under the SIC 57 (Retailers of electrical appliance, furniture). This search strategy generated only six comparables, so KPMG decided to expand the search to include retailers of other products such as clothes, jewelry, shoes; with an aim to achieve functional comparability as it was not possible to achieve product and function comparability within a single search.

7.1 Selection of Standard Industrial Classification Codes

The standard procedure for beginning a search for comparable firms relies on Standard Industrial Classification ("SIC") codes to identify companies that are comparable to the tested party, in terms of functions performed and risks borne. SIC codes are numerical classifications of companies by industry. Each SIC code contains a brief industry description of the type of company included in the classification. KPMG utilized three electronic databases – Standard and Poor's Compustat, Compact Disclosure, and Mergent Company Data – to identify potentially comparable firms. These databases contain financial information and business descriptions on thousands of active U.S. companies, categorized by SIC code.

To identify companies that perform retail functions similar to RAC-Stores, KPMG searched the three databases for companies that provide these services in SIC codes 57x (Home Furniture, Furnishings, And Equipment Stores), 5311 (Department Stores), 5331 (Variety Stores), 5399 (Miscellaneous General Merchandise Stores), 56 (Apparel And Accessory Stores), 5941 (Sports Goods and Bicycle), 5948 (Luggage and leather Goods) and 5999 (Retail not elsewhere). This yielded 257 unique, potentially broadly comparable firms. KPMG then performed a series of quantitative and qualitative tests on these firms to eliminate those that perform different functions, bear different risks, or serve different markets from RAC-Stores.

This search was limited to North American companies to ensure that economic factors affecting the companies were similar to those that will be faced by RAC-Stores. Economic factors tend to vary in different geographic markets. In addition, financial accounting and reporting standards can vary from country to country.

7.2 Quantitative Screening

Quantitative screens were applied to each of the potential comparable companies. Such screening is useful because certain quantitative characteristics may identify companies possessing valuable intangible assets; performing more diverse, or unrelated operations; operating in different markets; or assuming different risks than RAC-Stores. In addition, companies had to perform retail activities broadly similar to those that are provided by RAC-Stores.

7.2.1 Insufficient Financial Data

KPMG eliminated companies lacking sufficient current financial data. Specifically, the search eliminated companies that did not have at least three consecutive years of net sales and whose most recently reported sales were prior to fiscal year 2001 ("FY01"). The use of multi-year data captures market cycles and reduces the likelihood that single year anomalies in financial results will distort the arm's-length range. These screens eliminated 45 companies, leaving 212 companies in the set.

7.2.2 Research and Development

KPMG then screened out companies with R&D to sales ratios greater than three percent. R&D spending generates technological or knowledge-based intangibles. Such expenditures do not necessarily lead to the development of successful products, but it is unlikely that many companies would sustain high levels of R&D expenditures without having achieved some technological success. Thus, the R&D screen is helpful in identifying firms with valuable intangible assets in the form of patents or general know-how. Ownership of such assets would be expected to have a material impact on the profitability of the company, which cannot be adjusted for in a reliable manner. Because RAC-Stores do not perform R&D, comparable companies should not have significant R&D expenses. Based on our experience and the functions performed by RAC-Stores, we determined that three percent is a reasonable point at which to eliminate potential comparable companies. Of the 212 companies remaining, we eliminated 10 that reported R&D to sales greater than three percent, leaving 202 companies in our set.

7.2.3 Advertising Expenditure

Our next screen was to eliminate companies with advertising expenses to sales ratio greater than three percent. Significant advertising is likely to create intangible assets such as brand equity. Ownership of these intangibles would be expected to have a material impact on the profitability of these companies, for which reliable adjustments could not be made. Eighty-one companies in our set reported advertising expenses to sales greater than three percent, leaving 121 for further review.

7.3 Qualitative Screening

KPMG then began a qualitative analysis of the remaining firms. This step entails reading the business descriptions provided in the databases to screen out companies that had

unrelated operations, performed different functions, bore different risks, or served different markets than RAC-Stores. This review led to the elimination of 102 companies for qualitative reasons, leaving 19 independent, broadly comparable companies in the final set. KPMG believes that the companies, shown in table 7.1 below, are the independent firms most likely to provide reliable data for setting an arm's-length range for RAC-Stores.

Table 7.1
Retail Comparable Firms

- 1 Burlington Coat Fact Whse
- 2 Charming Shoppes, Inc. (Unite
- 3 Elegant Illusions Inc.
- 4 Finish Line, Inc.
- 5 Footstar Inc.
- 6 Galyan's Trading Inc.
- 7 Gart Sports Co. (United State
- 8 Hastings Entertainment, Inc.
- 9 Hibbett Sporting Goods, Inc.
- 10 Hot Topic Inc.
- 11 Leslie S Poolmart Inc
- 12 Pacific Sunwear of CA Inc
- 13 Peebles Inc.
- 14 Shoe Pavilion, Inc.
- 15 TOO, Inc.
- 16 Trans World Entertainment Cor
- 17 Tweeter Home Entmt Group Inc
- 18 Ultimate Electronics
- 19 United Retail Group, Inc.

A complete audit trail for comparable companies can be found in Appendix 1.

7.4 Economic Adjustments: Accounts Receivable, Accounts Payable, and Inventory

The §482 regulations require that for an uncontrolled transaction to be considered comparable to a controlled transaction, it must be sufficiently similar and that it provides a reliable measure of an arm's-length result. If there are differences between the controlled and uncontrolled transactions that can be reduced or eliminated by adjusting the data, then adjustments must be made to improve the reliability of the results. These adjustments must be based on statistical analysis, economic principles, and contractual terms.

The analysis uses the return on total cost ("ROTC") of these companies to construct an arm's-length range of operating profitability, against which RAC-Stores' operating profitability can be compared. The ROTC, defined as ratio of pre-tax, pre-interest, pre-extraordinary items operating profit to total costs, was chosen as the most reliable measure of RAC-Stores' profitability. Total costs include expenses reported under cost of goods sold and operating expenses.

KPMG believes that the ROTC provides an appropriate indicator of arm's-length profitability, since the return to RAC-Store for providing retail services will be driven by the associated costs of providing those services.

To enhance the profit comparability of the set of comparable companies and RAC-Stores, the profitability of the comparable companies was adjusted to reflect the same level of financing activity as would be reflected in RAC-Stores' accounts receivable and payable balances, and inventory levels. The adjustments were based on the assumption that RAC-Stores have zero accounts receivable, payable and inventory as RAC-Stores do not take ownership of inventory but only accept the delivery of the products, moving all the inventory risk to RAC-Management. Appendix 4 presents a short description of the accounts payable, accounts receivable and inventory adjustments applied to the comparable firms' financial data.

7.5 Determination of Arm's-Length Compensation

KPMG calculated the three-year period weighted average ("PWAVG") ROTC ratio for the comparable companies, as shown in the below table.

Table 7.2: Adjusted ROTC for Broadly Comparable Retailer

Company	Adjusted ROTC
Burlington Coat Fact	2.40%
Charming Shoppes, Inc	3.20%
Elegant Illusions Inc.	1.00%
Finish Line, Inc.	2.50%
Footstar Inc.	6.60%
Galyan's Trading Inc.	4.30%
Gart Sports Co.	2.30%
Hastings Entertainment, Inc.	-0.50%
Hibbett Sporting Goods, Inc.	7.00%
Hot Topic Inc.	14.50%
Leslie S Poolmart Inc	3.00%
Pacific Sunwear of CA Inc	10.20%
Peebles Inc.	7.50%
Shoe Pavilion, Inc.	1.60%
TOO, Inc.	10.90%
Trans World Entertainment Corp	5.60%
Tweeter Home Entmt Group Inc	4.50%
Ultimate Electronics	3.30%
United Retail Group, Inc	1.70%
Interquartile Range	
25th Percentile	2.30%
50th Percentile	3.30%
75th Percentile	7.00%

As shown in Table 7.2, the arm's-length range of adjusted average ROTC values for the broadly comparable firms is between 2.3 percent and 7.0 percent, with a median of 3.3 percent. This implies that the RAC operating units should earn an ROTC between 2.3 percent and 7.0 percent after paying intercompany royalties for the routine functions they perform. For planning purposes, KPMG recommends using the median value to calculate the appropriate return.

8. DETERMINATION OF TRADEMARK ROYALTY

In determining an arm's-length range of appropriate royalty rates due to RAC West from RAC-Management and RAC East, KPMG relied on the guidance provided by §1.482-4 regulations. Section 5 of this report detailed the three primary methods to be used in determining an arm's-length charge for the intercompany use of intangible property. These methods were the CUT, CPM, and PSM.

KPMG gathered information during interviews with Company personnel and reviewed publicly available financial information regarding RAC. The royalty charged by ColorTyme (a subsidiary of RAC) can be considered a potential CUT to benchmark the royalty rate to be paid to RAC West by its related parties, for the following reasons:

- The circumstances under which the transaction takes place is similar in both cases. The inter-company transaction between RAC West and RAC-Management, and RAC West and RAC East involves the use of a trademark. Similarly ColorTyme gives its franchisees the right to use its trademark.
- The tested party and the comparable company are in the same line of business (rental business), and thus are impacted by similar economic risk.
- In the case of the tested party and comparable company, the trademarks are for similar products and within the same industry and market and thus have similar profit potential.

Based on the above analysis an arm's-length royalty charge for RAC trademarks would be in the range of two percent to four percent of gross revenue. KPMG did not search for external benchmarks as an internal CUT was available.

9. CONCLUSION

The purpose of this report was to determine the intercompany pricing that should be adopted by RAC for its intercompany transactions. The following facts highlight the results of the information gathered and analyzed:

- The functions performed by RAC-Stores are similar to a limited risk retailer.
- The CPM was considered the best method for determining the level of return that RAC-Management should guarantee RAC-Stores for operating the retail outlets.
- KPMG identified 19 retail companies to determine the arm's-length range for RAC-Stores. The profit level indicator used in this study is the ROTC defined as the ratio of pre-tax, pre-interest, pre-extraordinary item operating profit divided by total costs (cost of sales and operating expenses). This analysis eliminated retailers with significant intangibles as the purpose of this analysis is to determine arm's-length compensation for RAC-Store for the core retailing activities it performs.
- The CPM analysis determined that an arm's-length range of ROTC for routine retail functions would be between 2.3 percent and 7.0 percent with a median of 3.3 percent.
- RAC West owns the RAC trademark for which it should receive a royalty from the licensing companies, RAC-Management and RAC East.
- KPMG assessed that the transaction between ColorTyme and its franchisees can be considered an internal CUT. ColorTyme charges its franchisees a royalty based on gross monthly sales in the range of two percent to four percent for the use of the ColorTyme trademark.

As RAC-Store acts as a limited risk retailer, performing low risk functions, KPMG recommends that RAC-Management reward RAC-Stores a markup on their expenses (costs of goods sold and operating expenses), which falls at the lower end of the arm's-length range. Based on the economic analyses performed by KPMG, KPMG suggests that RAC-Management guarantee RAC-Stores a markup in the range of 2.3 percent and 7.0 percent after they pay any intercompany royalties, with all residual profits rewarded to RAC-Management.

With regard to the trademark royalty, KPMG suggests that a royalty rate in the range of two percent to four percent would be considered at arm's length.

KPMG recommends that RAC update this study periodically to ensure that the Company's intercompany transactions continue to be priced on an arm's-length basis.

The opinions expressed above are rendered only with respect to the specific matters discussed herein, and KPMG expresses no opinion with respect to any other federal or state income tax or legal aspect. If any of the above-stated facts, circumstances, or assumptions is not entirely complete or accurate, it is imperative that KPMG be informed

immediately, as the inaccuracy or incompleteness could have a material effect on the conclusions. In rendering this opinion, KPMG is relying upon the relevant provisions of the IRC of 1986, as amended, the regulations thereunder, and judicial and administrative interpretations thereof, which are subject to change and or modification by subsequent legislative, regulatory, administrative, or judicial decisions. Any such changes could also have an effect on the validity of KPMG's opinion. The opinions contained herein are not binding upon the IRS, any other tax authority or any court, and no assurance can be given that a position contrary to that expressed herein will not be asserted by a tax authority and ultimately sustained by a court.

**APPENDIX 1: AUDIT TRAIL OF SEARCH FOR COMPARABLE RETAIL
COMPANIES**

Primary SIC Codes: 5999, 5948, 5941, 56x, 5399, 5331, 5311, 57x

Databases
Interpreter

Disk Date
Dec-02

of Companies
257

Firms Eliminated Due to Insufficient Years of Available Sales Data

1. 24Holdings Inc (United State
2. Aeropostale (United States)
3. Affordable Telecommunications Tech Corp
4. Airbomb.com Inc. (New) (Unite
5. American Resources & Developm
6. BAKERS FOOTWEAR GROUP -REDH
7. Bobby Allison Wireless Corp.
8. BUCK A DAY CO INC
9. Buy Com Inc
10. DAIEI INC -ADR
11. Designer & Decorator House Inc
12. Dickie Walker Marine, Inc. (U
13. DIXONS GROUP PLC -ADR
14. Donna Karan International Inc
15. Duckwall-Alco Stores, Inc.
16. Egghead Com Inc
17. eNucleus Inc. (United States)
18. Fred Meyer Inc New
19. Heilig-Meyers Co.
20. House2Home, Inc.
21. Intimate Brands Inc
22. IRON AGE HOLDINGS CORP
23. Kirkland's Inc (United States
24. LECHTERS INC
25. LIMITED INC-PROFORMA
26. Loehmann's Inc.
27. MKR Holding (Canada)
28. MTS INC
29. National Record Mart, Inc.
30. NETMAXIMIZER.COM INC
31. Oshman S Sporting Goods Inc
32. OurPet's Company
33. Palm Desert Art, Inc.
34. PAUL HARRIS STORES
35. Petrie Stores Liquidating Tr.
36. R Tec Technologies Inc
37. Security Intelligence Technologies Inc
38. Slabsdirect Com Inc
39. Sound Advice Inc
40. Sportsend Inc
41. Stage Stores Inc Nv
42. Track 'N Trail, Inc.
43. Weiner S Stores Inc
44. Wickliffe International Corp
45. World Wide Web Inc

Firms Eliminated Due to R&D/Sales Greater than 3 Percent

1. AbleAuctions.com, Inc.
2. barnesandnoble.com, inc.
3. BigStar Entertainment, Inc.
4. Cyberian Outpost Inc
5. HOUSEHOLD DIRECT INC
6. Medical International Technology Inc New
7. MM Companies, Inc.
8. MotherNature.com Inc
9. Pets Com Inc
10. Sames Corp

Firms Eliminated Due to Advertising/Sales Greater than 3 Percent

1. American Eagle Outfitters, In
2. Ames Department Stores, Inc.
3. Appliance Recycling Ctrs Amer
4. BARBEQUES GALORE LTD -ADR
5. Bebe Stores Inc (United State
6. BIG 5 CORP
7. Big 5 Sporting Goods Corp (Un
8. Bluefly Inc.
9. Bombay Co., Inc. (The)
10. Bon-Ton Stores, Inc. (The) (U
11. BRADLEES INC
12. Brookstone, Inc.
13. Brown Shoe Co., Inc. (United
14. Casual Male Corp (MA)
15. CD Warehouse Inc.
16. Chico's FAS, Inc. (United Sta
17. Circuit City Group
18. CIRCUIT CITY STORES -CONSOL
19. Cost Plus, Inc. (CA) (United
20. dELIA's Corp.
21. Elder-Beerman Stores Corp.
22. Esynch Corp. (United States)
23. F A O Inc
24. Factory 2-U Stores, Inc.
25. Fashionmall.com, Inc.
26. Federated Department Stores,
27. FLOORING AMERICA INC
28. Fragrancenet.com Inc
29. Genesco Inc. (United States)
30. Good Guys, Inc.
31. Goodys Family Clothing, Inc.
32. Gottschalks, Inc.
33. GUESS ?, Inc.
34. Guitar Center Inc.
35. Harold's Stores, Inc.
36. Haverty Furniture Cos., Inc.
37. HBOA HOLDINGS INC
38. HearUSA, Inc
39. InterTan Inc.
40. Jacobson Stores Inc.
41. Jennifer Convertibles, Inc.
42. K-Tel International, Inc.
43. Kohl's Corp.

44. Loehmann's Holdings, Inc.
45. MATTRESS DISCOUNTERS CORP
46. May Department Stores Co
47. Men's Wearhouse, Inc (The)
48. Michaels Stores, Inc.
49. Neiman-Marcus Group, Inc.
50. Oshkosh B & Gosh, Inc.
51. Overstock.com Inc. (DE) (Unit
52. PAPER WAREHOUSE INC
53. Party City Corp. (United Stat
54. Payless Shoesource Inc. (DE)
55. Penney (J.C.) Co., Inc. (Holdi
56. Pier 1 Imports, Inc
57. Programmer's Paradise Inc.
58. RadioShack Corp.
59. Rag Shops, Inc.
60. Restoration Hardware, Inc. (D
61. Rex Stores Corp.
62. S & K Famous Brands, Inc. (Un
63. Saks, Inc. (United States)
64. Sears, Roebuck & Co.
65. SERVICE MERCHANDISE CO
66. Shoe Carnival, Inc. (United S
67. SK TELECOM LTD -ADR
68. SONUS CORP
69. Sports Entertainment Enterpri
70. Stage Stores Inc.
71. Stein Mart, Inc.
72. STEREOSCAPE.COM INC
73. Stride Rite Corp.
74. Syms Corp.
75. Talbots, Inc.
76. The Gap, Inc.
77. TIGER TELEMATICS INC
78. Today's Man, Inc.
79. Tuesday Morning Corp. (United
80. Value America Inc
81. Value City Department Stores,

Firms Eliminated Due to Qualitative Reasons

- | | | |
|-----|-------------------------------|-------------------------|
| 1. | 99 Cents Only Stores | Different Market |
| 2. | A.C. Moore Arts & Crafts, Inc | Different Market |
| 3. | Abercrombie & Fitch Co. | Significant intangibles |
| 4. | Allou Health Care Inc | Different Market |
| 5. | Alloy Inc | Marketing services |
| 6. | Ann Taylor Stores Corp. | Significant intangibles |
| 7. | Anntaylor Inc | Significant intangibles |
| 8. | Aramark Corp. (New) | Different Market |
| 9. | Barneys New York Inc | Significant intangibles |
| 10. | Bed, Bath & Beyond, Inc. | Significant intangibles |
| 11. | BELK INC | Significant intangibles |
| 12. | Best Buy Co., Inc. | Significant intangibles |
| 13. | Big Dog Holdings, Inc. (Unite | Significant intangibles |
| 14. | Big Lots, Inc. (United States | Different Market |
| 15. | BJ's Wholesale Club, Inc. | Significant intangibles |
| 16. | Buckle, Inc. (The) | Significant intangibles |

17.	Cache, Inc.	Significant intangibles
18.	Canterbury Consulting Group I	Consulting Services
19.	Cash America Intl., Inc.	Different Market
20.	Casual Male Retail Group Inc	Significant intangibles
21.	Cato Corp.	Significant intangibles
22.	Charlotte Russe Holding Inc	Significant intangibles
23.	Children's Place Retail Store	Designs and manufactures cloths
24.	Christopher & Banks Corp.	Significant intangibles
25.	CINRAM INTERNATIONAL INC	Man. and distr. pre-recorded DVDs
26.	Claire's Stores, Inc.	Significant intangibles
27.	COLE COMPUTER CORP	Different functions
28.	COLES MYER LTD -ADR	Foreign
29.	CONTROLADORA COMML MEX -GDR	Foreign
30.	Costco Wholesale Corp (New)	Significant intangibles
31.	Cost-U-Less, Inc. (United Sta	Different Market
32.	Daisytek International Corp.	Different functions
33.	DEB Shops Inc.	Significant intangibles
34.	Dillard's Inc.	Significant intangibles
35.	Disco Sa	Different Market
36.	Dollar General Corp. (TN)	Different Market
37.	Dollar Tree Stores Inc.	Different Market
38.	Dress Barn, Inc. (The)	Significant intangibles
39.	E Com Ventures Inc (United St	Different Market
40.	Eagle Food Centers, Inc. (Uni	Different Market
41.	Edge Technology Group Inc.	Consulting Services
42.	Electronics Boutique Holdings	Operates internationally
43.	Family Dollar Stores	Significant intangibles
44.	Florsheim Group Inc.	Significant intangibles
45.	Foot Locker, Inc.	Significant intangibles
46.	Fred's Inc.	Different Market
47.	Fruit Of The Loom Ltd	Significant intangibles
48.	G & G RETAIL INC	Private company-No information available
49.	Gadzooks, Inc.	Significant intangibles
50.	Gallery of History, Inc.	Different Market
51.	Gamestop Corp. (United States	Significant intangibles
52.	Global Imaging Systems Inc	No retail
53.	GRUPO ELEKTRA SA -ADR	Foreign
54.	GUCCI GROUP NV -ADR	Foreign
55.	Gymboree Corp.	Significant intangibles
56.	Harvey Electronics Inc.	Significant operating loses
57.	Internet Infinity, Inc. (Unit	No retail
58.	ITO YOKADO CO LTD -ADR	Foreign
59.	J CREW GROUP INC	Different Market
60.	J Jill Group, Inc (The) (Unit	Different functions
61.	Jo-Ann Stores, Inc. (United S	Significant intangibles
62.	Jos. A. Bank Clothiers, Inc.	Significant intangibles
63.	K Mart Corp.	Significant intangibles
64.	King Power Intl Group Ltd.	Foreign
65.	Limited Brands Inc. (United S	Significant intangibles
66.	Linens'n Things, Inc.	Significant intangibles
67.	LIQUIDATION WORLD INC	Different functions
68.	Mothers Work, Inc.	Designs and manufactures cloths
69.	Nordstrom, Inc.	Significant intangibles
70.	Nutek Inc	Different Market
71.	Odd Job Stores Inc	Significant operating loses
72.	One Price Clothing Stores	Different Market

73.	Peoplepc Inc	Different Market
74.	Pet Quarters Inc	Different functions
75.	PETCO ANIMAL SUPPLIES INC	Significant intangibles
76.	PETsMART, Inc. (United States	Significant intangibles
77.	Phillips-Van Heusen Corp.	Operates factory outlet stores
78.	PriceSmart Inc.	Significant intangibles
79.	Rawlings Sporting Goods Co	Significant intangibles
80.	Rock of Ages Corp. (DE)	Owns and operates cemeteries
81.	Ross Stores, Inc.	Significant intangibles
82.	SANTA ISABEL S A -SPON ADR	Foreign
83.	School Specialty, Inc.	Different functions
84.	Shopko Stores, Inc. (WI) (Uni	Significant intangibles
85.	Sport Chalet, Inc.	Different functions
86.	Sports Authority, Inc. (The)	Significant intangibles
87.	Star Gas Partners, L.P.	Home energy distributor
88.	TANGIBLE ASSET GALLERIES INC	Sells rare products and collectables
89.	Target Corp	Significant intangibles
90.	TJX Companies, Inc. (New)	Designs and manufactures cloths
91.	Urban Outfitters, Inc.	Significant intangibles
92.	Versatech Inc	Significant intangibles
93.	Video City, Inc. (United Stat	Going concern
94.	WAL MART DE MEXICO SA -ADR	Foreign
95.	Wal-Mart Stores, Inc.	Significant intangibles
96.	Warwick Valley Telephone Co.	Provides communication services
97.	Wet Seal, Inc. (The) (United	Significant intangibles
98.	WHEREHOUSE ENTMT INC	Private company-No information available
99.	Williams-Sonoma, Inc. (Unite	Significant intangibles
100.	Wilsons Leather Experts Inc.	Significant intangibles
101.	Winmark Corp (United States)	Significant intangibles
102.	Xynergy Corp (United States)	Different Market

Final Set

1.	Burlington Coat Fact Whse
2.	Charming Shoppes, Inc. (Unite
3.	Elegant Illusions Inc.
4.	Finish Line, Inc.
5.	Footstar Inc.
6.	Galyan's Trading Inc.
7.	Gart Sports Co. (United State
8.	Hastings Entertainment, Inc.
9.	Hibbett Sporting Goods, Inc.
10.	Hot Topic Inc.
11.	Leslie S Poolmart Inc
12.	Pacific Sunwear of CA Inc
13.	Peebles Inc.
14.	Shoe Pavilion, Inc.
15.	TOO, Inc.
16.	Trans World Entertainment Cor
17.	Tweeter Home Entmt Group Inc
18.	Ultimate Electronics
19.	United Retail Group, Inc.

APPENDIX 2: BUSINESS DESCRIPTIONS OF RETAIL COMPANIES

1. Burlington Coat Fact

Co. and its subsidiaries operate, through its Burlington Coat Factory division, a chain of department stores which provide current brand name merchandise for men, women and children at prices substantially below traditional full retail prices generally charged by other department and specialty stores. Co. provides customers a complete line of men, women and children's wear and accessories (such as handbags, belts, perfume, watches, etc.) as well as a linens (linens, bath shop items, gifts and luggage) department, a children's furniture department, and a shoe department. Co. has two major product categories, apparel and home products. The apparel category includes departments offering all clothing items for men, women and children and apparel accessories such as shoes, jewelry, perfumes and watches. The home products category includes departments offering linens, home furnishings, gifts, baby furniture and baby furnishings.

2. Charming Shoppes, Inc.

The group's principal activity is to operate a chain of retail specialty stores located throughout the continental United States. The group merchandises low- to moderate- and better-priced junior, misses, large-size and girls-size sportswear, dresses, coats, lingerie, accessories and casual footwear. The group operates 2,446 women's specialty apparel stores in 48 states under the brand names Lane Bryant, Fashion Bug, Fashion Bug Plus, Catherine's Plus Sizes and Modern Woman chain. The group stores sell both brand name merchandise and specially manufactured garments under one of the group's private labels.

3. Elegant Illusions Inc.

The group's principal activities are to own and operate retail copy jewelry business and fine art galleries. The group operates 19 retail copy jewelry stores, two fine jewelry stores and three fine art galleries and one reproduction art gallery. The copy jewelry stores sell copies of fine jewelry including rings, pendants, earrings, necklaces, bracelets, pearl enhancers and ear charms manufactured in 14 carat gold, sterling silver vermeil and gold bonded white metal. The fine jewelry stores sell fine jewelry including rings, pendants, earrings, necklaces, bracelets, manufactured in 10 carat, 12 carat and 14 carat gold and other precious metals set with precious and semi-precious stones and certain giftware items. The fine art gallery sells original oil paintings by contemporary Italian artists. The retail copy jewelry stores are located in Indiana, Louisiana, Michigan, Minnesota, Missouri, Nevada, Texas, U.S. Virgin Islands, Utah and Wisconsin.

4. Finish Line, Inc.

The group is a mall-based specialty retailer of brand name athletic, outdoor and lifestyle footwear, active wear and accessories in the United States. The group's store generally carries a large selection of men, women and children's athletic and lifestyle shoes, as well as a broad assortment of active wear and accessories. Brand names offered by the group include Nike, Adidas, Reebok, New Balance, and 1, K-Swiss, Timberland, Saucony and Skechers. At 4-May-2002, the group operated 449 stores in 43 states. Footwear accounted for 82 percent of fiscal 2002 revenues and active wear and accessories, 18 percent.

5. Footstar Inc.

The group's principal activity is to retail the branded athletic footwear and apparels. The group operates through two business segments: discount and family footwear segment (meldisco) and athletic footwear and apparel segment (footaction). Meldisco has operated licensed footwear departments in discount chains and sells a wide variety of family footwear, including men's, women's and children's dress, casual and athletic footwear, work shoes and slippers. Footaction consists of retail outlets specializing in the sale of branded athletic footwear and apparel and related accessories. The group acquired j. Baker, Inc. In 2001, Discount and family footwear accounted for 59 percent of 2001 revenues and athletic footwear and apparel, 41 percent.

6. Galyan's Trading Inc.

The company's principal activity is to provide a broad range of outdoor and athletic equipment, apparel, footwear and accessories and casual apparel and footwear through a chain of retail outlets. The company currently operates 28 stores in 14 states. Athletic equipment includes golf and racquet sports, team sports, fitness, health and exercise equipment and family recreation games. Athletic and casual apparel include running, training and aerobics apparel, khakis, jeans, sweaters and shorts, swimwear, licensed products and golf, tennis and team apparel. Footwear includes athletic shoes, casual footwear and hiking and hunting boots and footwear. Outdoor equipment includes camping, hunting and fishing equipment, winter sports equipment, water sports merchandise and bicycles and in-line skates. Outdoor apparel includes technical and fashion outerwear, hunting and fishing apparel, ski apparel and mountain outerwear, rainwear and work apparel.

7. Gart Sports Co.

The group's principal activity is the retail of sports goods. The group operates 179 stores in 25 states in the Midwest and western United States. The major product categories are hardline and softline sports goods. The hardline category includes skis, golf equipment, bicycles, exercise equipment and camping, hunting and fishing gear. The softline category consists of apparel, footwear and outerwear. The group sells the products under the trademarks and trade names such as gart sports, gart sports superstore, gart bros. Sporting Goods Company, Oshman's, Sportmart, Sniagrab, Sportscastle, Supersports Usa and alpine design. Hardline sports goods accounted for 52 percent of fiscal 2002 revenues and softline sports goods, 48 percent.

8. Hastings Entertainment, Inc.

The group's principal activity is to operate a chain of retail superstores in 21 states, primarily in the western and Midwestern United States. The stores sell books, music, software, periodicals, videocassette, video game and DVD products and also offer rentals of video games and videocassettes. As of 28-mar-2002, the group operates 141 superstores in small-to medium-sized markets in the United States. The group also operates a multimedia entertainment e-commerce web site, www.Gohastings.Com offering various entertainment products, gifts and toys. The group operates through three subsidiaries: Hastings properties, inc., Hastings Internet Inc. And Hastings College stores, inc. Retail stores accounted for 100 percent of 2001 revenues and Internet operations, nom.

9. Hibbett Sporting Goods, Inc.

The group's principal activity is to operate full line sporting goods stores. The group serves small to mid-sized markets predominantly in the southeastern United States. The retail stores of the group offer products that emphasize on team and individual sports. The products of the group include footwear, apparel and athletic equipment. The merchandise mix of the group is complimented by a selection of localized apparel and accessories designed to appeal to a wide range of customers within each market. The group operates 309 sports stores, 16 shoe stores and four super stores in 20 states.

10. Hot Topic Inc.

The group's principal activities are to sell music licensed and music influenced apparel, accessories and gift items for young men and women principally between the ages of 12 and 22. The group operates mall based retail stores throughout the United States. The group maintains a website, www.Hottopic.Com, through which it markets its stores and merchandise. The trademarks of the group are hot topic(r), morbid make-up(r), morbid scents(r), morbid metals(r), morbid adornments(r), tragedy(r), misery(r), mt:2(r), morbid threads(r) and everything about the music(r). As of 02-feb-2002, the group operates 352 stores in 45 states across the United States. Apparel and t-shirts accounted for 53 percent of 2001 revenues; accessories, 26 percent; gifts, 15 percent and intimate apparel and shoes, 6 percent.

11. Leslie S Poolmart Inc

Retails swimming pool supplies and related products, including maintenance items, such as chemicals, equipment, pool covers and recreational items such as games, fins and snorkels, through retail stores and mail order catalogs.

12. Pacific Sunwear of CA Inc

The principal activity of the company is to operate nationwide mall-based retail chain of stores selling casual apparel including shirts, shorts, pants, over shirts, sweatshirts, outerwear, footwear and related accessories designed to meet the needs of teenagers and young adults. The company's products are sold under the brand names Quicksilver, Billabong, Hurley, D.E.M.O. And phat farm. The company operates the retail stores under the names 'pacific Sunwear' (also known as pacsun), 'Pacific Sunwear outlet' and d.E.M.O. The company operates 735 stores in 48 states and Puerto Rico. In addition, the company operates a web site through a wholly owned subsidiary, which sells merchandise online, provides content and community for its target customers. Guys apparel accounted for 46 percent of 2001 revenues; girls apparel, 28 percent; accessories, 17 percent and footwear, 9 percent.

13. Peebles Inc.

Co. operates retail department stores offering predominately fashion merchandise for the entire family and selected home accessories. At Feb. 2, 2002, Co. was operating 137 stores located primarily in small and medium sized communities, which typically do not have a mall-based department store. The stores serve communities in 17 states, located primarily in the Southeast and Mid-Atlantic.

14. Shoe Pavilion, Inc.

The group's principal activity is the retailing of footwear on an independent basis. The group offers a broad selection of women's and men's footwear label and name brand merchandise. As at 29-dec-2001, the group operated 83 retail stores in the states of California, Washington and Oregon and 38 licensed shoe departments in Colorado, Illinois, Iowa, Kansas, Missouri, Nebraska North Dakota, Oklahoma and South Dakota. The group offers designer and name brand footwear such as Diesel, Fila, Ralph Lauren, Rockport, Steve Madden, vans and Via Spiga. The stores operate under the trade names shoe pavilion and shoe pavilion designer shoe warehouse. The group purchases large blocks of over-runs, over-orders, late-season deliveries and last season's stock from over 100 domestic and international vendors, independent re-sellers and manufacturers.

15. TOO, Inc.

The company's principal activity is to design and sell retail branded apparel and lifestyle products for teenage girls. The company operates in two retailing businesses, limited too and mishmash. Limited too sells apparel, underwear, sleepwear, swimwear, footwear, lifestyle and personal care products for young girls aged between seven to fourteen years. Mishmash sells cosmetics, sportswear, intimate apparel and footwear to young women aged between 14 to 19 years. The company's products also include accessories, jewelry, room decor furnishings and lifestyle products. The company has 459 stores in 46 states.

16. Trans World Entertainment Corp

The group's principal activity is to operate a chain of retail entertainment stores of compact discs, prerecorded audiocassettes, prerecorded videocassettes, digital versatile discs and related accessories. The group offers a broad selection of music and video titles at competitive prices in convenient and attractive stores. It operates four distinct store concepts, fye (for your entertainment) stores, super fye stores, Saturday matinee stores and freestanding stores, designed to take advantage of real estate opportunities and to satisfy varying consumer demands. Music categories include rock, pop, rap, soundtracks, latin, urban and classical. At 02-feb-2002, the group operated 902 stores in 46 states. The group stocks and promotes brand name blank audio cassettes, compact discs, audio cassettes and videocassettes, including maintenance and cleaning products, storage cases, portable electronics and headphones. The group operates only in the do

17. Tweeter Home Entertainment Group Inc

The principal activity of the group is retailing mid to high-end audio and video consumer electronics products through a chain of 154 retail stores. The stores of the group are located in new England, the mid-Atlantic, the southeast, Texas, California, greater Chicago, Florida and Arizona the products of the group include large screen televisions, DVD players, digital satellite systems, video cassette recorders and camcorders. Home and car stereo installation services along with warranty and non-warranty repair services are provided through all the stores of the group. The group stocks products from over fifty vendors, including, alpine, Bose, Boston acoustics, Denon, eclipse, Kenwood, Klipsch, mirage, mission, Mitsubishi, monster cable, Panasonic, pioneer, Sony and Yamaha. Video equipment accounted for 50 percent of fiscal 2001 revenues; audio equipment, 28 percent and mobile equipment and other, 22 percent.

18. Ultimate Electronics

The group's principal activity is to sell through retail distribution consumer electronic and home entertainment products such as audio, video, television and mobile electronic products. Television includes conventional and projection television. Audio includes audio components and compact disc players. Video includes VCRs, camcorders and digital cameras. Mobile electronics include car stereo components. Home office includes computers and fax machines. Others include audio video furniture and blank tapes. The group operates 54 stores, including 35 stores in Arizona, Idaho, Illinois, Iowa, Missouri, Nevada, New Mexico, Oklahoma, South Dakota, Texas and Utah under the trade name ultimate electronics, 11 stores in Colorado under the trade name soundtrack and eight stores in Minnesota under the trade name audio king. Television/satellite accounted for 38 percent of 2001 revenues; audio, 20 percent; video, 17 percent; mobile, 9 percent; home office, 4 percent and other, 12 percent.

19. United Retail Group, Inc.

The group's principal activity is the retail sale of large size women's fashion apparel and accessories. This includes casual wear, career wear, specialty items, women's shoes and accessories. The casual wear assortment includes comfortably fitted jeans, slacks, t-shirts, skirts, active wear and sweaters. Casual wear comprises the majority of the group's sales. The career assortment includes slacks, skirts, jackets, soft blouses and dresses. Accessories include earrings, pins, scarves and a selection of gift items. These products are sold under the trademark avenue(r), which is used on storefronts and principal trademarks avenue(r) and cloud walkers(r), which are used on merchandise labels. The group makes sales through Internet websites (www.Avenue.Com and www.Cloudwalkers.Com) and its catalog. The group operates over 550 stores throughout the United States. Avenue retail stores accounted for 97 percent of 2001 revenues and Internet and catalog, 3 percent.

**APPENDIX 3: FINANCIAL DATA FOR BROADLY COMPARABLE
COMPANIES**

BURLINGTON COAT FACTORY WRHS

bcf

5651

	May01	May00	May99	3-yr Avg.
Sales-Net	\$2,400.289	\$2,198.696	\$1,988.513	\$2,299.493
Cost of Goods Sold	<u>\$1,517.965</u>	<u>\$1,406.625</u>	<u>\$1,278.717</u>	<u>\$1,462.295</u>
Gross Profit	\$882.324	\$792.071	\$709.796	\$837.198
Gross Margin	36.8%	36.0%	35.7%	36.4%
SG&A Expense	\$745.570	\$673.027	\$610.022	\$709.298
Depreciation-Amortization	<u>\$49.335</u>	<u>\$41.028</u>	<u>\$35.046</u>	<u>\$45.181</u>
Total Operating Expenses	<u>\$794.905</u>	<u>\$714.055</u>	<u>\$645.068</u>	<u>\$754.480</u>
Operating Profit	<u>\$87.419</u>	<u>\$78.016</u>	<u>\$64.728</u>	<u>\$82.718</u>
ASSETS				
Cash & Equivalents	\$77.407	\$127.818	\$106.952	\$102.612
Receivables-Total	\$20.334	\$20.119	\$14.227	\$20.226
Inventories-Total	\$535.429	\$513.018	\$501.040	\$524.224
Prepaid Expenses	\$0.000	\$0.000	\$0.000	\$0.000
Current Assets-Other	<u>\$44.882</u>	<u>\$32.579</u>	<u>\$29.451</u>	<u>\$38.730</u>
Current Assets-Total	\$678.052	\$693.534	\$651.670	\$685.793
PP&E-Total Net	\$364.025	\$318.316	\$252.221	\$341.171
Invstmnts & Advances-Other	\$6.200	\$23.659	\$24.175	\$14.930
Invstmnts & Advances-Equity	\$0.000	\$0.000	\$0.000	\$0.000
Intangibles	\$0.000	\$0.000	\$0.000	\$0.000
Deferred Charges	\$0.000	\$0.000	\$0.000	\$0.000
Other Assets	<u>\$12.498</u>	<u>\$10.538</u>	<u>\$13.569</u>	<u>\$11.518</u>
Assets-Total	<u>\$1,060.775</u>	<u>\$1,046.047</u>	<u>\$941.635</u>	<u>\$1,053.411</u>

CHARMING SHOPPES

chrs

5621

	Jan01	Jan00	Jan99	3-yr Avg.
Sales-Net	\$1,607.079	\$1,196.529	\$1,035.160	\$1,401.804
Cost of Goods Sold	<u>\$1,096.488</u>	<u>\$823.989</u>	<u>\$738.784</u>	<u>\$960.239</u>
Gross Profit	\$510.591	\$372.540	\$296.376	\$441.565
Gross Margin	31.8%	31.1%	28.6%	31.5%
SG&A Expense	\$384.188	\$282.932	\$246.747	\$333.560
Depreciation-Amortization	<u>\$42.951</u>	<u>\$30.785</u>	<u>\$32.323</u>	<u>\$36.868</u>
Total Operating Expenses	<u>\$427.139</u>	<u>\$313.717</u>	<u>\$279.070</u>	<u>\$370.428</u>
Operating Profit	<u>\$83.452</u>	<u>\$58.823</u>	<u>\$17.306</u>	<u>\$71.137</u>
Net Profit Margin	5.2%	4.9%	1.7%	5.1%
Berry Ratio	1.20	1.19	1.06	1.19
Return on Assets	12.8%	11.4%	4.4%	12.2%
Cost Plus	46.6%	45.2%	40.1%	46.0%
Net Cost Plus	5.5%	5.2%	1.7%	5.3%
Operating Expense/Sales	26.6%	26.2%	27.0%	26.4%
Avg. Operating Assets/Sales	40.6%	43.0%	38.1%	41.6%
Avg. Accts. Receivable/Sales	0.2%	0.3%	0.0%	0.2%
Avg. Accts. Payable/COGS	8.4%	9.1%	8.4%	8.7%

ASSETS

Cash & Equivalents	\$105.361	\$75.638	\$144.532	\$90.500
Receivables-Total	\$0.000	\$6.808	\$0.000	\$3.404
Inventories-Total	\$259.127	\$260.792	\$171.327	\$259.960
Prepaid Expenses	\$0.000	\$0.000	\$0.000	\$0.000
Current Assets-Other	<u>\$67.426</u>	<u>\$51.083</u>	<u>\$45.681</u>	<u>\$59.255</u>
Current Assets-Total	\$431.914	\$394.321	\$361.540	\$413.118
PP&E-Total Net	\$217.863	\$190.924	\$154.583	\$204.394
Invstmnts & Advances-Other	\$76.461	\$74.490	\$145.882	\$75.475
Invstmnts & Advances-Equity	\$0.000	\$0.000	\$0.000	\$0.000
Intangibles	\$92.520	\$97.405	\$0.000	\$94.962
Deferred Charges	\$0.000	\$0.000	\$0.000	\$0.000
Other Assets	<u>\$34.009</u>	<u>\$27.656</u>	<u>\$22.644</u>	<u>\$30.832</u>
Assets-Total	<u>\$852.767</u>	<u>\$784.796</u>	<u>\$684.649</u>	<u>\$818.782</u>
Total Operating Assets	\$670.945	\$634.668	\$394.235	\$652.807
Avg. Operating Assets	\$652.807	\$514.451	\$394.235	\$583.629
Average Accts. Receivable	\$3.404	\$3.404	\$0.000	\$3.404
Average Inventory	\$259.960	\$216.059	\$171.327	\$238.009
Average Accounts Payable	\$91.801	\$75.264	\$61.806	\$83.532

LIABILITIES

Accounts Payable	\$94.881	\$88.721	\$61.806	\$91.801
Liabilities-Other	<u>\$264.617</u>	<u>\$259.812</u>	<u>\$239.271</u>	<u>\$262.214</u>
Liabilities-Total	<u>\$359.498</u>	<u>\$348.533</u>	<u>\$301.077</u>	<u>\$354.015</u>

KPMG LLP

Economic Consulting Services

RAC WEST 0316
ROA 0458

ELEGANT ILLUSIONS INC
3eill
5944

(\$ MILLIONS, EXCEPT RATIOS)

	Dec01	Dec00	Dec99	3-yr Avg.
Sales-Net	\$9.258	\$9.629	\$10.626	\$9.838
Cost of Goods Sold	<u>\$2.746</u>	<u>\$2.829</u>	<u>\$3.299</u>	<u>\$2.958</u>
Gross Profit	\$6.512	\$6.800	\$7.327	\$6.880
Gross Margin	70.3%	70.6%	69.0%	69.9%
SG&A Expense	\$5.940	\$5.631	\$6.670	\$6.080
Depreciation-Amortization	<u>\$0.472</u>	<u>\$0.470</u>	<u>\$0.434</u>	<u>\$0.459</u>
Total Operating Expenses	<u>\$6.412</u>	<u>\$6.101</u>	<u>\$7.104</u>	<u>\$6.539</u>
Operating Profit	<u>\$0.100</u>	<u>\$0.699</u>	<u>\$0.223</u>	<u>\$0.341</u>
Net Profit Margin	1.1%	7.3%	2.1%	3.5%
Berry Ratio	1.02	1.11	1.03	1.05
Return on Assets	1.7%	12.7%	4.1%	6.1%
Cost Plus	237.1%	240.4%	222.1%	232.6%
Net Cost Plus	1.1%	7.8%	2.1%	3.6%
Operating Expense/Sales	69.3%	63.4%	66.9%	66.5%
Avg. Operating Assets/Sales	63.0%	57.3%	50.6%	56.7%
Avg. Accts. Receivable/Sales	2.5%	3.8%	4.7%	3.7%
Avg. Accts. Payable/COGS	7.6%	7.8%	7.3%	7.6%
ASSETS				
Cash & Equivalents	\$1.609	\$1.900	\$1.760	\$1.756
Receivables-Total	\$0.237	\$0.232	\$0.503	\$0.324
Inventories-Total	\$3.357	\$2.868	\$2.599	\$2.941
Prepaid Expenses	\$0.307	\$0.279	\$0.299	\$0.295
Current Assets-Other	<u>\$0.000</u>	<u>\$0.000</u>	<u>\$0.000</u>	<u>\$0.000</u>
Current Assets-Total	\$5.510	\$5.279	\$5.161	\$5.317
PP&E-Total Net	\$2.022	\$2.196	\$1.892	\$2.037
Invstmnts & Advances-Other	\$0.000	\$0.000	\$0.000	\$0.000
Invstmnts & Advances-Equity	\$0.000	\$0.000	\$0.000	\$0.000
Intangibles	\$0.001	\$0.016	\$0.020	\$0.012
Deferred Charges	\$0.000	\$0.000	\$0.000	\$0.000
Other Assets	<u>\$0.079</u>	<u>\$0.068</u>	<u>\$0.065</u>	<u>\$0.071</u>
Assets-Total	<u>\$7.612</u>	<u>\$7.559</u>	<u>\$7.138</u>	<u>\$7.436</u>
Total Operating Assets	\$6.003	\$5.659	\$5.378	\$5.680
Avg. Operating Assets	\$5.831	\$5.519	\$5.378	\$5.576
Average Accts. Receivable	\$0.234	\$0.368	\$0.503	\$0.368
Average Inventory	\$3.113	\$2.734	\$2.599	\$2.815
Average Accounts Payable	\$0.208	\$0.221	\$0.240	\$0.223

FINISH LINE INC -CL A
finl
5661

	Feb01	Feb00	Feb99	3-yr Avg.
Sales-Net	\$663.906	\$585.963	\$522.623	\$624.935
Cost of Goods Sold	<u>\$465.936</u>	<u>\$409.136</u>	<u>\$362.183</u>	<u>\$437.536</u>
Gross Profit	\$197.970	\$176.827	\$160.440	\$187.399
Gross Margin	29.8%	30.2%	30.7%	30.0%
SG&A Expense	\$156.820	\$139.273	\$117.507	\$148.047
Depreciation-Amortization	<u>\$16.391</u>	<u>\$14.369</u>	<u>\$10.987</u>	<u>\$15.380</u>
Total Operating Expenses	<u>\$173.211</u>	<u>\$153.642</u>	<u>\$128.494</u>	<u>\$163.427</u>
Operating Profit	<u>\$24.759</u>	<u>\$23.185</u>	<u>\$31.946</u>	<u>\$23.972</u>
Net Profit Margin	3.7%	4.0%	6.1%	3.8%
Berry Ratio	1.14	1.15	1.25	1.15
Return on Assets	9.5%	9.2%	13.4%	9.4%
Cost Plus	42.5%	43.2%	44.3%	42.8%
Net Cost Plus	3.9%	4.1%	6.5%	4.0%
Operating Expense/Sales	26.1%	26.2%	24.6%	26.2%
Avg. Operating Assets/Sales	39.3%	42.9%	45.5%	41.0%
Avg. Accts. Receivable/Sales	1.0%	1.5%	1.3%	1.2%
Avg. Accts. Payable/COGS	10.3%	11.3%	14.0%	10.8%
ASSETS				
Cash & Equivalents	\$51.935	\$24.481	\$25.268	\$38.208
Receivables-Total	\$3.476	\$10.311	\$6.951	\$6.893
Inventories-Total	\$145.503	\$148.979	\$135.303	\$147.241
Prepaid Expenses	\$0.000	\$0.000	\$0.000	\$0.000
Current Assets-Other	<u>\$7.233</u>	<u>\$1.473</u>	<u>\$3.673</u>	<u>\$4.353</u>
Current Assets-Total	\$208.147	\$185.244	\$171.195	\$196.696
PP&E-Total Net	\$94.474	\$101.619	\$90.434	\$98.047
Invstmnts & Advances-Other	\$0.000	\$0.000	\$15.656	\$0.000
Invstmnts & Advances-Equity	\$0.000	\$0.000	\$0.000	\$0.000
Intangibles	\$0.000	\$0.000	\$0.000	\$0.000
Deferred Charges	\$0.000	\$0.000	\$0.000	\$0.000
Other Assets	<u>\$6.247</u>	<u>\$2.232</u>	<u>\$1.270</u>	<u>\$4.240</u>
Assets-Total	<u>\$308.868</u>	<u>\$289.095</u>	<u>\$278.555</u>	<u>\$298.982</u>
Total Operating Assets	\$256.933	\$264.614	\$237.631	\$260.774
Avg. Operating Assets	\$260.774	\$251.122	\$237.631	\$255.948
Average Accts. Receivable	\$6.893	\$8.631	\$6.951	\$7.762
Average Inventory	\$147.241	\$142.141	\$135.303	\$144.691
Average Accounts Payable	\$47.819	\$46.430	\$50.672	\$47.125
LIABILITIES				
Accounts Payable	\$53.450	\$42.188	\$50.672	\$47.819
Liabilities-Other	<u>\$28.671</u>	<u>\$24.515</u>	<u>\$19.204</u>	<u>\$26.593</u>
Liabilities-Total	<u>\$82.121</u>	<u>\$66.703</u>	<u>\$69.876</u>	<u>\$74.412</u>

FOOTSTAR INC

fts

5661

(\$ MILLIONS, EXCEPT RATIOS)

	Dec01	Dec00	Dec99	3-yr Avg.
Sales-Net	\$2,460.500	\$2,237.100	\$1,880.000	\$2,192.533
Cost of Goods Sold	<u>\$1,704.600</u>	<u>\$1,530.300</u>	<u>\$1,294.500</u>	<u>\$1,509.800</u>
Gross Profit	\$755.900	\$706.800	\$585.500	\$682.733
Gross Margin	30.7%	31.6%	31.1%	31.1%
SG&A Expense	\$567.100	\$495.400	\$396.900	\$486.467
Depreciation-Amortization	<u>\$45.300</u>	<u>\$40.000</u>	<u>\$34.700</u>	<u>\$40.000</u>
Total Operating Expenses	<u>\$612.400</u>	<u>\$535.400</u>	<u>\$431.600</u>	<u>\$526.467</u>
Operating Profit	<u>\$143.500</u>	<u>\$171.400</u>	<u>\$153.900</u>	<u>\$156.267</u>
Net Profit Margin	5.8%	7.7%	8.2%	7.1%
Berry Ratio	1.23	1.32	1.36	1.30
Return on Assets	17.8%	25.6%	26.5%	22.8%
Cost Plus	44.3%	46.2%	45.2%	45.2%
Net Cost Plus	6.2%	8.3%	8.9%	7.7%
Operating Expense/Sales	24.9%	23.9%	23.0%	24.0%
Avg. Operating Assets/Sales	32.8%	29.9%	30.9%	31.3%
Avg. Accts. Receivable/Sales	2.8%	2.2%	2.3%	2.4%
Avg. Accts. Payable/COGS	5.7%	6.1%	7.8%	6.4%
ASSETS				
Cash & Equivalents	\$12.400	\$14.300	\$31.800	\$19.500
Receivables-Total	\$84.600	\$54.200	\$42.800	\$60.533
Inventories-Total	\$368.500	\$360.600	\$271.300	\$333.467
Prepaid Expenses	\$0.000	\$0.000	\$0.000	\$0.000
Current Assets-Other	<u>\$46.200</u>	<u>\$28.100</u>	<u>\$34.900</u>	<u>\$36.400</u>
Current Assets-Total	\$511.700	\$457.200	\$380.800	\$449.900
PP&E-Total Net	\$258.600	\$261.700	\$198.700	\$239.667
Invstmnts & Advances-Other	\$0.000	\$0.000	\$0.000	\$0.000
Invstmnts & Advances-Equity	\$0.000	\$0.000	\$0.000	\$0.000
Intangibles	\$42.400	\$0.000	\$0.000	\$14.133
Deferred Charges	\$0.000	\$0.000	\$0.000	\$0.000
Other Assets	<u>\$53.300</u>	<u>\$54.800</u>	<u>\$32.700</u>	<u>\$46.933</u>
Assets-Total	<u>\$866.000</u>	<u>\$773.700</u>	<u>\$612.200</u>	<u>\$750.633</u>
Total Operating Assets	\$853.600	\$759.400	\$580.400	\$731.133
Avg. Operating Assets	\$806.500	\$669.900	\$580.400	\$685.600
Average Accts. Receivable	\$69.400	\$48.500	\$42.800	\$53.567
Average Inventory	\$364.550	\$315.950	\$271.300	\$317.267
Average Accounts Payable	\$97.850	\$93.700	\$100.500	\$97.350
LIABILITIES				
Accounts Payable	\$108.800	\$86.900	\$100.500	\$98.733
Liabilities-Other	<u>\$449.500</u>	<u>\$362.400</u>	<u>\$243.800</u>	<u>\$351.900</u>
Liabilities-Total	<u>\$558.300</u>	<u>\$449.300</u>	<u>\$344.300</u>	<u>\$450.633</u>

GALYANS TRADING CO INC

glyn

5940

	Jan01	Jan00	Jan99	3-yr Avg.
Sales-Net	\$421.662	\$328.121	\$0.000	\$374.891
Cost of Goods Sold	<u>\$295.211</u>	<u>\$233.750</u>	<u>\$0.000</u>	<u>\$264.480</u>
Gross Profit	\$126.451	\$94.371	N/A	\$110.411
Gross Margin	30.0%	28.8%	N/A	29.5%
SG&A Expense	\$93.276	\$74.306	\$0.000	\$83.791
Depreciation-Amortization	<u>\$11.504</u>	<u>\$10.671</u>	<u>\$0.000</u>	<u>\$11.087</u>
Total Operating Expenses	<u>\$104.780</u>	<u>\$84.977</u>	<u>\$0.000</u>	<u>\$94.878</u>
Operating Profit	<u>\$21.671</u>	<u>\$9.394</u>	<u>#VALUE!</u>	<u>\$15.532</u>
Net Profit Margin	5.1%	2.9%	N/A	4.1%
Berry Ratio	1.21	1.11	N/A	1.16
Return on Assets	11.9%	11.2%	N/A	11.7%
Cost Plus	42.8%	40.4%	N/A	41.7%
Net Cost Plus	5.4%	2.9%	N/A	4.3%
Operating Expense/Sales	24.8%	25.9%	#DIV/0!	25.3%
Avg. Operating Assets/Sales	43.3%	25.5%	#DIV/0!	35.5%
Avg. Accts. Receivable/Sales	0.5%	0.1%	N/A	0.3%
Avg. Accts. Payable/COGS	5.9%	3.0%	#DIV/0!	4.6%
ASSETS				
Cash & Equivalents	\$3.756	\$2.662	\$0.000	\$3.209
Receivables-Total	\$3.963	\$0.630	\$0.000	\$2.297
Inventories-Total	\$91.495	\$73.524	\$0.000	\$82.510
Prepaid Expenses	\$0.000	\$0.000	\$0.000	\$0.000
Current Assets-Other	<u>\$4.776</u>	<u>\$4.864</u>	<u>\$0.000</u>	<u>\$4.820</u>
Current Assets-Total	\$103.990	\$81.680	\$0.000	\$92.835
PP&E-Total Net	\$70.568	\$62.031	\$0.000	\$66.299
Invstmnts & Advances-Other	\$0.000	\$4.621	\$0.000	\$2.310
Invstmnts & Advances-Equity	\$0.000	\$0.000	\$0.000	\$0.000
Intangibles	\$19.117	\$19.900	\$0.000	\$19.509
Deferred Charges	\$4.532	\$6.510	\$0.000	\$5.521
Other Assets	<u>\$2.882</u>	<u>\$0.058</u>	<u>\$0.000</u>	<u>\$1.470</u>
Assets-Total	<u>\$201.089</u>	<u>\$174.800</u>	<u>\$0.000</u>	<u>\$187.945</u>
Total Operating Assets	\$197.333	\$167.517	\$0.000	\$182.425
Avg. Operating Assets	\$182.425	\$83.758	\$0.000	\$133.092
Average Accts. Receivable	\$2.297	\$0.315	\$0.000	\$1.306
Average Inventory	\$82.510	\$36.762	\$0.000	\$59.636
Average Accounts Payable	\$17.422	\$6.997	\$0.000	\$12.209
LIABILITIES				
Accounts Payable	\$20.852	\$13.993	\$0.000	\$17.422
Liabilities-Other	<u>\$111.198</u>	<u>\$93.893</u>	<u>\$0.000</u>	<u>\$102.546</u>
Liabilities-Total	<u>\$132.050</u>	<u>\$107.886</u>	<u>\$0.000</u>	<u>\$119.968</u>

GART SPORTS CO

grts
5940

	Jan01	Jan00	Jan99	3-yr Avg.
Sales-Net	\$751.124	\$680.995	\$658.047	\$716.060
Cost of Goods Sold	<u>\$545.002</u>	<u>\$506.333</u>	<u>\$494.595</u>	<u>\$525.668</u>
Gross Profit	\$206.122	\$174.662	\$163.452	\$190.392
Gross Margin	27.4%	25.6%	24.8%	26.6%
SG&A Expense	\$164.830	\$150.985	\$148.348	\$157.908
Depreciation-Amortization	<u>\$14.776</u>	<u>\$11.149</u>	<u>\$9.317</u>	<u>\$12.963</u>
Total Operating Expenses	<u>\$179.606</u>	<u>\$162.134</u>	<u>\$157.665</u>	<u>\$170.870</u>
Operating Profit	<u>\$26.516</u>	<u>\$12.528</u>	<u>\$5.787</u>	<u>\$19.522</u>
Net Profit Margin	3.5%	1.8%	0.9%	2.7%
Berry Ratio	1.15	1.08	1.04	1.11
Return on Assets	8.0%	3.8%	1.8%	5.9%
Cost Plus	37.8%	34.5%	33.0%	36.2%
Net Cost Plus	3.7%	1.9%	0.9%	2.8%
Operating Expense/Sales	23.9%	23.8%	24.0%	23.9%
Avg. Operating Assets/Sales	44.1%	48.5%	49.3%	46.2%
Avg. Accts. Receivable/Sales	0.9%	1.2%	1.5%	1.1%
Avg. Accts. Payable/COGS	21.4%	25.1%	25.6%	23.1%
ASSETS				
Cash & Equivalents	\$8.381	\$7.843	\$10.779	\$8.112
Receivables-Total	\$6.454	\$7.036	\$9.670	\$6.745
Inventories-Total	\$230.800	\$240.891	\$223.837	\$235.846
Prepaid Expenses	\$0.000	\$0.000	\$0.000	\$0.000
Current Assets-Other	<u>\$9.233</u>	<u>\$8.255</u>	<u>\$10.403</u>	<u>\$8.744</u>
Current Assets-Total	\$254.868	\$264.025	\$254.689	\$259.447
PP&E-Total Net	\$59.298	\$60.441	\$59.033	\$59.870
Invstmnts & Advances-Other	\$0.000	\$0.000	\$0.000	\$0.000
Invstmnts & Advances-Equity	\$0.000	\$0.000	\$0.000	\$0.000
Intangibles	\$0.000	\$0.000	\$0.000	\$0.000
Deferred Charges	\$0.000	\$0.000	\$0.000	\$0.000
Other Assets	<u>\$20.962</u>	<u>\$19.782</u>	<u>\$21.397</u>	<u>\$20.372</u>
Assets-Total	<u>\$335.128</u>	<u>\$344.248</u>	<u>\$335.119</u>	<u>\$339.688</u>
Total Operating Assets	\$326.747	\$336.405	\$324.340	\$331.576
Avg. Operating Assets	\$331.576	\$330.373	\$324.340	\$330.974
Average Accts. Receivable	\$6.745	\$8.353	\$9.670	\$7.549
Average Inventory	\$235.846	\$232.364	\$223.837	\$234.105
Average Accounts Payable	\$116.403	\$126.944	\$126.478	\$121.673
LIABILITIES				
Accounts Payable	\$105.395	\$127.410	\$126.478	\$116.403
Liabilities-Other	<u>\$140.847</u>	<u>\$150.944</u>	<u>\$145.175</u>	<u>\$145.896</u>
Liabilities-Total	<u>\$246.242</u>	<u>\$278.354</u>	<u>\$271.653</u>	<u>\$262.298</u>

HASTINGS ENTERTAINMENT INC
hast
5735

	Jan01	Jan00	Jan99	3-yr Avg.
Sales-Net	\$458.203	\$447.155	\$398.668	\$452.679
Cost of Goods Sold	<u>\$285.326</u>	<u>\$251.789</u>	<u>\$194.884</u>	<u>\$268.557</u>
Gross Profit	\$172.877	\$195.366	\$203.784	\$184.122
Gross Margin	37.7%	43.7%	51.1%	40.7%
SG&A Expense	\$139.800	\$153.864	\$127.085	\$146.832
Depreciation-Amortization	<u>\$33.155</u>	<u>\$32.923</u>	<u>\$55.301</u>	<u>\$33.039</u>
Total Operating Expenses	<u>\$172.955</u>	<u>\$186.787</u>	<u>\$182.386</u>	<u>\$179.871</u>
Operating Profit	<u>(\$0.078)</u>	<u>\$8.579</u>	<u>\$21.398</u>	<u>\$4.251</u>
Net Profit Margin	0.0%	1.9%	5.4%	0.9%
Berry Ratio	1.00	1.05	1.12	1.02
Return on Assets	0.0%	3.7%	9.9%	1.9%
Cost Plus	60.6%	77.6%	104.6%	68.6%
Net Cost Plus	0.0%	2.0%	5.7%	0.9%
Operating Expense/Sales	37.7%	41.8%	45.7%	39.7%
Avg. Operating Assets/Sales	49.1%	51.2%	54.4%	50.1%
Avg. Accts. Receivable/Sales	1.5%	0.8%	0.2%	1.2%
Avg. Accts. Payable/COGS	24.0%	21.6%	21.8%	22.9%
ASSETS				
Cash & Equivalents	\$4.257	\$7.026	\$5.394	\$5.641
Receivables-Total	\$7.759	\$6.272	\$0.807	\$7.015
Inventories-Total	\$130.676	\$152.065	\$145.432	\$141.370
Prepaid Expenses	\$0.000	\$0.000	\$0.000	\$0.000
Current Assets-Other	<u>\$5.461</u>	<u>\$5.624</u>	<u>\$6.235</u>	<u>\$5.543</u>
Current Assets-Total	\$148.153	\$170.987	\$157.868	\$159.570
PP&E-Total Net	\$65.319	\$73.242	\$64.124	\$69.280
Invstmnts & Advances-Other	\$0.000	\$0.000	\$0.000	\$0.000
Invstmnts & Advances-Equity	\$0.000	\$0.000	\$0.000	\$0.000
Intangibles	\$0.000	\$0.000	\$0.000	\$0.000
Deferred Charges	\$0.000	\$0.000	\$0.000	\$0.000
Other Assets	<u>\$0.012</u>	<u>\$3.704</u>	<u>\$0.159</u>	<u>\$1.858</u>
Assets-Total	<u>\$213.484</u>	<u>\$247.933</u>	<u>\$222.151</u>	<u>\$230.708</u>
Total Operating Assets	\$209.227	\$240.907	\$216.757	\$225.067
Avg. Operating Assets	\$225.067	\$228.832	\$216.757	\$226.950
Average Accts. Receivable	\$7.015	\$3.539	\$0.807	\$5.277
Average Inventory	\$141.370	\$148.749	\$145.432	\$145.060
Average Accounts Payable	\$68.551	\$54.487	\$42.406	\$61.519
LIABILITIES				
Accounts Payable	\$70.534	\$66.568	\$42.406	\$68.551
Liabilities-Other	<u>\$67.159</u>	<u>\$91.274</u>	<u>\$63.612</u>	<u>\$79.216</u>
Liabilities-Total	<u>\$137.693</u>	<u>\$157.842</u>	<u>\$106.018</u>	<u>\$147.767</u>

KPMG LLP

Economic Consulting Services

RAC WEST 0322
ROA 0464

HIBBETT SPORTING GOODS INC
hibb
5940

	Jan01	Jan00	Jan99	3-yr Avg.
Sales-Net	\$209.626	\$174.312	\$143.350	\$191.969
Cost of Goods Sold	<u>\$145.800</u>	<u>\$121.962</u>	<u>\$100.409</u>	<u>\$133.881</u>
Gross Profit	\$63.826	\$52.350	\$42.941	\$58.088
Gross Margin	30.4%	30.0%	30.0%	30.3%
SG&A Expense	\$40.789	\$34.142	\$28.720	\$37.465
Depreciation-Amortization	<u>\$4.802</u>	<u>\$3.762</u>	<u>\$3.056</u>	<u>\$4.282</u>
Total Operating Expenses	<u>\$45.591</u>	<u>\$37.904</u>	<u>\$31.776</u>	<u>\$41.747</u>
Operating Profit	<u>\$18.235</u>	<u>\$14.446</u>	<u>\$11.165</u>	<u>\$16.341</u>
Net Profit Margin	8.7%	8.3%	7.8%	8.5%
Berry Ratio	1.40	1.38	1.35	1.39
Return on Assets	20.1%	19.3%	16.5%	19.7%
Cost Plus	43.8%	42.9%	42.8%	43.4%
Net Cost Plus	9.5%	9.0%	8.4%	9.3%
Operating Expense/Sales	21.7%	21.7%	22.2%	21.7%
Avg. Operating Assets/Sales	43.4%	43.0%	47.2%	43.2%
Avg. Accts. Receivable/Sales	1.1%	1.3%	1.6%	1.2%
Avg. Accts. Payable/COGS	12.8%	14.5%	16.2%	13.6%
ASSETS				
Cash & Equivalents	\$1.884	\$0.860	\$0.945	\$1.372
Receivables-Total	\$2.649	\$2.137	\$2.240	\$2.393
Inventories-Total	\$70.058	\$58.066	\$47.694	\$64.062
Prepaid Expenses	\$0.000	\$0.000	\$0.000	\$0.000
Current Assets-Other	<u>\$1.932</u>	<u>\$1.454</u>	<u>\$1.540</u>	<u>\$1.693</u>
Current Assets-Total	\$76.523	\$62.517	\$52.419	\$69.520
PP&E-Total Net	\$23.710	\$19.957	\$15.406	\$21.833
Invstmnts & Advances-Other	\$0.000	\$0.000	\$0.000	\$0.000
Invstmnts & Advances-Equity	\$0.000	\$0.000	\$0.000	\$0.000
Intangibles	\$0.000	\$0.000	\$0.000	\$0.000
Deferred Charges	\$0.000	\$0.000	\$0.000	\$0.000
Other Assets	<u>\$1.019</u>	<u>\$0.804</u>	<u>\$0.727</u>	<u>\$0.912</u>
Assets-Total	<u>\$101.252</u>	<u>\$83.278</u>	<u>\$68.552</u>	<u>\$92.265</u>
Total Operating Assets	\$99.368	\$82.418	\$67.607	\$90.893
Avg. Operating Assets	\$90.893	\$75.013	\$67.607	\$82.953
Average Accts. Receivable	\$2.393	\$2.189	\$2.240	\$2.291
Average Inventory	\$64.062	\$52.880	\$47.694	\$58.471
Average Accounts Payable	\$18.658	\$17.640	\$16.233	\$18.149
LIABILITIES				
Accounts Payable	\$18.268	\$19.047	\$16.233	\$18.658
Liabilities-Other	<u>\$16.319</u>	<u>\$10.030</u>	<u>\$7.059</u>	<u>\$13.175</u>
Liabilities-Total	<u>\$34.587</u>	<u>\$29.077</u>	<u>\$23.292</u>	<u>\$31.832</u>

HOT TOPIC INC

hott

5600

	Jan01	Jan00	Jan99	3-yr Avg.
Sales-Net	\$257.187	\$168.949	\$103.371	\$213.068
Cost of Goods Sold	<u>\$145.652</u>	<u>\$98.108</u>	<u>\$61.786</u>	<u>\$121.880</u>
Gross Profit	\$111.535	\$70.841	\$41.585	\$91.188
Gross Margin	43.4%	41.9%	40.2%	42.8%
SG&A Expense	\$67.918	\$44.749	\$29.077	\$56.333
Depreciation-Amortization	<u>\$8.645</u>	<u>\$5.891</u>	<u>\$4.069</u>	<u>\$7.268</u>
Total Operating Expenses	<u>\$76.563</u>	<u>\$50.640</u>	<u>\$33.146</u>	<u>\$63.602</u>
Operating Profit	<u>\$34.972</u>	<u>\$20.201</u>	<u>\$8.439</u>	<u>\$27.587</u>
Net Profit Margin	13.6%	12.0%	8.2%	12.9%
Berry Ratio	1.46	1.40	1.25	1.43
Return on Assets	59.9%	48.3%	24.7%	55.0%
Cost Plus	76.6%	72.2%	67.3%	74.8%
Net Cost Plus	15.7%	13.6%	8.9%	14.9%
Operating Expense/Sales	29.8%	30.0%	32.1%	29.9%
Avg. Operating Assets/Sales	22.7%	24.8%	33.1%	23.5%
Avg. Accts. Receivable/Sales	0.0%	0.0%	0.0%	0.0%
Avg. Accts. Payable/COGS	4.4%	4.3%	3.5%	4.4%
ASSETS				
Cash & Equivalents	\$51.288	\$39.550	\$24.574	\$45.419
Receivables-Total	\$0.000	\$0.000	\$0.000	\$0.000
Inventories-Total	\$21.336	\$15.367	\$10.447	\$18.352
Prepaid Expenses	\$0.000	\$0.000	\$0.000	\$0.000
Current Assets-Other	<u>\$6.496</u>	<u>\$2.301</u>	<u>\$1.762</u>	<u>\$4.398</u>
Current Assets-Total	\$79.120	\$57.218	\$36.783	\$68.169
PP&E-Total Net	\$39.166	\$31.721	\$21.895	\$35.444
Invstmnts & Advances-Other	\$0.000	\$0.000	\$0.000	\$0.000
Invstmnts & Advances-Equity	\$0.000	\$0.000	\$0.000	\$0.000
Intangibles	\$0.000	\$0.000	\$0.000	\$0.000
Deferred Charges	\$0.000	\$0.000	\$0.000	\$0.000
Other Assets	<u>\$0.360</u>	<u>\$0.083</u>	<u>\$0.087</u>	<u>\$0.222</u>
Assets-Total	<u>\$118.646</u>	<u>\$89.022</u>	<u>\$58.765</u>	<u>\$103.834</u>
Total Operating Assets	\$67.358	\$49.472	\$34.191	\$58.415
Avg. Operating Assets	\$58.415	\$41.832	\$34.191	\$50.123
Average Accts. Receivable	\$0.000	\$0.000	\$0.000	\$0.000
Average Inventory	\$18.352	\$12.907	\$10.447	\$15.629
Average Accounts Payable	\$6.424	\$4.201	\$2.186	\$5.312
LIABILITIES				
Accounts Payable	\$6.632	\$6.215	\$2.186	\$6.424
Liabilities-Other	<u>\$12.723</u>	<u>\$15.529</u>	<u>\$7.830</u>	<u>\$14.126</u>
Liabilities-Total	<u>\$19.355</u>	<u>\$21.744</u>	<u>\$10.016</u>	<u>\$20.549</u>

LESLIE S POOLMART INC
Disclosure Data

(\$ MILLIONS, EXCEPT RATIOS)

	Sep-01	Sep-00	Oct-99	3-yr Avg.
Sales-Net	\$301.700	\$303.163	\$282.349	\$295.737
Cost of Goods Sold	<u>\$166.402</u>	<u>\$171.968</u>	<u>\$159.933</u>	<u>\$166.101</u>
Gross Profit	\$135.298	\$131.195	\$122.416	\$129.636
Gross Margin	44.8%	43.3%	43.4%	43.8%
SG&A Expense	\$117.860	\$122.501	\$110.257	\$116.873
Depreciation-Amortization	<u>\$0.413</u>	<u>\$0.742</u>	<u>\$0.742</u>	<u>\$0.632</u>
Total Operating Expenses	<u>\$118.273</u>	<u>\$123.243</u>	<u>\$110.999</u>	<u>\$117.505</u>
Operating Profit	<u>\$17.025</u>	<u>\$7.952</u>	<u>\$11.417</u>	<u>\$12.131</u>
Net Profit Margin	5.6%	2.6%	4.0%	4.1%
Berry Ratio	1.14	1.06	1.10	1.10
Return on Assets	13.2%	6.0%	8.6%	9.2%
Cost Plus	81.3%	76.3%	76.5%	78.0%
Net Cost Plus	6.0%	2.7%	4.2%	4.3%
Operating Expense/Sales	39.2%	40.7%	39.3%	39.7%
Avg. Operating Assets/Sales	42.7%	43.7%	47.0%	44.4%
Avg. Accts. Receivable/Sales	2.7%	2.7%	2.6%	2.7%
Avg. Accts. Payable/COGS	13.6%	12.4%	10.6%	12.2%
ASSETS				
Cash & Equivalents	\$6.768	\$5.252	\$0.193	\$4.071
Receivables-Total	\$7.450	\$9.143	\$7.350	\$7.981
Inventories-Total	\$55.935	\$57.642	\$58.729	\$57.435
Prepaid Expenses	\$0.000	\$0.000	\$0.000	\$0.000
Current Assets-Other	<u>\$7.294</u>	<u>\$7.669</u>	<u>\$7.250</u>	<u>\$7.404</u>
Current Assets-Total	\$77.447	\$79.706	\$73.522	\$76.892
PP&E-Total Net	\$44.781	\$46.678	\$47.336	\$46.265
Invstmnts & Advances-Other	\$0.000	\$0.000	\$0.000	\$0.000
Invstmnts & Advances-Equity	\$0.000	\$0.000	\$0.000	\$0.000
Intangibles	\$7.836	\$8.277	\$9.019	\$8.377
Deferred Charges	\$1.744	\$2.420	\$2.460	\$2.208
Other Assets	<u>\$0.502</u>	<u>\$0.496</u>	<u>\$0.443</u>	<u>\$0.480</u>
Assets-Total	<u>\$132.310</u>	<u>\$137.577</u>	<u>\$132.780</u>	<u>\$134.222</u>
Total Operating Assets	\$125.542	\$132.325	\$132.587	\$130.151
Avg. Operating Assets	\$128.934	\$132.456	\$132.587	\$131.326
Average Accts. Receivable	\$8.297	\$8.247	\$7.350	\$7.964
Average Inventory	\$56.789	\$58.186	\$58.729	\$57.901
Average Accounts Payable	\$22.662	\$21.406	\$16.937	\$20.335
LIABILITIES				
Accounts Payable	\$19.449	\$25.875	\$16.937	\$20.754
Liabilities-Other	<u>\$122.831</u>	<u>\$121.940</u>	<u>\$122.275</u>	<u>\$122.349</u>
Liabilities-Total	<u>\$142.280</u>	<u>\$147.815</u>	<u>\$139.212</u>	<u>\$143.102</u>

PACIFIC SUNWEAR CALIF INC

 psun
5651

	Jan01	Jan00	Jan99	3-yr Avg.
Sales-Net	\$589.438	\$436.808	\$321.125	\$513.123
Cost of Goods Sold	<u>\$371.944</u>	<u>\$269.893</u>	<u>\$202.411</u>	<u>\$320.919</u>
Gross Profit	\$217.494	\$166.915	\$118.714	\$192.204
Gross Margin	36.9%	38.2%	37.0%	37.5%
SG&A Expense	\$133.999	\$96.117	\$70.370	\$115.058
Depreciation-Amortization	<u>\$19.872</u>	<u>\$14.294</u>	<u>\$10.448</u>	<u>\$17.083</u>
Total Operating Expenses	<u>\$153.871</u>	<u>\$110.411</u>	<u>\$80.818</u>	<u>\$132.141</u>
Operating Profit	<u>\$63.623</u>	<u>\$56.504</u>	<u>\$37.896</u>	<u>\$60.064</u>
Net Profit Margin	10.8%	12.9%	11.8%	11.7%
Berry Ratio	1.41	1.51	1.47	1.45
Return on Assets	29.9%	37.0%	29.4%	32.9%
Cost Plus	58.5%	61.8%	58.6%	59.9%
Net Cost Plus	12.1%	14.9%	13.4%	13.3%
Operating Expense/Sales	26.1%	25.3%	25.2%	25.8%
Avg. Operating Assets/Sales	36.1%	35.0%	40.1%	35.6%
Avg. Accts. Receivable/Sales	0.4%	0.4%	0.3%	0.4%
Avg. Accts. Payable/COGS	7.0%	6.3%	6.9%	6.7%
ASSETS				
Cash & Equivalents	\$28.971	\$32.417	\$19.032	\$30.694
Receivables-Total	\$2.754	\$2.178	\$0.899	\$2.466
Inventories-Total	\$82.693	\$60.002	\$42.470	\$71.347
Prepaid Expenses	\$10.187	\$7.043	\$5.045	\$8.615
Current Assets-Other	<u>\$2.992</u>	<u>\$2.542</u>	<u>\$2.657</u>	<u>\$2.767</u>
Current Assets-Total	\$127.597	\$104.182	\$70.103	\$115.890
PP&E-Total Net	\$135.782	\$93.213	\$66.924	\$114.497
Invstmnts & Advances-Other	\$0.000	\$0.000	\$0.000	\$0.000
Invstmnts & Advances-Equity	\$0.000	\$0.000	\$0.000	\$0.000
Intangibles	\$6.883	\$7.244	\$7.785	\$7.063
Deferred Charges	\$0.000	\$0.000	\$0.000	\$0.000
Other Assets	<u>\$7.191</u>	<u>\$4.703</u>	<u>\$2.963</u>	<u>\$5.947</u>
Assets-Total	<u>\$277.453</u>	<u>\$209.342</u>	<u>\$147.775</u>	<u>\$243.397</u>
Total Operating Assets	\$248.482	\$176.925	\$128.743	\$212.703
Avg. Operating Assets	\$212.703	\$152.834	\$128.743	\$182.769
Average Accts. Receivable	\$2.466	\$1.538	\$0.899	\$2.002
Average Inventory	\$71.347	\$51.236	\$42.470	\$61.292
Average Accounts Payable	\$25.873	\$16.991	\$13.868	\$21.432
LIABILITIES				
Accounts Payable	\$31.632	\$20.113	\$13.868	\$25.873
Liabilities-Other	<u>\$32.690</u>	<u>\$27.403</u>	<u>\$17.210</u>	<u>\$30.046</u>
Liabilities-Total	<u>\$64.322</u>	<u>\$47.516</u>	<u>\$31.078</u>	<u>\$55.919</u>

TOO INC

too
5600

	Jan01	Jan00	Jan99	3-yr Avg.
Sales-Net	\$545.040	\$452.355	\$376.943	\$498.697
Cost of Goods Sold	<u>\$335.923</u>	<u>\$278.218</u>	<u>\$241.166</u>	<u>\$307.070</u>
Gross Profit	\$209.117	\$174.137	\$135.777	\$191.627
Gross Margin	38.4%	38.5%	36.0%	38.4%
SG&A Expense	\$137.285	\$117.878	\$96.758	\$127.582
Depreciation-Amortization	<u>\$16.536</u>	<u>\$13.804</u>	<u>\$10.563</u>	<u>\$15.170</u>
Total Operating Expenses	<u>\$153.821</u>	<u>\$131.682</u>	<u>\$107.321</u>	<u>\$142.752</u>
Operating Profit	<u>\$55.296</u>	<u>\$42.455</u>	<u>\$28.456</u>	<u>\$48.875</u>
Net Profit Margin	10.1%	9.4%	7.5%	9.8%
Berry Ratio	1.36	1.32	1.27	1.34
Return on Assets	40.5%	40.9%	32.0%	40.7%
Cost Plus	62.3%	62.6%	56.3%	62.4%
Net Cost Plus	11.3%	10.4%	8.2%	10.9%
Operating Expense/Sales	28.2%	29.1%	28.5%	28.6%
Avg. Operating Assets/Sales	25.0%	22.9%	23.6%	24.1%
Avg. Accts. Receivable/Sales	0.5%	0.5%	0.4%	0.5%
Avg. Accts. Payable/COGS	6.7%	4.3%	1.3%	5.6%
ASSETS				
Cash & Equivalents	\$54.788	\$59.984	\$0.987	\$57.386
Receivables-Total	\$2.422	\$2.863	\$1.440	\$2.642
Inventories-Total	\$54.765	\$40.827	\$32.802	\$47.796
Prepaid Expenses	\$0.000	\$0.000	\$0.000	\$0.000
Current Assets-Other	<u>\$4.306</u>	<u>\$3.408</u>	<u>\$3.533</u>	<u>\$3.857</u>
Current Assets-Total	\$116.281	\$107.082	\$38.762	\$111.681
PP&E-Total Net	\$81.184	\$61.874	\$44.894	\$71.529
Invstmnts & Advances-Other	\$0.000	\$0.000	\$0.000	\$0.000
Invstmnts & Advances-Equity	\$0.000	\$0.000	\$0.000	\$0.000
Intangibles	\$0.000	\$0.000	\$0.000	\$0.000
Deferred Charges	\$0.000	\$0.000	\$0.000	\$0.000
Other Assets	<u>\$11.646</u>	<u>\$9.637</u>	<u>\$6.313</u>	<u>\$10.641</u>
Assets-Total	<u>\$209.111</u>	<u>\$178.593</u>	<u>\$89.969</u>	<u>\$193.852</u>
Total Operating Assets	\$154.323	\$118.609	\$88.982	\$136.466
Avg. Operating Assets	\$136.466	\$103.795	\$88.982	\$120.131
Average Accts. Receivable	\$2.642	\$2.151	\$1.440	\$2.397
Average Inventory	\$47.796	\$36.814	\$32.802	\$42.305
Average Accounts Payable	\$22.483	\$11.931	\$3.108	\$17.207
LIABILITIES				
Accounts Payable	\$24.213	\$20.754	\$3.108	\$22.483
Liabilities-Other	<u>\$105.187</u>	<u>\$112.372</u>	<u>\$35.761</u>	<u>\$108.780</u>
Liabilities-Total	<u>\$129.400</u>	<u>\$133.126</u>	<u>\$38.869</u>	<u>\$131.263</u>

TRANS WORLD ENTMT CORP

twmc

5735

	Jan01	Jan00	Jan99	3-yr Avg.
Sales-Net	\$1,414.589	\$1,358.132	\$698.469	\$1,386.360
Cost of Goods Sold	<u>\$915.754</u>	<u>\$856.988</u>	<u>\$414.933</u>	<u>\$886.371</u>
Gross Profit	\$498.835	\$501.144	\$283.536	\$499.989
Gross Margin	35.3%	36.9%	40.6%	36.1%
SG&A Expense	\$380.157	\$335.889	\$196.437	\$358.023
Depreciation-Amortization	<u>\$38.433</u>	<u>\$37.709</u>	<u>\$19.473</u>	<u>\$38.071</u>
Total Operating Expenses	<u>\$418.590</u>	<u>\$373.598</u>	<u>\$215.910</u>	<u>\$396.094</u>
Operating Profit	<u>\$80.245</u>	<u>\$127.546</u>	<u>\$67.626</u>	<u>\$103.895</u>
Net Profit Margin	5.7%	9.4%	9.7%	7.5%
Berry Ratio	1.19	1.34	1.31	1.26
Return on Assets	11.4%	25.6%	21.2%	17.3%
Cost Plus	54.5%	58.5%	68.3%	56.4%
Net Cost Plus	6.0%	10.4%	10.7%	8.1%
Operating Expense/Sales	29.6%	27.5%	30.9%	28.6%
Avg. Operating Assets/Sales	50.0%	36.7%	45.7%	43.4%
Avg. Accts. Receivable/Sales	0.5%	0.3%	0.5%	0.4%
Avg. Accts. Payable/COGS	42.8%	29.9%	38.4%	36.6%
ASSETS				
Cash & Equivalents	\$265.084	\$280.026	\$116.420	\$272.555
Receivables-Total	\$8.726	\$5.973	\$3.148	\$7.349
Inventories-Total	\$475.747	\$437.363	\$211.378	\$456.555
Prepaid Expenses	\$0.000	\$0.000	\$0.000	\$0.000
Current Assets-Other	<u>\$5.771</u>	<u>\$5.203</u>	<u>\$5.248</u>	<u>\$5.487</u>
Current Assets-Total	\$755.328	\$728.565	\$336.194	\$741.947
PP&E-Total Net	\$152.741	\$144.694	\$88.903	\$148.717
Invstmnts & Advances-Other	\$0.000	\$0.000	\$0.000	\$0.000
Invstmnts & Advances-Equity	\$0.000	\$0.000	\$0.000	\$0.000
Intangibles	\$43.773	\$31.433	\$0.000	\$37.603
Deferred Charges	\$0.000	\$0.000	\$0.000	\$0.000
Other Assets	<u>\$50.160</u>	<u>\$51.718</u>	<u>\$10.589</u>	<u>\$50.939</u>
Assets-Total	<u>\$1,002.002</u>	<u>\$956.410</u>	<u>\$435.686</u>	<u>\$979.206</u>
Total Operating Assets	\$736.918	\$676.384	\$319.266	\$706.651
Avg. Operating Assets	\$706.651	\$497.825	\$319.266	\$602.238
Average Accts. Receivable	\$7.349	\$4.561	\$3.148	\$5.955
Average Inventory	\$456.555	\$324.371	\$211.378	\$390.463
Average Accounts Payable	\$391.740	\$256.407	\$159.520	\$324.073
LIABILITIES				
Accounts Payable	\$430.185	\$353.294	\$159.520	\$391.740
Liabilities-Other	<u>\$122.995</u>	<u>\$108.943</u>	<u>\$64.183</u>	<u>\$115.969</u>
Liabilities-Total	<u>\$553.180</u>	<u>\$462.237</u>	<u>\$223.703</u>	<u>\$507.708</u>

TWEETER HOME ENTMT GROUP INC

twtr

5731

(\$ MILLIONS, EXCEPT RATIOS)

	Sep01	Sep00	Sep99	3-yr Avg.
Sales-Net	\$540.123	\$404.729	\$283.287	\$409.380
Cost of Goods Sold	<u>\$334.171</u>	<u>\$250.694</u>	<u>\$178.606</u>	<u>\$254.490</u>
Gross Profit	\$205.952	\$154.035	\$104.681	\$154.889
Gross Margin	38.1%	38.1%	37.0%	37.8%
SG&A Expense	\$166.791	\$121.014	\$84.047	\$123.951
Depreciation-Amortization	<u>\$11.376</u>	<u>\$7.276</u>	<u>\$5.198</u>	<u>\$7.950</u>
Total Operating Expenses	<u>\$178.167</u>	<u>\$128.290</u>	<u>\$89.245</u>	<u>\$131.901</u>
Operating Profit	<u>\$27.785</u>	<u>\$25.745</u>	<u>\$15.436</u>	<u>\$22.989</u>
Net Profit Margin	5.1%	6.4%	5.4%	5.6%
Berry Ratio	1.16	1.20	1.17	1.17
Return on Assets	8.3%	15.4%	11.1%	10.8%
Cost Plus	61.6%	61.4%	58.6%	60.9%
Net Cost Plus	5.4%	6.8%	5.8%	5.9%
Operating Expense/Sales	33.0%	31.7%	31.5%	32.2%
Avg. Operating Assets/Sales	61.9%	41.3%	49.0%	52.1%
Avg. Accts. Receivable/Sales	4.3%	3.0%	3.4%	3.6%
Avg. Accts. Payable/COGS	9.0%	8.0%	10.3%	9.0%
ASSETS				
Cash & Equivalents	\$3.278	\$34.293	\$0.999	\$12.857
Receivables-Total	\$31.251	\$14.663	\$9.557	\$18.490
Inventories-Total	\$129.173	\$85.967	\$62.136	\$92.425
Prepaid Expenses	\$0.000	\$0.000	\$0.000	\$0.000
Current Assets-Other	<u>\$7.523</u>	<u>\$4.003</u>	<u>\$2.578</u>	<u>\$4.701</u>
Current Assets-Total	\$171.225	\$138.926	\$75.270	\$128.474
PP&E-Total Net	\$109.142	\$51.938	\$34.243	\$65.108
Invstmnts & Advances-Other	\$1.194	\$1.653	\$1.846	\$1.564
Invstmnts & Advances-Equity	\$3.398	\$3.214	\$0.000	\$2.204
Intangibles	\$194.931	\$38.044	\$30.068	\$87.681
Deferred Charges	\$0.000	\$0.000	\$0.000	\$0.000
Other Assets	<u>\$0.538</u>	<u>\$1.263</u>	<u>\$0.192</u>	<u>\$0.664</u>
Assets-Total	<u>\$480.428</u>	<u>\$235.038</u>	<u>\$141.619</u>	<u>\$285.695</u>
Total Operating Assets	\$472.558	\$195.878	\$138.774	\$269.070
Avg. Operating Assets	\$334.218	\$167.326	\$138.774	\$213.439
Average Accts. Receivable	\$22.957	\$12.110	\$9.557	\$14.875
Average Inventory	\$107.570	\$74.052	\$62.136	\$81.253
Average Accounts Payable	\$30.029	\$19.939	\$18.377	\$22.782
LIABILITIES				
Accounts Payable	\$38.558	\$21.500	\$18.377	\$26.145
Liabilities-Other	<u>\$109.478</u>	<u>\$38.587</u>	<u>\$35.997</u>	<u>\$61.354</u>
Liabilities-Total	<u>\$148.036</u>	<u>\$60.087</u>	<u>\$54.374</u>	<u>\$87.499</u>

ULTIMATE ELECTRONICS INC

ulte

5731

	Jan01	Jan00	Jan99	3-yr Avg.
Sales-Net	\$484.408	\$384.983	\$337.454	\$434.695
Cost of Goods Sold	<u>\$323.814</u>	<u>\$262.661</u>	<u>\$233.464</u>	<u>\$293.238</u>
Gross Profit	\$160.594	\$122.322	\$103.990	\$141.458
Gross Margin	33.2%	31.8%	30.8%	32.5%
SG&A Expense	\$128.414	\$99.922	\$89.010	\$114.168
Depreciation-Amortization	<u>\$8.260</u>	<u>\$6.835</u>	<u>\$6.390</u>	<u>\$7.548</u>
Total Operating Expenses	<u>\$136.674</u>	<u>\$106.757</u>	<u>\$95.400</u>	<u>\$121.715</u>
Operating Profit	<u>\$23.920</u>	<u>\$15.565</u>	<u>\$8.590</u>	<u>\$19.742</u>
Net Profit Margin	4.9%	4.0%	2.5%	4.5%
Berry Ratio	1.18	1.15	1.09	1.16
Return on Assets	15.9%	12.5%	7.3%	14.4%
Cost Plus	49.6%	46.6%	44.5%	48.2%
Net Cost Plus	5.2%	4.2%	2.6%	4.8%
Operating Expense/Sales	28.2%	27.7%	28.3%	28.0%
Avg. Operating Assets/Sales	31.1%	32.2%	34.8%	31.6%
Avg. Accts. Receivable/Sales	5.0%	5.0%	5.3%	5.0%
Avg. Accts. Payable/COGS	8.8%	10.9%	12.8%	9.8%
ASSETS				
Cash & Equivalents	\$2.954	\$29.314	\$4.421	\$16.134
Receivables-Total	\$28.499	\$20.420	\$17.814	\$24.460
Inventories-Total	\$67.567	\$51.269	\$46.908	\$59.418
Prepaid Expenses	\$0.000	\$0.000	\$0.000	\$0.000
Current Assets-Other	<u>\$6.351</u>	<u>\$2.331</u>	<u>\$1.087</u>	<u>\$4.341</u>
Current Assets-Total	\$105.371	\$103.334	\$70.230	\$104.353
PP&E-Total Net	\$66.309	\$53.734	\$48.365	\$60.021
Invstmnts & Advances-Other	\$0.000	\$0.000	\$0.000	\$0.000
Invstmnts & Advances-Equity	\$0.000	\$0.000	\$0.000	\$0.000
Intangibles	\$1.751	\$2.026	\$2.300	\$1.889
Deferred Charges	\$0.000	\$0.000	\$0.000	\$0.000
Other Assets	<u>\$0.589</u>	<u>\$0.935</u>	<u>\$1.009</u>	<u>\$0.762</u>
Assets-Total	<u>\$174.020</u>	<u>\$160.029</u>	<u>\$121.904</u>	<u>\$167.025</u>
Total Operating Assets	\$171.066	\$130.715	\$117.483	\$150.891
Avg. Operating Assets	\$150.891	\$124.099	\$117.483	\$137.495
Average Accts. Receivable	\$24.460	\$19.117	\$17.814	\$21.788
Average Inventory	\$59.418	\$49.089	\$46.908	\$54.253
Average Accounts Payable	\$28.651	\$28.757	\$29.888	\$28.704
LIABILITIES				
Accounts Payable	\$29.677	\$27.626	\$29.888	\$28.651
Liabilities-Other	<u>\$38.373</u>	<u>\$43.531</u>	<u>\$44.341</u>	<u>\$40.952</u>
Liabilities-Total	<u>\$68.050</u>	<u>\$71.157</u>	<u>\$74.229</u>	<u>\$69.604</u>

UNITED RETAIL GROUP INC
urg
5621

	Jan01	Jan00	Jan99	3-yr Avg.
Sales-Net	\$419.712	\$382.631	\$378.562	\$401.172
Cost of Goods Sold	<u>\$313.951</u>	<u>\$275.723</u>	<u>\$268.784</u>	<u>\$294.837</u>
Gross Profit	\$105.761	\$106.908	\$109.778	\$106.335
Gross Margin	25.2%	27.9%	29.0%	26.5%
SG&A Expense	\$91.474	\$77.778	\$79.221	\$84.626
Depreciation-Amortization	<u>\$9.202</u>	<u>\$7.031</u>	<u>\$7.027</u>	<u>\$8.116</u>
Total Operating Expenses	<u>\$100.676</u>	<u>\$84.809</u>	<u>\$86.248</u>	<u>\$92.742</u>
Operating Profit	<u>\$5.085</u>	<u>\$22.099</u>	<u>\$23.530</u>	<u>\$13.592</u>
Net Profit Margin	1.2%	5.8%	6.2%	3.4%
Berry Ratio	1.05	1.26	1.27	1.15
Return on Assets	3.5%	18.1%	21.6%	10.2%
Cost Plus	33.7%	38.8%	40.8%	36.1%
Net Cost Plus	1.2%	6.1%	6.6%	3.5%
Operating Expense/Sales	24.0%	22.2%	22.8%	23.1%
Avg. Operating Assets/Sales	34.5%	31.9%	28.7%	33.3%
Avg. Accts. Receivable/Sales	0.4%	0.2%	0.1%	0.3%
Avg. Accts. Payable/COGS	9.5%	7.5%	5.3%	8.6%
ASSETS				
Cash & Equivalents	\$36.781	\$45.223	\$45.894	\$41.002
Receivables-Total	\$2.573	\$1.146	\$0.513	\$1.859
Inventories-Total	\$59.002	\$55.323	\$45.564	\$57.163
Prepaid Expenses	\$7.980	\$6.265	\$6.375	\$7.122
Current Assets-Other	<u>\$0.000</u>	<u>\$1.647</u>	<u>\$0.000</u>	<u>\$0.823</u>
Current Assets-Total	\$106.336	\$109.604	\$98.346	\$107.970
PP&E-Total Net	\$77.651	\$63.302	\$48.017	\$70.476
Invstmnts & Advances-Other	\$0.000	\$0.000	\$0.000	\$0.000
Invstmnts & Advances-Equity	\$0.000	\$0.000	\$0.000	\$0.000
Intangibles	\$0.000	\$0.000	\$0.000	\$0.000
Deferred Charges	\$0.000	\$0.000	\$0.000	\$0.000
Other Assets	<u>\$7.643</u>	<u>\$7.432</u>	<u>\$8.229</u>	<u>\$7.538</u>
Assets-Total	<u>\$191.630</u>	<u>\$180.338</u>	<u>\$154.592</u>	<u>\$185.984</u>
Total Operating Assets	\$154.849	\$135.115	\$108.698	\$144.982
Avg. Operating Assets	\$144.982	\$121.906	\$108.698	\$133.444
Average Accts. Receivable	\$1.859	\$0.830	\$0.513	\$1.345
Average Inventory	\$57.163	\$50.444	\$45.564	\$53.803
Average Accounts Payable	\$29.869	\$20.601	\$14.208	\$25.235
LIABILITIES				
Accounts Payable	\$32.746	\$26.993	\$14.208	\$29.869
Liabilities-Other	<u>\$37.088</u>	<u>\$35.588</u>	<u>\$39.237</u>	<u>\$36.338</u>
Liabilities-Total	<u>\$69.834</u>	<u>\$62.581</u>	<u>\$53.445</u>	<u>\$66.208</u>

APPENDIX 4: ADJUSTMENTS TO IMPROVE COMPARABILITY

The transfer pricing regulations state that differences between comparable companies and the tested party should be adjusted for when those adjustments can improve the reliability of the comparison. Specifically, the regulations state:

"If there are material differences between the controlled and uncontrolled transactions, adjustments must be made if the effect of such differences on prices or profits can be ascertained with sufficient accuracy to improve the reliability of the results... Generally, such adjustments must be made to the results of the uncontrolled comparable and must be based on commercial practices, economic principles, or statistical analyses. The extent and reliability of any adjustments will affect the relative reliability of the analysis."¹⁴

Typically there are two adjustments made to improve comparability: adjustments for differences in terms of purchase and sale, and adjustments for different levels of inventory holding.

Adjustments for Different Terms of Purchase and Sale

The extent to which companies extend and receive credit in the form of accounts payable and receivable has an impact on their sales and cost of sales. Sellers extend credit to purchasers in the form of an accounts receivable balance. Sellers perform two functions; they sell a product and extend credit. The selling price, therefore, incorporates two elements: the price of the product and the time value of the money lent. Presumably, if a company were to make all sales on a cash basis, it would be willing to accept a slightly lower price for its product than if it allowed its customers to pay in, for example, 60 days. Of course, the argument works in reverse for a company that holds accounts payable. Its cost of goods sold reflects not only the "cash" purchase price of its goods but also the time value of the money for the loan from its supplier. Differences in the terms of sales and terms of purchase can affect profitability comparisons.

As an example, imagine that two firms paid the same price for a product, but one company sold the product on a cash basis while the other extended credit and charged a slightly higher price to cover the time value of the money lent to the customer. Without an adjustment for the different terms of sale, it would appear that the company that sold its product for cash earned a lower gross margin than the other company.

The same example can be used to illustrate different terms of purchase. A company that paid cash to its supplier would have higher gross margins (because its cost of goods was lower) than a company that received credit from its suppliers, all other factors being equal.

¹⁴ IRC §1.482-1 (d) (2).

When different terms of purchase and sale distort the cost of goods and the sales revenue of a group of companies, then a comparison of their profitability will be distorted. To eliminate that distortion, adjustments must be made to the sales of each company so that the terms of purchase and sale are the same across companies. The comparable companies were adjusted to the tested party or taxpayer's terms.

To adjust for different terms of sale, the calculation is as follows for ROTC:

$$((AAR/COST)_{Comp} - (AAR/COST)_{TP}) \times COST_{Comp} \times i$$

Where:

AAR = the average of beginning of year and end of year accounts receivable balances.

COST = total costs and expenses

i = the interest rate ratio. The interest rate ratio is calculated as an interest rate divided by one plus the interest rate.¹⁵ The interest rate used is the three year average of the prime rate.

Comp = the uncontrolled comparable firm.

TP = the Tested Party.

The adjustment is subtracted from sales.

For the adjustment for different terms of purchase, a similar methodology as that described for the terms of sales adjustment was applied. The calculation for the adjustment to ROTC is as follows:

$$((AAP/COST)_{Comp} - (AAP/COST)_{TP}) \times COST_{Comp} \times i$$

Where:

AAP = the average of beginning of year and end of year accounts payable balances.

COST = total costs and expenses

i = the interest rate ratio, as described above.

Comp = the uncontrolled comparable firm.

TP = the Tested Party.

The adjustment is added to the gross profit or operating profit. The extent to which each comparable firm's profitability increases or decreases as a result of the terms of purchase and sale adjustments depends on its relative holdings of accounts payable and accounts receivable as a percentage of sales.

¹⁵ Dividing the interest rate by one plus the interest rate removes from the A/R or A/P amount the implicit interest cost built into the purchases or sales prices.

Adjustment for Inventory

The reason for performing an inventory adjustment is that different levels of inventory holdings reflect different services that each company offers its customers or suppliers. For example, assume that Company A holds no inventory; therefore, its customers must wait five days to receive their purchases. On the other hand, assume that Company B holds enough inventory so that every product it sells is in stock, and customers can receive their products immediately. Customers presumably are willing to pay slightly more for products from Company B because they do not have to wait for their product. Company B also needs to charge a higher price (everything else equal) to its customers to cover the cost of holding inventory. Conversely, a distributor that relieves its supplier of the burden of carrying finished goods inventories may expect to receive favorable pricing to compensate it for this added function. Different levels of inventory reflect different services offered by companies.

To apply the adjustment, each comparable company's profitability is adjusted to reflect what its estimated profitability would have been if it held the same amount of inventory as the tested party. As a result of the adjustment, the tested party's margins remain the same while the margin for each of the comparable companies changes.

The formula for the inventory adjustment to a comparable company's ROTC is as follows:

$$((AI/COST)_{Comp} - (AI/COST)_{TP}) \times COST_{Comp} \times i$$

Where:

AI = the average of beginning of year and end of year balances of inventory.

i = the three-year average prime interest rate

COST = Total costs and expenses. Note the COGS part of COST is adjusted for accounts payable for the comparable firms, and unadjusted for the tested party.

Comp = the uncontrolled comparable firm.

TP = the Tested Party.

This adjustment is subtracted from the operating or gross profit.

RAC Rent-A-Center

RENT-A-CENTER WEST, INC.

Revenue by State

FYE 12/31/2004

Date: 11/14/2006

Time 9:57 AM

L123104\Apportionment Data\Revenue\Revenue 2004.xls\RACW

	State	Rental Revenue	Installment/ Merchandise Sales	Other Income	Total Revenue Before Gross Proceeds	Gross Proceeds	Total Revenue
1	AK - Alaska	5,721,160.65	897,505.34	93.68	6,618,759.67	0.00	6,618,759.67
2	AZ - Arizona	46,676,198.47	4,120,151.77	72,177.96	50,868,528.20	35,479.38	50,904,007.58
3	CA - California	119,910,577.60	12,412,085.99	166,727.98	132,489,391.57	86,270.34	132,575,661.91
4	CO - Colorado	29,397,155.28	2,699,885.21	26,964.37	32,124,004.86	49,118.05	32,173,122.91
5	DE - Delaware	0.00	0.00	133,260.44	133,260.44	0.00	133,260.44
6	HI - Hawaii	11,207,234.55	1,551,887.62	36,391.30	12,795,513.47	5,750.00	12,801,263.47
7	ID - Idaho	4,865,587.27	510,943.36	4,455.68	5,380,986.31	0.00	5,380,986.31
8	KS - Kansas	22,969,078.79	2,024,942.59	112,142.22	25,106,163.60	14,132.45	25,120,296.05
9	MN - Minnesota	3,185,162.64	228,462.01	5,639.09	3,419,263.74	0.00	3,419,263.74
10	MT - Montana	3,010,087.58	274,756.53	1,082.51	3,285,926.62	0.00	3,285,926.62
11	ND - North Dakota	909,901.25	108,489.85	747.20	1,019,138.30	0.00	1,019,138.30
12	NE - Nebraska	5,539,780.34	482,763.36	6,325.31	6,028,869.01	4,279.85	6,033,148.86
13	NV - Nevada	16,544,347.63	1,531,001.81	35,278.87	18,110,628.31	8,733.51	18,119,361.82
14	OR - Oregon	16,469,361.15	1,680,514.80	27,468.54	18,177,344.49	3,900.00	18,181,244.49
15	SD - South Dakota	2,699,518.22	253,420.35	7,976.48	2,960,915.05	1,084.00	2,961,999.05
16	UT - Utah	10,085,513.57	1,131,509.91	11,423.99	11,228,447.47	18,200.00	11,246,647.47
17	WA - Washington	28,600,406.89	3,079,329.51	45,192.57	31,724,928.97	13,500.00	31,738,428.97
18	WY - Wyoming	3,880,993.52	398,891.07	5,762.85	4,285,647.44	2,000.00	4,287,647.44
	Grand Total without Texas	331,672,065.40	33,386,541.08	701,111.04	365,759,717.52	242,447.58	366,002,165.10
19	Royalty Income	0.00	0.00	55,221,912.35	55,221,912.35	0.00	55,221,912.35
20	Sale of Trademark	0.00	0.00	2,780,000.00	2,780,000.00	0.00	2,780,000.00
	Grand Total	331,672,065.40	33,386,541.08	58,703,023.39	423,761,629.87	242,447.58	424,004,077.45
Reconciled with:							
J:\123104\Financial Statements\SUMMARY IS.xls\RAC COMPANY				J:\123104\Apportionment Data\2004 proceeds.xls\RACW			
J - RAC WEST		331,672,065.40	33,386,541.08	55,430,369.81	420,488,976.29	242,447.58	420,731,423.87
J - RAC WEST Interest Income (GL ACCT# 6101)				133,260.44	133,260.44	0.00	133,260.44
J - RAC WEST (Sale of Trademark)				2,780,000.00	2,780,000.00	0.00	2,780,000.00
J - RAC WEST - Add Back	GL ACCT# 6024		COST OF SALES	4,936.51	4,936.51	0.00	4,936.51
J - RAC WEST - Add Back	GL ACCT# 6026		COST OF SALES	109,850.97	109,850.97	0.00	109,850.97
J - RAC WEST - Add Back	GL ACCT# 6027		COST OF SALES	244,605.66	244,605.66	0.00	244,605.66
GL Total		331,672,065.40	33,386,541.08	58,703,023.39	423,761,629.87	242,447.58	424,004,077.45
Variance		0.00	0.00	0.00	0.00	0.00	0.00



South Carolina Department of Revenue

2005

Corporate Tax Instructions

www.sctax.org

Federal Tax Form 1120, 1120A, 1120F, or 1120S must be completed before a state Form SC1120 or SC1120S can be prepared!

ELECTRONIC SERVICES

- EFT - Corporate income taxes, including estimated tax payments and license tax, can be paid electronically.
- DORePAY - Corporate declaration payments and Corporate extensions with payments can now be made by an electronic payment system. Go to **www.sctax.org** and look for the DORePAY logo.
- See page 3 for information on electronic payment options.

You may obtain forms or tax information by visiting our website at **www.sctax.org** or at your nearest Taxpayer Service Centers which are listed on page 3.

Mail Returns To: SC Department of Revenue, Corporation Return, Columbia SC 29214-0100

TOLL FREE NUMBER: Forms/Fax-On-Demand: 1-800-768-3676

POLICY DOCUMENT SUMMARY

The South Carolina Department of Revenue issues Policy Documents on a variety of tax related topics. Some examples of these documents which may be of interest to corporate taxpayers are as follows:

1. New Jobs Credit: County Rankings - S.C. Revenue Information Bulletin.
2. New Jobs Credit: Computation and Examples - S.C. Revenue Ruling #99-5.
3. Per Capita Income of Counties - S.C. Revenue Information Bulletin.
4. Quarterly Interest Rate - S.C. Information Letter.
5. Policy Document Index - S.C. Information Letter.

6. Single Member Limited Liability Company - S.C. Revenue Ruling #98-11.
7. Nexus for Income Tax (Geoffrey Implications) - S.C. Revenue Ruling #98-3.
8. Public Law 86-272 and South Carolina Income Tax - S.C. Revenue Ruling #97-15.
9. License Fee Based on Capital Stock and Paid-In or Capital Surplus - Computation and Proration Questions. Revenue Ruling #05-11

These Policy Documents are available from the South Carolina Department of Revenue. The SCDOR Internet Address is: www.sctax.org

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ABBREVIATED INSTRUCTIONS - FORM SC1120

If all of the corporation's activities are in South Carolina, federal taxable income is modified by Schedule A and B adjustments to arrive at South Carolina taxable income. After making this modification complete Part 1, page 1 to arrive at the income (loss) and compute the tax. Complete SC1120-TC for any nonrefundable credits. Then complete line 14 in Schedule D and take the total stated capital amount to Part II, page 1 to compute the license tax. Then complete the remainder of Schedule D.

If the corporation's activities are multi-state, federal taxable income as modified by Schedule A and B adjustments is taken to Schedule G for allocation and apportionment. Complete Schedule F to directly allocate dividends and capital gains on real estate and income items not related to the business of the corporation. Complete Schedule H to apportion the business income (loss) of the corporation. Generally manufacturers, retailers and others dealing with tangible personal property use the four factor apportionment ratio of Schedule H-1. Service providers, construction contractors, renters of real estate and others not dealing with tangible personal property use the single factor formula apportionment method of Schedule H-2. After allocation and apportionment, complete Schedule G to arrive at total South Carolina income (loss). Take the Schedule G amount to Part I, Page 1 to compute the tax. Complete SC1120-TC for any nonrefundable credits. For License tax purposes take total stated capital on line 14, Schedule D to Schedule E for apportionment and take this amount as apportioned to Part II, page 1 to compute the license tax. Then complete the remainder of Schedule D.

POSTAL RATE INFORMATION

You must put sufficient postage on your envelope. Envelopes without enough postage will be returned to you by the post office. Envelopes with insufficient postage will be returned and not considered timely filed

If not received by the due date. If your envelope contains more than three pages, it may require additional postage. Oversized envelopes may also require additional postage. In these cases, you should consider taking the return to the post office to determine proper postage. Your envelope should include your complete return address in the upper left corner.

TAXPAYER IDENTIFICATION FOR SC1120 AND SC1120S.

S.C. FILE NUMBER. Your South Carolina Corporate Income Tax File Number is printed on your postcard. Please include on return. If using preparer software, the file number should be entered in this area.

INCOME TAX PERIOD ENDING. If you are a 52-53 week federal filer, you must use a 52 week period for SC purposes. For example, if the Federal 52/53 week ends on January 3, enter December 31. NOTE: The federal taxable income entered on Line 1, Part 1 is not affected.

LICENSE FEE PERIOD ENDING. This period is one year ahead of the income tax period. For instance, if the income tax period ends December 31 of the current year, the license fee period ends December 31 of the following year.

FEDERAL IDENTIFICATION NUMBER. Please include on return.

NAME. Include name of Corporation.

MAILING ADDRESS. This should be the address used for all corporate income tax correspondence.

If there is a change of address, mark the appropriate block. If there is a change of accounting period, mark the appropriate block.

WHAT'S NEW

GENERAL

South Carolina has updated income tax laws to generally conform to the Internal Revenue Code of 1986 as amended through December 31, 2004, including the effective dates, with the modifications explained in the instructions.

The increased Section 179 limits provided in the Jobs and Growth Tax Relief Reconciliation Act of 2003 (P.L. 108-27) are effective only for taxable years beginning after December 31, 2003.

FEDERAL TAX LAW CHANGES NOT RECOGNIZED BY SOUTH CAROLINA

South Carolina does not recognize the deduction for domestic production activities provided in IRC Section 199. The amount of the deduction must be added back.

Also, South Carolina does not recognize the federal election for special taxation of income from qualifying shipping activities provided in IRC Section 1354. The income taxed at the special rate must be added back.

The federal deduction for domestic production activities and the special taxation of income from qualifying shipping activities are provided in the American Jobs Creation Act of 2004.

APPORTIONMENT OF CERTAIN DIVIDENDS

For taxable years beginning after 2004, dividends received from corporate stocks not connected with a taxpayer's business, less all related expenses, are allocated to the state of the corporation's principal place of business.

COMPOSITE FILING

For taxable years beginning after 2004, nonresidents can participate in a composite filing, even if they have other sources of South Carolina income. Corporate taxpayers cannot participate in a composite return.

CONSERVATION EASEMENTS

No credit is allowed for conservation easements unless the contribution meets the requirements of both IRC Section 170 and S.C. Code Section 12-6-5590.

REFUNDABLE CREDIT FOR ANHYDROUS AMMONIA ADDITIVE

For taxable years beginning after 2004, a resident taxpayer engaged in the business of farming is allowed a refundable income tax credit equal to the amount expended by the taxpayer to obtain the additive required to comply with the provisions of Section 44-53-375(E)(2)(a)(ii) for the agricultural use of anhydrous ammonia. Claim the credit on I-333.

REFUNDABLE CREDIT FOR PRODUCTION AND SALE OF MILK

For taxable years beginning after 2004, a resident taxpayer engaged in the business of producing milk for sale is allowed a refundable income tax credit based on the amount of milk produced and sold when the USDA Class I price of fluid milk in South Carolina drops below the production price anytime during the taxable year. The credit amount is \$10,000 for the production and sale of the first 500,000 pounds of milk sold below the production price over a calendar year, and \$5,000 for each additional 500,000 pounds of milk sold below the production price. The initial credit and the additional credit must be prorated on a quarterly basis. Claim the credit on I-334.

TAX CREDIT FOR FEES PAID FOR QUALITY PROGRAM

Effective June 9, 2005, taxpayers that pay an annual fee to the South Carolina Quality Forum to participate in quality programs are allowed a tax credit equal to the annual registration fee. Taxpayers also are allowed a tax credit equal to fifty percent of any fees charged to participate in the organizational performance excellence assessment process. Credits earned are limited to the amount of tax liability on the return and are not refundable. The credit may not be carried forward. Claim the credit on TC-28.

NEW JOB AND INVESTMENT CREDIT FOR USE OF PORT FACILITIES

Companies primarily engaged in manufacturing, warehousing, or distribution, which use port facilities in this State and which increase their base port cargo volume at these facilities by a minimum of five percent over 2005 totals, are eligible to take either a five hundred dollar additional tax credit for each new full-time job created, or an additional two percent investment tax credit for investments in new facilities, plants, and equipment.

CORPORATE TAX MORATORIUM

Eligibility for the corporate tax moratorium provided in Section 12-6-3365 expired July 1, 2005.

CERTIFIED HISTORIC STRUCTURE CREDIT

Section 12-6-3535 provides that a taxpayer who qualifies for the federal rehabilitation credit under IRC Section 47 also qualifies for a South Carolina credit for making qualified rehabilitation expenditures for a certified historic structure. For tax years after 2004, the South Carolina credit can be claimed against income or license tax.

VENTURE CAPITAL INVESTMENT CREDIT

The Venture Capital Investment Act creates a Venture Capital Authority within the Department of Commerce and expands the venture capital investment credit to allow the credit to be applied against corporate and personal income tax, bank and title company taxes, insurance premiums tax, and corporate license fees and other business license taxes. The act is effective June 3, 2005. The credit may be claimed on TC-26.

WHAT'S NEW

FORMS CHANGES FOR 2005

New Credit Forms

TC-26 Venture Capital Credit

TC-28 Quality Forum Credit

I-333 Anhydrous Ammonia Additive Credit

I-334 Milk Credit

SC1120T, SC1129S-WH and SC1120CDP

The SC1120T, SC1120S-WH and SC1120CDP were three on a page. Now they are a whole sheet format with a remittance form at the bottom to be cut off and sent in by taxpayer.

REMINDERS



Calculator - A penalty and interest calculator is now available on our website under: www.sctax.org>Penalty and Interest Calculator.

CONTINGENT FEES FOR RETURN PREPARATION

South Carolina generally recognizes the Internal Revenue Code of 1986, as amended through December 31, 2004, and the current Treasury Circular No. 230. The United States Treasury Circular No. 230 is a document published to consolidate federal statutes and regulations that affect individuals who are eligible to practice before the Internal Revenue Service. Treasury Circular No. 230 states that a practitioner may not charge a contingent fee for preparing an original tax return or for any advice rendered in connection with a position taken or to be taken on an original tax return.

PAYMENT BY ELECTRONIC FUNDS TRANSFER

Corporations can pay income tax, estimated income tax, and license tax payments electronically. To get started the company must register with the SC Department of Revenue. The registration process takes up to three weeks. For more information about electronic funds transfers (EFT)

or to receive an EFT Program Guide call 1-800-476-0311 or in the Columbia area (803) 898-5740, or write to SCDOR, EFT/EDI Help Desk, Columbia, SC 29214-0016. After transmitting your payments electronically, be sure to check the EFT block on your return.



DORePAY - ELECTRONIC PAYMENT SYSTEM

- Corporate Filers can submit SC1120-CDP (corporate declaration payments), SC1120-T, extension payments and receivable payments directly to the SC Department of Revenue via DORePAY. Go to www.sctax.org and look for the DOR ePAY logo.
- Payment must be submitted by credit card or by Electronic Funds Withdrawal (bank draft).
- Corporations must use their assigned South Carolina Corporate Income Tax File Number in order to transmit their payments. If you do not have this number you may contact the Corporate Section at (803) 898-5705.

TAXPAYER SERVICE CENTERS

MAIN OFFICE Columbia Mills Building, 301 Gervais Street, P.O. Box 125, Columbia, SC 29214 (803) 898-5000

Charleston Southpark Office Building, 3 Southpark Circle, Suite 202, Charleston, SC 29407 (843) 852-3600 (843) 556-1780 (FAX)

Florence 1452 West Evans Street, P.O. Box 5418, Florence, SC 29502 (843) 661-4850 (843) 662-4876 (FAX)

Greenville Century Plaza, 211 Century Drive, Suite 210-B, Greenville, SC 29607 (864) 241-1200 (864) 232-5008 (FAX)

Myrtle Beach 1330 Howard Parkway, Myrtle Beach, SC 29577-1407

Rock Hill Business and Technology Center, 454 S. Anderson Road, Suite 202, P.O. Box 12099, Rock Hill, SC 29731 (803) 324-7641 (803) 324-8289 (FAX)

CORPORATE FACTS TO REMEMBER

The SC Department of Revenue has identified several basic corporate requirements that result in the majority of correspondence between the SC Department of Revenue and corporations. Most errors found when processing corporate returns involve the following basic requirements:

1. An Initial Annual Report (CL-1) is required to be filed by both Qualified and Non-Qualified Corporations.
2. A South Carolina Corporate return is required to be filed, **regardless of the activity**, from the date the charter/authority is granted through the date of voluntary dissolution/withdrawal.
3. If any corporate income tax or license fee is anticipated to be due, the taxpayer must make payment with SC1120-T by original due date.

If no income tax or license fee is anticipated to be due and the taxpayer has requested a federal extension, the federal extension will be accepted as a South Carolina extension if the corporate return is received within the time as extended by the Internal Revenue Service.

A copy of the federal or South Carolina extension(s) must be attached to the return when filed.

There is no extension for payment of corporate income tax or license fee. Any income tax or license fee due must be paid by the prescribed due date to avoid the assessment of late penalties and interest.

4. Corporations filing a consolidated return should file a single South Carolina extension and attach a schedule listing the corporations to be included in the **South Carolina consolidation**. A federal extension will be accepted if all corporations filing in South Carolina are included in one or more federal extensions. **A schedule must also be attached listing the corporations included in the South Carolina consolidation.**

5. The period covered by the South Carolina corporate return must be the same as that covered by the Federal return (except for 52-53 week filers whose year end should be the last day of the previous month).

6. The license fee is calculated using Capital Stock and Paid-in Surplus. Do not use Retained Earnings in the calculation.

7. A consolidated return must include the calculation of a separate license fee for the parent and each subsidiary. A separate annual report and profit-and-loss statement are also required using each member's own apportionment ratio.

8. When claiming withholding, the corporation must provide all necessary withholding statements (i.e. W2's/1099's) and a schedule of payments made to South Carolina when the corporation closes its books on a fiscal year basis.

9. The corporation is required to pay 100% of the total income tax due in quarterly estimated payments, even in the first year of filing.

10. Be sure to use your South Carolina Corporate Income Tax File Number on all returns and correspondence.

11. Appropriate forms must be sent with all remittances. Checks should be made payable to SC Department of Revenue and should include the South Carolina Corporate Income Tax File Number (see below).

In an effort to ensure voluntary compliance, please remember these basic requirements. Corporations transacting business in South Carolina are subject to all corporate filing requirements set forth in the South Carolina Code of Laws.

If you have any questions, please contact the Corporate Section of the SC Department of Revenue at (803) 898-5705.

REMITTANCE BY CHECK:

1. Checks must be made payable to: SC DEPARTMENT OF REVENUE
2. Verify the dollar and written amount of the check.
3. Indicate type of tax and South Carolina Corporate Income Tax File Number on the check.
4. Complete signature must be provided.
5. Return and check must be mailed in the same envelope.

Your Name _____		20 _____	
Your Address _____			
Any town, State, Zip _____			
SAMPLE			
Pay to _____ (1)	\$ _____ (2)		
FOR _____ (3)	_____ (4)		
:: 123456789 :: 123456 " 1234			

SC1120 GENERAL INSTRUCTIONS (Rev. 8/31/05)

FILING REQUIREMENTS - Every corporation, except those listed below, that is transacting or conducting business within this state is required to file SC1120. A corporation must be chartered or qualified to do business in this state with the Office of the Secretary of State.

Special Returns for certain organizations not required to file SC1120:

Non-profit corporations: see SC990T and instructions

Banks: file SC1101B

Savings and Loans: file SC1104

S Corporations: file SC1120S

(See page 12 of instructions for SC1120S information).

Insurance Companies: File with the South Carolina Department of Insurance.

Homeowners Associations filing federal Form 1120H with no taxable income.

A copy of the federal form and supporting schedules must be attached to each return.



CAUTION: A corporation must continue to file a return and pay the license fee until such charter or qualification is canceled regardless of the activity of the corporation. (See the section of these instructions entitled "Final Return").

BASIS OF RETURN

The taxable income as shown on federal Form 1120, 1120A, or 1120F is the basis of the South Carolina return, with certain adjustments for federal and state differences. A copy of the federal return and all supporting schedules must be attached to the South Carolina return. The South Carolina gross income and taxable income of a corporation is the corporation's gross income and taxable income as determined under the Internal Revenue Code subject to the modifications required by state law.

WHEN TO FILE

In general, a corporation must file its income tax return by the fifteenth day of the third month after the end of the tax year. A new corporation filing a short period return must generally file by the fifteenth day of the third month after the short period ends. A corporation that has dissolved must file by the fifteenth day of the third month after the date it has dissolved and filed the Articles of Dissolution with the Secretary of State.

REQUEST FOR EXTENSION TO FILE

If any corporate income tax or license fee is anticipated to be due, the taxpayer must use South Carolina extension SC1120-T or file electronically at www.sctax.org under DORePAY.

If no income tax or license fee is anticipated to be due and the taxpayer has requested a federal extension, the federal extension will be accepted as a South Carolina extension if the corporate return is received within the time as extended by the Internal Revenue Service.

Corporations filing a consolidated return should file a single South Carolina extension and attach a schedule listing the corporations to be included in the **South Carolina consolidation**. A federal extension will be accepted if all corporations filing in South Carolina are included in one or more federal extensions. A schedule must also be attached listing the corporations included in the South Carolina consolidation.

A copy of the federal or South Carolina extension(s) must be attached to the return when filed.

There is no extension for payment of corporate income tax or license fee. Any income tax or license fee due must be paid by the prescribed due date to avoid the assessment of late penalties and interest.

An extension of time to file the **Corporate Income Tax Return** requested on an SC1120-T or on a federal extension does not extend the **Business Personal Property Return (Form PT-100)** which must be filed by the last day of the fourth month following the end of the taxable year.

CORPORATIONS ARE REQUIRED TO INCLUDE INFORMATION IN THE HEADING OF THE RETURN (See next two items below).

TOTAL GROSS RECEIPTS

The amount to enter for Total Gross Receipts is the amount from Line 1c of the Federal Return Form 1120 or 1120S. If there is no entry for Line 1c, enter total income from all other sources.

TOTAL COST OF DEPRECIABLE PERSONAL PROPERTY IN SOUTH CAROLINA

The amount to enter for depreciable personal property in South Carolina includes the total original cost of furniture, fixtures, machinery, equipment and vehicles without regard to any deductions for depreciation.

If filing consolidated, enter the total cost of these respective amounts for all members of the consolidated group. Attach a schedule showing the separate amounts for each corporation.

DECLARATION OF ESTIMATED TAX

The corporation must file a declaration of estimated income tax with the SC Department of Revenue on or before the fifteenth day of the fourth month following the beginning of the taxable year. If the amount of estimated tax is less than one hundred dollars, no such declaration is required. A declaration of estimated tax for the period must be completed on SC1120-CDP and (100%) one hundred percent of the tax liability shown to be due thereon must be paid on or before the fifteenth day of the fourth month, after the close of the preceding income year or in four equal installments on the fifteenth day of the fourth, sixth, ninth and twelfth months.

A corporation may avoid the penalty for Underpayment of Declaration by paying each payment timely if the total tax paid is at least the same as the total tax due, pursuant to requirements for federal estimated income tax in Internal Revenue Code Section 6655. See SC2220 for computation of the penalty.

PENALTIES AND INTEREST

Avoid penalties and interest by correctly filing and paying the tax when due.

- A corporation is required under Code Section 12-54-210 to keep books, papers, memoranda, records, render statements, make returns and comply with regulations as the department prescribes. If a Corporation fails to comply with the provisions of this section, a **failure to comply penalty** must be added not to exceed five hundred dollars for the period covered by the return in addition to other penalties provided by law.

- If a corporation fails to file its tax return when due (including any extensions of time for filing), it may be subject to a **failure to file penalty** of five percent of the amount of the tax due. If failure is for not more than one month, with an additional five percent for each additional month or fraction thereof during which the failure continues, not exceeding twenty-five percent in the aggregate must be added. The penalty is calculated on the amount of tax shown due on the return reduced by any amounts paid on or before the date prescribed for payment of the tax. In any event the SC Department of Revenue may assess a late filing penalty of up to \$500.00 in addition to the above specified late filing penalties.

- If a corporation fails to pay any tax on or before the due date, a **failure to pay penalty** must be added to the tax. The penalty shall be one-half of one percent of the amount of the tax if the failure is for not more than one month, with an additional one-half of one percent for each additional month or fraction thereof during which the failure continues, not exceeding twenty-five percent.

- If a corporation underpays its tax liability and the underpayment is due to negligence or disregard of regulations, it will be charged a **negligence penalty** of five percent of the underpayment plus fifty percent of the interest payable.

- If a corporation substantially understates its tax, it will be charged a **substantial understatement penalty** of twenty-five percent of the understatement. A substantial understatement is the greater of ten percent of the tax liability or ten thousand dollars. In the case of an S Corporation or a personal holding company a substantial understatement is the greater of five thousand dollars or ten percent of the tax liability.

- If a corporation fails to remit the tax due it will be charged **interest** at the rate provided under Internal Revenue Code Sections 6621 and 6622. The interest must be calculated on the full amount of tax or portion thereof, exclusive of penalties, from the time the tax was due until paid in its entirety.

AMENDED RETURN

In order to amend a previously filed SC1120 or SC1120S, complete a new form and write "AMENDED" on the face of the return. An explanation of the adjustments and a copy of the federal 1120X must be attached to the amended return.

CONSOLIDATED RETURNS

For South Carolina Income Tax purposes a consolidated return shall mean a single return for two or more corporations in which income or loss and license fee is computed separately for each corporation and combined into one return. All corporations included in the consolidated return must be subject to tax in South Carolina and have the same accounting year. The election to file a consolidated return must be made on an original and timely filed return. Once an election is made, such election must be adhered to until permission is granted by the SC Department of Revenue to file a separate return.

These corporations must also be substantially under the control of the same interest. "Substantial control" means the ownership of at least eighty percent of all classes of stock. A domestic or multi-state corporation can file a consolidated return. You must compute the income and license fee separately for each entity included in the consolidation.

Remember: a multi-state corporation must compute and use a separate apportionment ratio in arriving at the SC taxable income and license fee for each entity included in the consolidation.

The following is an example of a multi-state consolidated return:

Income: Corporation	Taxable Income	SC Apportionment Ratio	SC Taxable Income
A	45,000	80%	36,000
B	(15,000)	90%	(13,500)
Total SC Taxable Income			22,500

License: Corporation	Total Stated Capital	SC Apportionment Ratio	(X .001 + 15.00) Not less than \$25
A	150,000	80%	135.00
B	1,000	90%	25.00
Total SC License Fee			160.00

TRANSFERS TO A CORPORATION CONTROLLED BY THE TRANSFEROR

If a person receives stock or securities of a corporation in exchange for property and no gain or loss is recognized under Section 351 of the Internal Revenue Code, the person (transferor) and the transferee must attach the same information required by the Internal Revenue Regulations 1.351-3.

FINAL RETURN

A corporation must follow the steps listed below when filing a "Final Return" and ceasing to exist or when withdrawing from this state.

1. A domestic corporation must file the Articles of Dissolution with the Secretary of State.
2. A corporation other than a domestic corporation must file the Articles of Withdrawal with the Secretary of State.
3. The corporation must file a final tax return by the fifteenth day of the third month after the end of the tax year after filing such Articles of Dissolution or Withdrawal. A schedule must accompany the final return showing the distribution of the assets to the stockholders.
 - An extension of time to file may be obtained by filing Form SC1120-T prior to expiration of the filing period **if there is tax due**.
 - If the taxpayer is not required to make a payment for tax or license fee at the time of the extension, and the taxpayer has been granted an extension of time to file a federal income tax return, it is not necessary to file a separate state extension form. Attach a copy of the properly filed federal extension to the final South Carolina return when filed.
4. The appropriate box in the upper right corner of the return should be marked in the space indicating the reason for the final return.

SIGNATURE

The return must be signed by an officer of the corporation duly authorized to make the report on behalf of the corporation.

The signature section of the return contains a "check the box" authorization for release of confidential information. A check in the "yes" box authorizes the Director of the Department of Revenue or delegate to discuss the return, its attachments and any notices, adjustments or assessments with the preparer.

ACCOUNTING METHOD

The accounting method must be the same as the method used for federal income tax purposes. If a change in accounting method is approved or changed by the Internal Revenue Service, the taxpayer must provide the SC Department of Revenue with a copy of the written permission (Form 1128) received from the Internal Revenue Service.

- (A) A taxpayer's method of accounting under this chapter must be the same as for federal income tax purposes.
- (B) If a taxpayer's method of accounting is changed for federal income tax purposes:
- (1) The method of accounting for South Carolina income tax purposes is changed. The taxpayer shall provide the department with a copy of the written permission received from the Internal Revenue Service. When written permission is not required to change a method of accounting, the taxpayer shall provide the department with a copy of the election or statement provided to the Internal Revenue Service.
 - (2) Additional South Carolina income or deductions which result from adjustments that are necessary because of a change in the method of accounting are included in or deducted from income as provided in the Internal Revenue Code.

DEFINITIONS

- 'Tangible property' is real property and corporeal personal property and does not mean money, bank deposits, shares of stock, bonds, credits, evidences of debt, choses in action, or evidences of an interest in property.
- 'Intangible property' is all property other than tangible property.

- 'Income year' is the calendar year or the fiscal year upon the basis of which the federal net income is computed.
- 'Fiscal year' is an income year ending on the last day of any month other than December.
- 'Received' for the purpose of the computations of net income under this chapter means 'received or accrued' and 'received and accrued' must be construed according to the method of accounting upon the basis of which the net income is computed.
- 'Foreign corporation' is any corporation chartered outside of South Carolina. A 'Domestic corporation' is chartered in South Carolina.
- The phrase 'property having an actual situs in this state' includes real property physically located within this state and personal property of a bona fide resident of this state wherever situated.
- All of the various terms defined in Sections 7701-7703 of the Internal Revenue Code have the same meaning for South Carolina income tax purposes, unless a different meaning is clearly required.
- 'Resident corporation' is a corporation whose principal place of business is located within this state. 'Non-resident corporation' is any corporation other than a resident corporation.

ROUNDING OFF CENTS TO THE NEAREST WHOLE DOLLAR

The corporation may show the money items on the return and accompanying schedules as whole dollar amounts. To do so, drop any amount less than 50 cents and increase any amount from 50 cents through 99 cents to the next higher dollar.

USE TAX ON OUT-OF-STATE PURCHASES

South Carolina schools lose funds each year because taxpayers buy merchandise out of state and do not pay South Carolina tax on those purchases. In addition to the loss of revenue for public education, South Carolina businesses are placed at an unfair disadvantage because they must collect the sales tax.

If you buy goods from out of state and bring those goods into South Carolina, you owe 5% state use tax (6% or 7% or applicable rate if you operate in a county with a local tax). The use tax is complementary to the sales tax and has been in existence since 1954. If you paid sales tax to another state, you are allowed a credit for the tax you already paid. For example, if you bought goods in North Carolina and paid 5%

sales tax there, you would owe no more use tax to South Carolina unless you operate in a local option tax county and then you would owe an additional 1% or 2% or applicable rate tax, depending on the county.

Use tax for corporations is usually paid under the corporation's Sales Tax License or Use Tax Registration number. If your corporation makes regular purchases of goods from out of state for use in South Carolina, you should obtain a Use Tax Registration number. If you need assistance, contact the Registration Unit at the Department at (803) 898-5872.

TAXPAYERS' BILL OF RIGHTS

- You have the right to apply for relief or assistance from the Taxpayer Rights' Advocate within the Department of Revenue. The Taxpayer Rights' Advocate is responsible for the resolution of taxpayer complaints and problems. Under certain conditions, the advocate may postpone until resolution any actions determined to cause you irreparable loss.
- You have the right to request and receive forms, instructions and other written materials in plain, easy-to-understand language.
- You have the right to prompt, courteous service from us in all your dealings with the Department of Revenue.
- You have the right to request and receive written information guides, which explain in simple and nontechnical language, appeal procedures and your remedies as a taxpayer.
- You have the right to receive notices which contain descriptions of the basis for and identification of amounts of any tax, interest and penalties due.

THE FAMILY PRIVACY PROTECTION ACT

Under the Family Privacy Protection Act, the collection of personal information from citizens by the Department of Revenue is limited to the information necessary for the Department to fulfill its statutory duties. In most instances, once this information is collected by the Department, it is protected by law from public disclosure. In those situations where public disclosure is not prohibited, the Family Privacy Protection Act prevents such information from being used by third parties for commercial solicitation purposes.

SC1120 C CORPORATION INSTRUCTIONS

Part I COMPUTATION OF INCOME TAX LIABILITY

Line 2. Net Adjustment

Complete Schedule A and B, page 2 and enter the amount from line 12.

Some of the **additions** to federal taxable income are:

- Interest on other states' obligations. (Interest on obligations from this state and any of its political subdivisions is exempt).
- State and local income taxes or state and local franchise taxes measured by net income, any income taxes, or any taxes measured by or with respect to net income.
- South Carolina law allows the same depletion as Internal Revenue Code Sections 611 through 613. A corporation that allocates or apportions income has the option of adding back depletion before apportionment and of deducting depletion after apportionment on mines, oil, and gas wells and other natural deposits located in this state, except that the allowances may not exceed fifty percent of the net income apportioned to South Carolina.
- Any taxpayer who is reporting income or deducting expenses over a time period as a result of a change of accounting method or accounting year, shall continue to report income or deduct expenses in the manner provided in the Internal Revenue Code and approved by the Internal Revenue Service. At the expiration of the authorized adjustment period, the balance of the income or expenses must be reported or deducted in the same manner and amount for South Carolina income tax purposes until all of the income or expenses have been fully reported or deducted.
- Transitional adjustment on items of prepaid income or deferred expenses. (See the instructions on Accounting Method and attach a schedule showing how the addition was derived).
- Federal net operating losses are additions to income.
- Taxpayers must reduce the basis of certain property to the extent the corporate headquarters credit is claimed. An addition must be made for the resulting reduction in depreciation.
- Effective for qualifying investments made after June 30, 1998, taxpayers must reduce the basis of the qualifying property to the extent the Economic Impact Zone Investment Tax Credit is claimed. An addition to federal taxable income must be made for the resulting reduction in depreciation.
- Corporate taxpayers that claim a child care program credit for donations to a nonprofit South Carolina corporation providing child care services to its employees (Schedule TC-9) are not allowed a deduction for these donations. The disallowed deductions are an addition to federal taxable income.
- The deduction for wages paid must be reduced by the amount of credit claimed for wages paid to employees terminated due to base closure or due to federal facility reduction in force (Schedule TC-10). The amount of this credit is an addition to federal taxable income.

Some of the **deductions** from federal taxable income are:

- The "gross-up" of dividends received from a Foreign Corporation located outside of the U.S. required by a Domestic U.S. corporation electing the foreign tax credit as provided for in Internal Revenue Code Section 78 is **subtracted** from federal net taxable income.

- Reduction in depreciable property due to investment credit election will result in an ordinary expense for South Carolina purposes.
- Effective for taxable years beginning after December 31, 1984, South Carolina has adopted federal depreciation and Internal Revenue Code Section 179 expensing for South Carolina income tax purposes. The deduction for depreciation cannot exceed your depreciable basis. As of 1985, the depreciation due to prior federal and state differences will occur at the end of the federal depreciation period. The balance of personal property basis will be depreciated at the rate of 50% per year and real property basis at the rate of 20% per year.
- If a corporation disposes of an asset that has a different South Carolina basis and federal basis, the corporation shall adjust SC gain or loss to reflect the difference in the basis of the assets.
- Transitional adjustment for items of prepaid income or deferred expenses. (See the instructions for Accounting and attach a schedule showing how the deduction was derived).
- If a taxpayer is reporting income from the liquidation of a corporation under Internal Revenue Code Section 337 using the installment method of reporting or from an installment sale under Internal Revenue Code Section 453, and the corporation has previously reported all the gain for South Carolina tax purposes, then SC income must be reduced by the amount of the installment gain.
- If a corporation is claiming a reduction in salaries and wages due to the federal jobs credit, subtract this amount for South Carolina purposes.
- Dividends received from foreign corporations (located outside of the U.S.) that are included in federal taxable income may be reduced in the same manner that dividends received from domestic corporations are deducted under Internal Revenue Code Section 243.

FEDERAL BONUS DEPRECIATION ADJUSTMENTS

South Carolina **did not** adopt the bonus federal depreciation signed into law in May 2002 or 2003. When the taxpayer includes the 30% or 50% additional depreciation allowance in calculating federal taxable income, the taxpayer must adjust the basis of the property for computing the first-year depreciation expense, as well as the subsequent year's depreciation expense on the qualifying property. An addition or subtraction is also required in the calculation of SC taxable income for the difference in the depreciation expense claimed for federal purposes and the amount allowed for SC purposes. Adjustments to SC taxable income on SC Corporate returns can be reported on Schedules A and B (Additions to/Deductions from Federal Taxable Income). Attach a schedule showing computation of the differences reported.

An addition or subtraction may be required when qualifying property is sold to reflect the difference in the amount of gain or loss on the sale of the property and the amount of any depreciation recapture, if any, as a result of the differing basis in the property for federal and state purposes. Attach a schedule showing computation of the differences reported.

Line 5

South Carolina Net Operating Loss ("NOL") Carryover. For taxable years beginning after December 31, 1984, South Carolina has adopted the federal net operating loss with modification as provided in Section 12-6-1110. However, for South Carolina Net Operating Loss purposes no carrybacks are allowed. If a corporation has a South Carolina loss carryover which has not expired as of January 1, 1985, the loss may be carried forward until exhausted or the statute (which is the same as Internal Revenue Code 172) has expired.

Be sure to make the addition on Schedule A, SC1120 if a federal net operating loss is claimed on the federal Form 1120. CAUTION: Do not make the adjustment for net operating loss on Schedule G, SC1120.



After adding the federal NOL to federal taxable income in Schedule A, the South Carolina NOL is subtracted on Line 5. If the prior year was the first year of loss, the current year Line 5 amount is obtained from Line 4 of the previous year.

Line 8

For South Carolina purposes, if a corporation has receipts from invoices issued by a seller directly to an unrelated purchaser outside the United States, better known as "foreign trade receipts", and wishes to defer the state income taxes, see Form TD-1 for instructions and computations. Line 8 would also include any deferred LIFO recapture tax pursuant to IRC Section 1363.

Line 10

If any credit is earned by a fellow member of a controlled group, attach a schedule with details.

Line 12

South Carolina recognizes the shareholders deferral of foreign trade receipts by a Domestic International Sales Corporation (DISC). Multiply the deferred federal foreign trade income by 5.0% to determine the South Carolina deferred income tax liability.

The interest for South Carolina is calculated by using the same interest rate used on the federal form. Enter only the interest determined on line 12, SC1120. Also, enter the interest applicable to deferred tax on line 8.

Also include on line 12 any interest on tax attributable to payments received on installment sale of certain timeshares and residential lots. Write "Section 453(l)(3)" to the left of the amount. Attach a statement showing the computations.

Line 14(a)

Attach Form W-2, I-290 or 1099. (South Carolina Schedule K-1 or Partner Information (SC1085) or Settlement Statements are not accepted.) See Code Section 12-8-590(D) and Code Section 12-8-1540(A). If you are a fiscal year taxpayer, include a schedule of amounts withheld on a monthly basis.

Line 14(b)

Include prior year overpayments in the total amount on this line.

Line 19

If line 15 is larger than line 18, enter the overpayment and indicate how the overpayment is to be applied.

Part II Computation of License Fee

Every corporation organized under the laws of the state of South Carolina and every corporation organized to do business under the laws of another state, territory or country and qualified to do business in this state and any other corporation required to file an income tax return shall compute and pay a license fee except:

- corporations organized for tax exempt purposes and exempt from income tax pursuant to Internal Revenue Code Section 501
- volunteer fire departments and rescue squads
- cooperative under Chapters 45 and 47 of Title 33
- building and loan association or credit union doing a strictly mutual business
- insurance, fraternal, beneficial, or mutual protection insurance company
- foreign corporation whose entire income is not included in gross income for federal income tax purposes due to any treaty obligation of the United States
- homeowner's association within the meaning of Internal Revenue Code Section 528(c)(1)

The license fee is computed on the total capital stock and the entire surplus of a corporation other than its earned surplus.

If a consolidated return is filed, the license fee shall be measured by the total capital and paid in surplus for each corporation considered separately without offset for investment of one corporation in the capital or surplus of another corporation in the group electing to file the consolidated return. Do not file separate returns paying the license fee if you are filing a consolidated return for income tax purposes.

The license fee for a bank holding company, a savings and loan holding company and an insurance holding company must be measured by the capital stock and paid in surplus of the holding company minus the capital stock and paid in surplus of any bank, savings and loan association, or insurance company that is a subsidiary of the holding company.

A corporation may prorate its license fee when its tax year is changed and a return of less than twelve months is required. This proration applies only to short periods due to a change in accounting period and does not apply to short periods due to initial or final returns. The prorated license fee cannot be less than \$25.00.

In place of the license fee based on capital stock and paid in capital, a license fee based on gross receipts from regulated business and South Carolina property used in the conduct of business is imposed on certain companies that are organized under South Carolina law or that are qualified to do business in South Carolina as a waterworks company, power company, electric cooperative, light company, gas company, telephone company, telegraph company, express company, street railway company, or navigation company. These enumerated companies are not defined by statute or regulation.

Line 20

The total capital and paid in surplus should be entered. If the corporation is subject to apportionment, Schedule E should be completed and the amount on line 2 entered.

Line 21

Multiply the total capital and paid in surplus by one mill (.001). Then add \$15.00. The license fee cannot be less than \$25.00. For a combined taxpayer, apply the above computation to each corporation in the combined group and then total them. The license fee for each of the corporations cannot be less than \$25.00.

Line 22

Enter the amount from SC1120-TC, Part II for credits applied to the license fee.

Line 24

Any amount paid with a tentative return or a transfer from the declaration of taxes should be entered. (Total payments should be entered on line 25.)

Line 27

Penalty and interest calculator is available on our website: www.sctax.org

Line 29

An overpayment, as indicated by line 29, may be (a) credited to the following year's estimated tax, (b) credited to the current year's tax liability, or (c) refunded.

Schedule A - Additions to Income

Refer to instructions for line 2.

Schedule B - Deductions from Income

Refer to instructions for line 2.

Schedule C - Summary of Credits

SC1120-TC along with the applicable Tax Credit Schedule must be attached to the tax return. See SC1120-TC for further instructions.

Schedule D - Annual Report

Complete all information requested.

Schedule E - License Fee-Multi-state

Complete all information requested.

SCHEDULE F - INCOME SUBJECT TO DIRECT ALLOCATION

Definitions:

- "Income from property not connected with the business" means income other than income from property connected with the business.
- "Principal place of business" means the domicile of a corporation, except when none of the business of the corporation is conducted in the state of domicile, in which circumstances the SC Department of Revenue shall determine, in light of the available evidence, the principal place of business.
- "Related expenses" means any cost incurred, directly or indirectly in connection with the investment for the production of income or future income which is or will be specifically or directly allocable.

Line 1 - Interest from intangible property not connected with the business of the taxpayer, less all related expenses, is allocated to the principal place of business of the corporation.

Line 2 - Dividends received from corporate stocks not connected with the taxpayer's business (after dividends received deductions under Internal Revenue Code Section 243) less all related expenses, are allocated to the state of the corporation's principal place of business.

Line 3 - Rents received from the lease or rental of real or tangible personal property and royalties from tangible property, where the property was not used in or connected with the business of the taxpayer during the income year, less all related expenses, are allocated to the state in which the property is located.

Line 4 - Gains or losses from the sale of real property are allocated to the state in which the property is located.

Line 5 - Gains or losses from the sale of intangible personal property not connected with the business of the taxpayer, less all related expenses, is allocated to the principal place of business of the corporation.

Line 6 - Income, less all related expenses from any other investment, including investments in subsidiaries, the net income from which is not properly includable in the net apportionable income of corporations engaged in Interstate Commerce under the Constitution of The United States because it is unrelated to the business activity of the corporation conducted partly within and partly without South Carolina, is allocated to the state in which the business situs of the investment is located; provided, that if the business situs of such investment is partly within and partly without South Carolina, the income is subject to apportionment.

NOTE: Attach an explanation of each type of income that is not allocated to South Carolina.

SCHEDULE G - MULTI-STATE OPERATIONS

If a multi-state business, complete this schedule.

SCHEDULE H-1 - FOUR FACTOR FORMULA (Double Weighted Sales)

A taxpayer whose principal business in the state is:

- (a) manufacturing or any form of collecting, buying, assembling or processing goods and materials within this state, or
- (b) selling, distributing or dealing in tangible personal property within this state,

shall make returns and pay annually an income tax upon a proportion of its remaining net income after allocation computed on the basis of the arithmetical average of the following factors:

(A) Property

- a) The property factor is a fraction in which the numerator is the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the taxable year and the denominator is the average value of all the taxpayer's real and tangible personal property owned or rented and used during the taxable year. The property factor does not include property which produces income that is allocated rather than apportioned.
- b) As used in this factor, tangible personal property means corporeal property such as machinery, tools, implements, equipment, goods, wares, and merchandise, but does not include cash, shares of stock, bonds, notes, accounts receivables, credits, special privileges, franchises, goodwill, or evidences of debt.
- c) The average value of property is determined by averaging the values at the beginning and end of the taxable year. If this average does not fairly represent the yearly average because of material changes during the year, the average must be determined on a monthly or daily basis.

d) For purposes of this factor, value of property is determined as follows:

(1) Inventory is valued using the taxpayer's book accounting practices unless in the department's opinion a different method more accurately reflects net income. If the taxpayer does not take or keep records of periodic inventories or if the method and time of taking the inventories does not accurately reflect the true average inventory, the department may determine the average inventory from information available.

(2) For property owned other than inventory, value is the original cost plus any additions or improvements without regard to deductions for depreciation, amortization, write-downs, or similar charges. If this method of valuation results in the taxation of more than one hundred percent of the income of the taxpayer in all the states in which the taxpayer files a return, the department may in its discretion adjust the value of the property within this state to bring the percentage to one hundred percent, but in no case can the property in this state be valued at less than eighty percent of the value as defined in this subsection.

(3) For rented and leased real and personal property, value is the net annual rental rate multiplied by eight. For rented or leased personal property the department may require a factor other than a multiplier of eight to be used if it better reflects the value. Net annual rental rate means the gross annual rate paid by the taxpayer, less the gross annual rental rate received by the taxpayer for any subrentals of real estate.

(4) In determining the value of property, no deduction may be made for encumbrances on the property.

(5) Inventories of unmanufactured tobacco stored in a warehouse in this state for subsequent shipment to a manufacturer in another state, are not considered property used in this state.

(B) Payrolls

a) The payroll factor is a fraction in which the numerator is the total amount paid by the taxpayer for compensation in this state during the taxable year and the denominator is the total compensation paid everywhere during the taxable year.

b) Compensation includes salaries, wages, commissions, and other personal service compensation paid or incurred in connection with the taxpayer's trade or business. For purposes of this factor, all compensation paid to employees chiefly working at, sent out from, or chiefly connected with an office, agency, or place of business of the taxpayer in this state is deemed to be in connection with the trade or business of the taxpayer in this state.

c) Compensation paid to general executive officers having company-wide authority is excluded from the payroll factor.

d) All compensation in connection with income separately allocated is excluded from the payroll factor.

(C) Sales

a) The sales factor is a fraction in which the numerator is the total sales of the taxpayer in this state during the taxable year and the denominator is the total sales of the taxpayer everywhere during the taxable year.

b) The term "sales in this state" includes sales of goods, merchandise, or property received by a purchaser in this state other than the United States Government. The place where goods are received by the purchaser after all transportation is completed is considered as the place at which the goods are received by the purchaser. Direct delivery into this state by the taxpayer to a person designated by a purchaser constitutes delivery to the purchaser in this state.

c) The word "sales" includes, but is 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.

Line 1 - Enter all land located in South Carolina at the beginning of the year in column (a) (Section 1, Within South Carolina) and the ending South Carolina land in column (b). Enter the total beginning land in column (a) (Section 2, Total Everywhere) and the total ending land in column (b).

Line 2 - Enter the buildings in the same manner as line 1.

Line 3 - Enter the machinery and equipment in the same manner as line 1.

Line 4 - Enter the inventory in the same manner as line 1.

Line 5 - Enter all tangible personal property not entered above.

Line 6 - Enter all property from Schedule F, line 9, column 6; construction in progress; any property not held or used to produce income and unmanufactured tobacco stored in a warehouse in South Carolina.

Line 7 - Add lines 1 through 5 and subtract line 6.

Line 8 - Add line 7 of columns (a) and (b) in Section 1, within South Carolina and divide by 2. Perform the same computation for Section 2, Total Everywhere.

Line 9 - Multiply by 8, the net annual rental value of the real estate and tangible personal property rented or leased and enter the results on line 9.

Line 10 - Add lines 8 and 9. Divide line 10, column 1 by line 10, column 2. Enter property ratio in column 3.

Line 11 - Enter all salaries, wages, commissions and other personal service compensation paid in connection with the business of the taxpayer. South Carolina does not recognize federal job credit reduction; therefore, use gross payroll.

Line 12 - Subtract all such compensation paid to general executive officers having company wide authority and all compensation from Schedule F, line 9, column 5.

Line 13 - Divide line 13, column 1 by line 13, column 2 and enter the results in column 3.

Line 14 - Enter the sales attributable to South Carolina in column 1 and total sales from everywhere in column 2. Divide line 14, column 1 by line 14, column 2 and enter the results in column 3.

Line 15 - Enter the same sales ratio computed on line 14.

Line 16 - Add column 3, lines 10, 13, 14 and 15.

Line 17 - Divide line 16 by 4 and enter results.

If the sales ratio does not exist, the average is computed by using two as a denominator. If a ratio other than the sales ratio does not exist, the average is computed by using three as a denominator. If only one factor exists, use the ratio derived in that factor.

SCHEDULE H-2 - GROSS RECEIPTS

If the principal profits or income of a taxpayer, other than a public service corporation and a utility and electric cooperative are derived from sources other than manufacturing, producing, collecting, buying, assembling, processing or selling, distributing or dealing in tangible personal property, such taxpayers shall make returns and pay annually an income tax upon a proportion of its remaining net income computed on the basis of the ratio of gross receipts from within this state during the income year to the total gross receipts of such year within and without the state. Examples of corporations subject to a gross receipts method of apportionment are construction contractors, service companies other than public service corporations and corporations primarily engaged in rental real estate activities.

Line 1 - Enter the total gross receipts from within South Carolina in column 1 and total gross receipts everywhere in column 2.

Line 2 - Items not included in gross receipts are those items of income listed in Schedule F Instructions, lines 1-6, that are specifically and directly allocated before apportionment of the remaining net income. For S corporations, exclusions are directly allocable items of income shown on lines 2 - 6 of Schedule SC-K Worksheet.

Line 3 - Subtract line 2 from line 1. Divide line 3, column 1 by line 3, column 2 and enter results on line 4, column 3.

SCHEDULE H-3 - PUBLIC SERVICE CORPORATIONS

The income remaining after allocation for the following companies must be apportioned using the following factors:

(1) Railroad Companies.

a) Railroad companies shall use a fraction in which the numerator is railway operating revenue from business done within this state during the taxable year and the denominator is total railway operating revenue from all business done by the taxpayer as shown by its records kept in accordance with the Uniform System of Accounts prescribed by the Interstate Commerce Commission.

b) If the department finds that the accounting records of a taxpayer do not accurately reflect the division of revenue by state lines as to each transaction involving interstate revenue, the department may adopt rules and promulgate regulations which determine averages which approximate with reasonable accuracy the proportion of interstate revenue actually earned upon lines in this state.

c) For the purposes of this item:

(i) "Railway operating revenue from business done within this State" means railway operating revenue from business wholly within this state, plus the equal mileage proportion within this state of each item of railway operating revenue received from the interstate business of the taxpayer.

(ii) "Equal mileage proportion" means the proportion which the distance of movement of property and passengers over lines in this state bears to the total distance of movement of property and passengers over lines of the taxpayer receiving the revenues.

(iii) "Interstate business" means railway operating revenue from the interstate transportation of persons or property into, out of, or through this state.

(2) Motor carriers of property and passengers shall use a fraction in which the numerator is vehicle miles within this state during the taxable year and the denominator is total vehicle miles everywhere during the taxable year.

(3) Telephone service companies shall use a fraction in which the numerator is gross receipts in this state during the taxable year and the denominator is total gross receipts everywhere. The term "gross receipts in this state" includes gross revenues derived from services rendered wholly within this state, plus that portion of the company's interstate revenues attributable to this state, in accordance with the Federal Communications Standard Classification of Accounts.

(4) Pipeline companies shall use a fraction in which the numerator is the revenue ton miles (one ton of solid property transported one mile), revenue barrel miles (one barrel of liquid property transported one mile), or revenue cubic foot miles (one cubic foot of gaseous property transported one mile) within this state during the taxable year and the denominator is the total revenue ton miles, revenue barrel miles, or revenue cubic foot miles, of the taxpayer everywhere during the taxable year.

(5) Airline companies shall use a fraction in which the numerator is revenue tons loaded and unloaded in this state during the taxable year, and the denominator is revenue tons loaded and unloaded everywhere during the taxable year. A revenue ton is a short ton (two thousand pounds) and is computed by using a standard weight of one hundred ninety pounds per passenger (including free baggage) multiplied by the number of passengers loaded and unloaded plus the tons of airmail, express, and freight loaded and unloaded within and without this state.

(6) Shipping Lines. Where the income is derived principally from the operation of a shipping line, the corporation shall apportion its net apportionable income to South Carolina on the basis of the ratio of revenue tons loaded and unloaded within and without this state for such year. A revenue ton is a short ton (two thousand pounds) and must be computed using a standard weight of one hundred ninety pounds per passenger (including free baggage) multiplied by the number of passengers loaded and unloaded.

SCHEDULE J

Must be completed for every corporation included in the consolidated return.

SC1120S S CORPORATION INSTRUCTIONS

General

Prior to January 1, 1984, South Carolina did not recognize S Corporations; therefore, all corporations in South Carolina were taxed as C Corporations. South Carolina statutes were changed to adopt the federal statutes with regard to treatment of S Corporations, including the tax on certain types of income. Note the following Transitional Rule.

Transitional Rule

For tax years beginning after December 31, 1983, a corporation which had a valid S election in effect for federal tax purposes, had the option: (1) to continue being taxed for South Carolina purposes as a C Corporation. (File SC1120.) or (2) to elect to be an S Corporation and exempt from corporate income tax. (File SC1120S.)

For tax years beginning after December 31, 1984, newly formed corporations and C Corporations making an S election are bound by the election for federal purposes and the option available does not apply. Foreign corporations with a valid S election that began operating in South Carolina after December 31, 1984, must file as an S Corporation. Once made in either event, a South Carolina S election may not be revoked or terminated unless the S election is revoked or terminated for federal income tax purposes. The approval of an S election by the Internal Revenue Service is approval for South Carolina income tax purposes as of the effective date of the federal election. An S election may be made for South Carolina income tax purposes, only if it is made for federal purposes or there is an existing S election for federal purposes. The rule of changing tax years does not apply for state purposes unless similarly applied for federal purposes (that is, a change in year is not mandated for South Carolina income tax purposes unless mandated for federal purposes also). A corporation shall give the SC Department of Revenue notice of its intent to be an S Corporation by filing with the Department a copy of the election it files with the Internal Revenue Service, although failure to file the notice does not void the corporation's S election for South Carolina income tax purposes.

Filing Requirements

Generally, if the corporation has a valid S election and is doing business in this state, SC1120S must be filed. If an S Corporation has met the requirements of the Transitional Rule and elected for South Carolina purposes to be treated as a C Corporation, SC1120 must be filed. Public Utilities must file SC1120U.

Request for Extension to File

- If any corporate income tax or license fee is anticipated to be due, the taxpayer must use South Carolina extension SC1120-T or file electronically at www.sctax.org under DORePAY.
- If no income tax or license fee is anticipated to be due and the taxpayer has requested a federal extension, then the federal extension will be accepted as a South Carolina extension if the corporate return is received within the time as extended by the Internal Revenue Service.
- A copy of the federal or South Carolina extension(s) must be attached to the return when filed.
- There is no extension for payment of corporate income tax or license fee. Any income tax or license fee due must be paid by the prescribed due date to avoid the assessment of late penalties and interest.
- Frequently, individual taxpayers, who are shareholders in S Corporations, extend their individual income tax returns because they don't have the information K-1's from the S Corporation. However, the S Corporation fails to file the required extension for the S Corporation. The S Corporation must file a State extension (SC1120-T) with the Department of Revenue or file a federal extension (Form 7004) by the original due date of the return.

Part I Computation of Income

Line 1. The amount on this line is the total of federal Schedule K lines 1 through 10 income (loss) amounts. This is necessary to make the S Corporation income tax return consistent with form SC1120S-WH (Withholding Tax on Income of Nonresident Shareholders).

Note: Generally all income (loss) amounts are considered business related and subject to apportionment by multi-state corporations.

Line 2. Include on this line the net amount of South Carolina adjustments to all of the income (loss) amounts included in the line 1 total. (Schedule SC-K is continued as a worksheet to arrive at the adjustments.) Additions to and subtractions from federal taxable income include the same adjustments possible for a C Corporation plus the following:

Excess net passive income under IRC Section 1375 when taxed on the federal return and built-in gains and certain capital gains under IRC Section 1374 when taxed on the federal return.

Line 4. If a multi-state S Corporation, the total net income as adjusted (line 3, page 1, SC1120S) is carried to Schedule G, line 1 for apportionment. Complete Schedule G and enter the results on line 4. If not a multi-state S Corporation, enter the amount from line 3 on line 4.

Line 5. Income on line 4 that is taxed to the shareholders is subtracted on line 5. This is generally the same amount shown on line 4, however, any income subject to tax on the Federal Form 1120S pursuant to IRC Sections 1374 and 1375 would not be subtracted on this line.

Lines 6 and 7. South Carolina imposes a corporate tax at the rate of .05 (5.0%) on the excess net passive income and/or built-in gains which are added to federal income. Also include on line 7 any deferred LIFO recapture tax pursuant to IRC Section 1363.

Schedules E, F, G and H

See Instructions for Schedules E, F, G, and H of C Corporations. If the related expenses for portfolio income are included in portfolio deductions the related expenses should not be entered in Schedule F to reduce directly allocated income.

Note:

- S Corporations do not have a net operating loss carryover, as the losses flow through to the shareholders each year.
- Deferral of income and tax on foreign trade receipts would flow through to the shareholders of an S Corporation. Interest is also paid by the shareholders. If applicable, give a schedule of details.

Part II Computation of License Fee and QSSS Procedures

An S Corporation pays a license fee the same as a C Corporation. An exception is Qualified Subchapter S Subsidiaries "QSSS". For S Corporations other than QSSS, see C Corporation Instructions under Computation of License Fee. For tax years beginning after December 31, 2000, a QSSS is treated as a disregarded entity for South Carolina "SC" license fee and annual report purposes. If a corporation owns a QSSS that is disregarded, the QSSS does not owe a separate corporate license fee. The QSSS is treated as part of the corporation which owns it and that corporation pays a license fee. List the Qualified Subchapter S Subsidiaries (QSSS) for SC purposes on page 4 of SC1120S.

For income tax purposes, assets, liabilities, income, and deductions of a QSSS are treated the same as for federal income tax purposes. Attach a schedule listing the entities included for SC income tax purposes.

SCHEDULE SC-K WORKSHEET INSTRUCTIONS

This schedule is provided primarily as a worksheet to make South Carolina adjustments to federal Schedule K items and to show the amount of these items that are apportioned or allocated to South Carolina. Column (C) additions to and subtractions from federal taxable income include the same adjustments possible for a C Corporation. The items appearing at numbers 1 through 10 on the federal Schedule K are generally classified as business related using South Carolina apportionment and allocation rules. If the S Corporation has multi-state operations, these items are subject to apportionment using the same (apportionment) ratio as determined in Schedule H of SC1120S. See exceptions in instructions to Line 2, page 1, SC1120S. Also, see instructions to lines 1, 2, and 4, Part I Computation of Income.

Column (F) shows the Column (D) items after application of apportionment and allocation rules. The amounts in Column (F) are taxable by the state of South Carolina.

Lines 11 through 12D. If the S Corporation has multi-state operations, multiply the amount(s) in Column (D) by the apportionment ratio determined in Schedule H of SC1120S.

Non-refundable credits

Any non-refundable credit is distributed to shareholders in proportion to shares held.

EXAMPLE MULTI-STATE S CORPORATION:

XYZ Corporation, a South Carolina S Corporation does business in South Carolina and Georgia and has the following income and deductions: dividend income of \$1,000, long term capital gain from the sale of South Carolina real estate of \$2,000, ordinary business income of \$60,000, and a cash charitable contribution of \$4,000. The Corporation has two shareholders - Mr. X who resides in South Carolina and owns seventy percent of the stock and Ms. Y who resides in Georgia and owns thirty percent. The dividend of \$1,000 should be allocated to the respective domiciles of the individual taxpayers, and the long term capital gain from the sale of real estate of \$2,000 is allocated to the state it is located in. The apportionment rates for the two states have been computed to be sixty percent for South Carolina and forty percent for Georgia. The ordinary business income and the charitable contribution should be apportioned per South Carolina law based on the apportionment rates.

TRANSACTIONS	TRANSACTION AMOUNT	60% APPORTIONED TO S.C.	100% ALLOCATED TO S.C.	Mr. X's S.C. SHARE (70%)	Ms. Y's S.C. SHARE (30%)
Ordinary Business Inc.	60000	36000		25200	10800
Dividend Income	1000		1000	700	0
Long Term Capital Gain	2000		2000	1400	600
Charitable Contribution	4000	2400		1680	720

Note: Only South Carolina Residents are taxed on dividend income for South Carolina tax purposes.

COMPUTATION OF INCOME TAX LIABILITY	1. Total of line 1 through 10, Schedule K of Federal Form 1120S	1.	63,000
	2. Net Adjustment from line 15, Schedule A and B	2.	< 0 >
	3. Total Net Income as Reconciled (add line 1 plus or minus line 2)	3.	63,000
	4. If Multi-state Corporation, enter amount from line 6, Schedule G; otherwise, enter amount from line 3.	4.	38,700
	5. LESS: Income on line 4 taxed to shareholders of S Corporation	5.	< 38,700 >
	6. South Carolina Net Income subject to tax (line 4 less line 5)	6.	0
	7. TAX: Multiply amount on line 6 by .05 (5.0%)	7.	0
	8. Payments: (a) Tax Withheld (see instructions) (b) Paid by Declaration		
	(c) Paid with Tentative Return (d) Credit from Line 23b		
	Refundable Credits: (e) Ammonia Additive (f) Milk Credit		
	9. Total Payments and Refundable Credits (add lines 8a through 8f)	9.	0
	10. Balance of Tax Due (line 7 less line 9)	10.	0
	11. Interest Due Penalty Due (See penalty and interest instructions.) Enter Total.	11.	0
12. TOTAL INCOME TAX, Interest and Penalty Due (add lines 10 and 11) BALANCE DUE	12.	0	
13. OVERPAYMENT (line 9 less line 7) To be applied as follows:			
(a) Estimated Tax (b) License Fee (c) Refunded		0	

SCHEDULE F INCOME SUBJECT TO DIRECT ALLOCATION

(A) Allocated Income	(B) Gross Amounts	(C) Related Expenses	(D) Net Amounts (Column B minus Column (C))	(E) Net Amounts Allocated Directly to SC
Dividend Income	1,000		1,000	700
Long Term Capital Gain	2,000		2,000	2,000
1. Total Allocated Income (Enter the total of Column D here)			3,000	
2. Total Income Allocated to SC (Enter the total of Column E)				2,700
Attach an explanation of each type of income listed above that is not allocated to South Carolina.				

SCHEDULE G COMPUTATION OF TAXABLE INCOME FOR CORPORATIONS CLAIMING MULTI-STATE OPERATIONS

1. Total net income as reconciled. Enter amount from line 3, Page 1	1.	63,000
2. Less: Income subject to direct allocation to SC and other states from Schedule F, line 1	2.	3,000
3. Total net income subject to apportionment (line 1 less line 2)	3.	60,000
4. Multiply amount on line 3 by appropriate ratio from Schedule H-1, 2, or 3 and enter result here	4.	36,000
5. Add: Income subject to direct allocation to SC from Schedule F, line 2	5.	2,700
6. Total S.C. Net Income (sum of lines 4 and 5 above) also enter on line 4, Part 1 of Page 1	6.	38,700

SCHEDULE SC-K WORKSHEET

* Enter amounts from corresponding lines on your federal Schedule K in Column B.

	(A) Description	(B) * Amounts From Federal Schedule K	(C) Plus or Minus South Carolina Adjustments	(D) Federal Schedule K Amounts After SC Adjustments	(E) Col. (D) Amounts Apportioned or Allocated to States Other than SC	(F) Col. (D) Amounts Apportioned or Allocated in SC
1	Ordinary Business Income (loss)	60,000		60,000	24,000	36,000
2	Net Real Estate Rents (loss)					
3	Other Net Rents (loss)					
4	Interest Income					
5	Dividends	1,000		0	300 *	700*
6	Royalties					
7	Net Short Term Cap. Gain (loss)	2,000		0		2,000
8	Net Long Term Cap. Gain (loss)					
9	Net §1231 Gain (loss)					
10	Other Income (loss)					
11	§ 179 Deduction					
12a	Contributions	4,000		4,000	1,600	2,400
12b	Investment Interest Expense					
12c	§ 59 (e)(2) Expenditures					
12d	Other Deductions					

*NOTE: Only SC Residents are taxed on dividend income for SC tax purposes.

Non-Refundable Tax Credits: Enter Total Credits from SC1120-TC, line 27.

SC1120-TC must be attached to return.



STATE OF SOUTH CAROLINA
DEPARTMENT OF REVENUE
WITHHOLDING TAX ON INCOME OF NONRESIDENT SHAREHOLDERS

SC1120S-WH
(Rev. 8/22/05)
3312

SC CORPORATE FILE #	FOR ACCOUNTING PERIOD ENDING
FED EI #	

(Signature of duly authorized officer taxpayer)

Date

Corporate Name and Address

1. Amount from line 5 of SC1120S (less allocated income). 1.

		3	8	0	0	0	.	0	0
--	--	---	---	---	---	---	---	---	---

 *
2. Line 1 times 30 % of income allocated to nonresident shareholders. 2.

		1	1	4	0	0	.	0	0
--	--	---	---	---	---	---	---	---	---
3. Amount of line 2 exempt from withholding. Attach statement. See instructions. 3.

							.	0	0
--	--	--	--	--	--	--	---	---	---
4. Subtract line 3 from line 2. 4.

		1	1	4	0	0	.	0	0
--	--	---	---	---	---	---	---	---	---
5. Withholding tax due - line 4 x .05. 5.

				5	7	0	.	0	0
--	--	--	--	---	---	---	---	---	---

 14-0822

* NOTE: \$38,700 (line 5 of the SC1120S) less \$700 directly allocated dividends. See page 13 and 14.

WITHHOLDING ON INCOME OF S CORPORATION SHAREHOLDERS WHO ARE NONRESIDENTS OF SOUTH CAROLINA

S Corporations are required annually to withhold 5% (percent) of the South Carolina taxable income of shareholders who are nonresidents of South Carolina. The income tax withheld must be paid to the SC Department of Revenue when filing SC1120S-WH by the fifteenth day of the third month following taxable year end of the S Corporation. By this same date, the S Corporation must provide nonresident shareholders a form 1099-MISC with "South Carolina Only" written at the top showing respective amounts of income and tax withheld. Along with filing SC1120S-WH and payment of tax, the S Corporation must attach a schedule disclosing the name, address, tax identification number, South Carolina taxable income and tax withheld for each nonresident shareholder. S Corporations requesting an extension of time to file SC1120S must estimate South Carolina taxable income of nonresidents and pay 5% withholding tax on this amount and file SC1120S-WH by the 15th of the third month following its taxable year end. Each nonresident must attach a copy of this form 1099-MISC to his respective income tax return as verification for claiming credit for this withholding.

A nonresident shareholder may provide the S Corporation with an affidavit agreeing that he is subject to the jurisdiction of the Department and the Courts of this State for purposes of determining and collecting South Carolina tax, interest and penalties which may be due. An affidavit form may be obtained from the SC Department of Revenue. The S Corporation may attach such affidavit to SC1120S-WH and the S Corporation is not required to withhold income tax on behalf of such shareholder. If an affidavit has previously been filed it should not be resubmitted. SC1120S-WH is not required to be filed if the S Corporation has no South Carolina taxable income for the year. **S Corporations that report the income of their nonresident shareholders on a composite return are not required to withhold tax, file SC1120S-WH or file affidavits. See composite filing below.**

COMPOSITE FILING

A composite return is a single nonresident individual income tax return (Schedule NR attached to SC1040) filed by an S-Corporation that computes and reports the income and tax of its nonresident shareholders. The return is due on or before the 15th day of the 4th month following the shareholder's taxable year end. Any tax due is paid along with filing the return.

The S-Corporation does not need to withhold on behalf of any shareholder participating in a composite return. Shareholders participating in a composite return do not need to pay estimated tax. For more detailed information, see Revenue Procedure 92-5 on our website: www.sctax.org

The heading of the composite return states the name, address and federal EIN of the S-Corporation. There is no need to use "Composite Return for" or "Shareholders of" in the name. Mark the box for filing a composite return. Mark "Single" filing status and one exemption for on the face of SC1040.

Two methods are available for calculating tax on a composite return: (1) Compute each participating shareholder's income tax separately as if the shareholder were separately reporting income on a nonresident return; OR (2) compute each participating individual's entire share of SC income without considering deductions and exemptions. Under either method, add the individual liabilities together to arrive at a total tax. Attach a schedule showing the separate computations. Total the separate tax amounts and enter on the "tax" line of SC1040, page 1.

In order to extend the time allowed for filing a composite return, file SC4868 using the name and EIN of the S-Corporation. Mark the composite box. Do not use the SC1120T to extend the composite return. The tax due must be estimated and paid along with filing the extension on or before the 15th day of the 4th month following the end of the shareholder's taxable year.

For taxable years after 2004, nonresident shareholders may participate in composite returns even if they have other sources of income taxable to South Carolina. Disregard the other sources of income taxable to South Carolina when preparing the composite return.

Mail Completed Returns To:
Department of Revenue
Corporation Return
Columbia, SC 29214-0100

PRESORTED
STANDARD
US Postage
PAID
SC Department
of Revenue



Starting a New Business?
Need Information or to register on line go
to www.scbos.com.

Register on line with the Secretary of State, Department of Revenue, Employment Security Commission and Department of Health and Environmental Control.

Current registrations included in: "Start New Business"

- **Secretary of State**
 - Register Foreign Corporation Name
 - Register Foreign Limited Liability Company Name
 - Certificate of Limited Partnership
 - Articles of Incorporation - Corporation
 - Certificate of Authority - Non-Profit Corporation
 - Certificate of Authority - Limited Liability Partnership
 - Certificate of Authority - Corporation
 - Certificate of Authority - Limited Liability Company
 - Articles of Incorporation - Statutory Close Corporation
 - Articles of Incorporation - Professional Corporation
 - Articles of Incorporation - Non-Profit Corporation
 - Articles of Organization - Limited Liability Company
 - Limited Liability Partnership - Registration
 - Foreign Limited Partnership - Registration
 - Assumed Name Certificate of Limited Partnership
- **Department of Revenue**
 - Sales Tax (Retail License)
 - Accommodations (Retail License)
 - Aviation Fuel Tax
 - Business Personal Property
 - Corporate Tax Account
 - Solid Waste Tax
 - Use Tax
 - Employee Withholding
- **Employment Security Commission**
 - Unemployment Insurance Tax
- **Department of Health and Environmental Control**
 - Well Permits
 - Asbestos Removal
 - Underground Storage Tanks

Taxpayer Service Centers

Contact the South Carolina Department of Revenue's Call Center
at 803-898-5000 or visit our website: www.sctax.org

MAIN OFFICE
Columbia Mill Building
301 Gervais Street
P.O. Box 125
Columbia, SC 29214
(803) 898-5000

CHARLESTON
Southpark Office Building
3 Southpark Circle
Suite 202
Charleston, SC 29407
(843) 852-3600
(843) 556-1780 (FAX)

GREENVILLE
211 Century Drive
Suite 210-B
Greenville, SC 29607
(864) 241-1200
(864) 232-5008 (FAX)

MYRTLE BEACH
1330 Howard Parkway
Myrtle Beach, SC, 29577

FLORENCE
1452 West Evans Street
P.O. Box 5418
Florence, SC 29502
(843) 661-4850
(843) 662-4876 (FAX)

ROCK HILL
Business and Technology Center
Suite 202
454 South Anderson Road
P.O. Box 12099
Rock Hill SC 29731
(803) 324-7641
(803) 324-8289 (FAX)



State of South Carolina
'C' CORPORATION INCOME TAX RETURN

Return is due on or before the 15th day of the 3rd month following the close of the taxable year.

Mail return to: SC DEPARTMENT OF REVENUE, Corporation Return, Columbia SC 29214-0100

SC 1120

(Rev 8/18/05)

3091

SC FILE # _____

INCOME TAX PERIOD ENDING _____

LICENSE FEE PERIOD ENDING _____

FED EI # _____

NAME _____

MAILING ADDRESS _____

CITY _____ STATE _____ ZIP CODE _____

Change of ☐ Address ☐ Accounting Period

A COMPLETE COPY OF FEDERAL RETURN MUST BE ATTACHED TO THIS RETURN.

County or Counties in SC Where Property is Located: _____

City _____ Audit Location _____ State _____

Audit Contact _____ Telephone Number _____

Check if ☐ Consolidated Return

Total Gross Receipts. _____ Total cost of depreciable personal property in SC. _____

If Filing a Final Return, See Instructions for Further Information.

☐ Merged ☐ Reorganized ☐ Dissolved ☐ Withdrawn

PART I
COMPUTATION OF INCOME TAX LIABILITY

1. Federal Taxable Income per Federal Form 1120 or 1120A 1. _____
2. Net Adjustment from line 12, Schedule A and B 2. _____
3. Total Net Income as Reconciled (line 1 plus or minus line 2) 3. _____
4. If Multi-state Corporation, enter amount from line 6, Schedule G; otherwise, enter amount from line 3. 4. _____
5. LESS: South Carolina net operating loss carryover, if applicable 5. _____
6. South Carolina Net Income subject to tax (line 4 less line 5) 6. _____
7. TAX: Multiply amount on line 6 by .05 (5.0%) 7. _____
8. Less tax deferred on income from foreign trade receipts (see instructions) 8. _____
9. Balance (line 7 less line 8) 9. _____
10. Credit Carryover (line 7, Schedule C) ☐ Non-refundable credits (line 5, Schedule C) ☐ 10. ☐ ☐
11. Balance of tax (line 9 less line 10). Enter the difference but not less than zero. 11. _____
12. Interest on DISC-deferred tax liability _____; or Foreign Trade Deferred Tax Liability 12. _____
13. Total tax and/or interest (add lines 11 and 12) 13. _____
14. Payments: (a) Tax Withheld (see instructions) _____ (b) Paid by Declaration ☐
(c) Paid with Tentative Return ☐ (d) Credit from Line 29b ☐
- Refundable Credits: (e) Ammonia Additive ☐ (f) Milk Credit ☐
15. Total Payments and Refundable Credits (add lines 14a through 14f) 15. _____
16. Balance of Tax and/or Interest Due (line 13 less line 15) 16. _____
17. Interest Due ☐ Penalty Due ☐ (See penalty and interest instructions.) Enter Total. 17. _____
18. **TOTAL INCOME TAX, Interest and Penalty Due (add lines 16 and 17) BALANCE DUE 18. _____**
19. **OVERPAYMENT (line 15 less line 13) _____ To be applied as follows:**
(a) Estimated Tax ☐ (b) License Fee ☐ (c) Refunded ☐

PART II
COMPUTATION OF LICENSE FEE

20. Total Capital And Paid in Surplus (Multi-State Corporations See Schedule E) 20. _____
21. FEE DUE - Line 20 x .001, plus \$15.00 (Fee cannot be less than \$25.00 per taxpayer) 21. _____
22. LESS: Applicable Credits against License Fee (attach SC1120-TC) 22. _____
23. Balance (line 21 less line 22) 23. _____
24. Payments: (a) Paid with Tentative Return ☐ (b) Credit from line 19b ☐
25. Total Payments (add line 24(a) and (b)) 25. _____
26. Balance of Fee Due (line 23 less line 25) 26. _____
27. Interest Due ☐ Penalty Due ☐ (See penalty and interest instructions.) Enter Total. 27. _____
28. **TOTAL LICENSE FEE, Interest and Penalty Due (add lines 26 and 27) BALANCE DUE 28. _____**
29. **OVERPAYMENT (line 25 less line 23) _____ To be applied as follows:**
(a) Estimated Tax ☐ (b) Income Tax ☐ (c) Refunded ☐
30. **GRAND TOTAL: INCOME TAX and LICENSE FEE DUE (add lines 18 and 28) EFT ☐ 30. _____**

I, the undersigned, a principal officer of the corporation for which this return is made declare that this return, including accompanying Annual Report, statements and schedules, has been examined by me and is to the best of my knowledge and belief, a true and complete return.

Please
Sign
Here

Signature of officer

Date

Title

Telephone Number

I authorize the Director of the Department of Revenue or delegate to discuss this return, attachments and related tax matters with the preparer.

Yes ☐ No ☐

Preparer's Printed Name

Paid

Preparer's
signature

Date

Check if
self-employed ☐

Preparer's telephone number

Preparer's
Use Only

Firm's name (or
yours if self-employed)
and address

EI # _____
ZIP Code _____

ROA 0496

SCHEDULE A AND B**ADDITIONS TO FEDERAL TAXABLE INCOME**

1. Taxes on or Measured By Income 1. _____
2. Federal Net Operating Loss 2. _____
3. _____ 3. _____
4. _____ 4. _____
5. Other Additions (attach schedule) 5. _____
6. Total Additions (add lines 1 through 5) 6. _____

DEDUCTIONS FROM FEDERAL TAXABLE INCOME

7. Interest On Obligations Of The U.S. 7. _____
8. _____ 8. _____
9. _____ 9. _____
10. Other Deductions (attach schedule) 10. _____
11. Total Deductions (add lines 7 through 10) 11. _____
12. Net Adjustment (line 6 less line 11) Also enter on line 2, Part 1, SC1120 12. _____

SCHEDULE C**SUMMARY OF CREDITS (FROM SC1120-TC)**

1. Credit Carryover From Previous Year's SC1120, Schedule C (NOTE: Should agree to SC1120-TC Column A, line 27.) ... 1. _____
2. Enter Total Credits from SC1120-TC, Column B, line 27. **SC1120-TC must be attached to return.** 2. _____
3. Total Credits (add lines 1 and 2). 3. _____
4. Tax (line 9, Part 1, SC1120). 4. _____
5. Lesser of line 3 or 4 (enter on line 10, Part 1, SC1120) (NOTE: Should agree to SC1120-TC, Column C, line 27.) ... 5. _____
6. Enter Credits Lost Due to Statute (NOTE: Should agree to SC1120-TC, Column D, line 27.) 6. _____
7. Credit Carryover (line 3 less lines 5 and 6) (NOTE: Should agree to SC1120-TC, Column E, line 27.) 7. _____

SCHEDULE D**ANNUAL REPORT TO BE COMPLETED BY ALL CORPORATIONS**

1. Name _____
2. Incorporated under the laws of the State of _____
3. Location of the Registered Office of the Corporation in the State of South Carolina is _____
In the City of _____ Registered Agent at such address is _____
4. Location of principal office (street address) _____
Nature of principal business in SC _____
5. The total number of **authorized shares** of capital stock, itemized by class and series, if any, within each class is as follows:
NUMBER OF SHARES: _____ CLASS: _____ SERIES: _____
6. The total number of **issued and outstanding shares** of capital stock itemized by class and series, if any, within each class is as follows:
NUMBER OF SHARES: _____ CLASS: _____ SERIES: _____
7. The names and business addresses of the directors (or individuals functioning as directors) and principal officers in the Corporation are:
(If additional space is necessary, attach separate schedule).

NAME	BUSINESS ADDRESS AND OFFICE
8. Date Incorporated _____ Date commenced business in the State of South Carolina was _____
9. Date of this report _____ Fed EI # _____
10. If Foreign Corporation, the date qualified to do business in the State of South Carolina is _____
11. Was the name of the Corporation changed during the year? _____ Give old name _____
12. The Corporation's books are in the care of _____
Located at (street address) _____
13. If filing consolidated, complete and attach Schedule J for each Corporation included in the consolidation.
14. The total amount of stated capital per balance sheet is:
 - A. Total paid in Capital Stock (cannot be a negative amount). \$ _____
 - B. Total paid in Capital Surplus (cannot be a negative amount). \$ _____
 - C. Total amount of stated Capital (cannot be a negative amount). \$ _____

SCHEDULES E, F, G, AND H ARE TO BE COMPLETED BY MULTI-STATE CORPORATIONS
SCHEDULE E COMPUTATION FOR LICENSE FEE - MULTI-STATE CORPORATIONS

1. Total Capital and Paid-in-Surplus at end of Year \$ _____
 2. SC PROPORTION: (line 1 X ratio from Schedule H-1, H-2 or H-3, as appropriate) Also enter on line 20, Part II \$ _____

SCHEDULE F INCOME SUBJECT TO DIRECT ALLOCATION

	Gross Amounts 1	Less: Related Expenses 2	Net Amounts Allocated Direct to SC and Other States 3	Net Amounts Allocated Directly to SC 4	Payrolls to be Excluded from Payroll Factor 5	Property to be Excluded from Property Factor 6
1. Interest not connected with business						
2. Dividends received						
3. Rents						
4. Gains/losses on real property						
5. Gains/losses on intangible pers. prop.						
6. Investment income directly allocated						
7. TOTAL INCOME DIRECTLY ALLOCATED						
8. INCOME DIRECTLY ALLOCATED TO SC						
9. TOTALS TO APPORTIONMENT FACTORS						

SCHEDULE G COMPUTATION OF TAXABLE INCOME FOR CORPORATIONS CLAIMING MULTI-STATE OPERATIONS

1. Total net income as reconciled. Enter amount from line 3, Page 1 1.
 2. Less: Income subject to direct allocation to SC and other states from Schedule F, line 7 2.
 3. Total net income subject to apportionment (line 1 less line 2) 3.
 4. Multiply amount on line 3 by appropriate ratio from Schedule H-1, 2, or 3 and enter result here 4.
 5. Add: Income subject to direct allocation to SC from Schedule F, line 8 5.
 6. Total S.C. Net Income (sum of lines 4 and 5 above) also enter on line 4, Part 1 of Page 1 6.

SCHEDULE H-1 COMPUTATION OF FOUR FACTOR APPORTIONMENT RATIO

	1. Property Within South Carolina		2. Total Property Everywhere	
	(a) Beginning Period	(b) Ending Period	(a) Beginning Period	(b) Ending Period
1. Land				
2. Buildings				
3. Machinery and Equipment				
4. Inventories				
5. Other Property				
6. Exclusions	< >	< >	< >	< >
7. TOTAL (add lines 1 - 5; subtract line 6)				
		1. Within SC	2. Total Everywhere	3. Ratio
8. Avg. of Beginning and Ending Period (add line 7a and b and divide by 2)				
9. Rental or Lease Value				
10. TOTAL Property Add lines 8 and 9. (Col. 1 ÷ Col. 2 and enter ratio in Col. 3)				%
11. GROSS Payroll				
12. Less: Officers Compensation and Exclusions	< >	< >		
13. TOTAL Payroll (Col. 1 ÷ Col. 2 and enter ratio in Col. 3)				%
14. TOTAL Sales (Col. 1 ÷ Col. 2 and enter ratio in Col. 3)				%
15. TOTAL Sales (same as line 14)				%
16. TOTAL of Ratios (add Column 3 - lines 10, 13, 14 and 15)				%
17. Arithmetical Average of Ratios				%

SCHEDULE H - 2 COMPUTATION OF GROSS RECEIPTS RATIO

	1. In SC	2. Total Everywhere	3. Ratio
1. Total Gross Receipts			
2. Less: Exclusion (see instructions)	< >	< >	
3. Gross Receipts (for ratio)			
4. Ratio of Gross Receipts (line 3, Col. 1 ÷ line 3, Col. 2)			%

SCHEDULE H - 3 COMPUTATION OF RATIO FOR PUBLIC SERVICE CORPORATIONS

	Amount	Ratio
1. Total Within South Carolina		
2. Total for System		
3. Ratio (South Carolina ÷ Total System)		%

SCHEDULE I

RESERVED

SCHEDULE J

CORPORATIONS INCLUDED IN CONSOLIDATED RETURN

AFFILIATED CORPORATION NO. 1

1. Name _____
2. Incorporated under the laws of the State of _____
3. Location of the Registered Office of the Corporation in the State of South Carolina is _____
In the City of _____ Registered Agent at such address is _____
4. Location of principal office (street address) _____
Nature of principal business in S.C. _____
5. The total number of **authorized shares** of capital stock, itemized by class and series, if any, within each class is as follows:
- | NUMBER OF SHARES | CLASS | SERIES |
|------------------|-------|--------|
|------------------|-------|--------|

6. The total number of **Issued and outstanding shares** of capital stock itemized by class and series, if any, within each class is as follows:
- | NUMBER OF SHARES | CLASS | SERIES |
|------------------|-------|--------|
|------------------|-------|--------|

7. The names and business addresses of the directors (or individuals functioning as directors) and principal officers in the Corporation are: (If additional space is necessary, attach separate schedule).

NAME

BUSINESS ADDRESS AND OFFICE

8. Date Incorporated _____ Date commenced business in the State of South Carolina was _____
9. Date of this report _____ Fed. EI # _____ SC File # _____
10. If Foreign Corporation, the date qualified to do business in the State of South Carolina is _____
11. Was the name of the Corporation changed during the year? _____ Give old name _____
12. The Corporation's books are in the care of _____
Located at (street address) _____
13. Corporate Mailing Address _____
14. The total amount of stated capital per balance sheet is:
- A. Total paid in Capital Stock (cannot be a negative amount) \$ _____
- B. Total paid in Capital Surplus (cannot be a negative amount) \$ _____
- C. Total amount of stated Capital (cannot be a negative amount) \$ _____

For additional affiliated corporations duplicate Schedule J as needed.

ATTACH COMPLETED COPY OF FEDERAL RETURN.

Make check payable to: SC Department of Revenue.