THE STATE OF SOUTH CAROLINA
In the Court of Appeals

APPEAL FROM THE ADMINISTRATIVE LAW COURT

The Honorable Ralph King Anderson, III, Chief Administrative Law Judge

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Case No. 09-ALJ-17-0204-CC
Appellant Case No. 2012-208608

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

v.

South Carolina Department of Revenue, ...Respondent.

FINAL BRIEF OF RESPONDENT

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PROOF OF SERVICE

I, Jean M. O'Connor, do hereby certify that I have caused to be mailed, via US Postal Service, postage pre-paid, a copy of the Department of Revenue's Brief to Bryson M. Geer, Esquire and John von Lehe, Jr., Esquire, Nelson Mullins Riley & Scarborough, LLP, PO Box 1806, Charleston, SC 29402 this 9th day of September 2015.

Jean M. O'Connor

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STATEMENT OF THE CASE

Rent-A-Center West, Inc. (Appellant or RAC West) has two primary sources of income: income from operating retail stores outside of South Carolina and royalty income from licensing its trademarks and trade names to affiliated companies that operate in many states including South Carolina. (See R. p. 354 (Attachment to RAC West's Protest Ex. 1, Tab 3 p. 2); R. pp. 273-74, 284 (KPMG's Analysis of RAC's Profit Distribution Ex. 1, Tab 13 pp. 5-6, 16).) The affiliated companies are Rent-A-Center Texas, L.P. (RAC Texas) and Rent-A-Center East, Inc. (RAC East), respectively. (R. pp. 269, 273, 284-85; KPMG's Analysis of RAC's Profit Distribution Ex. 1, Tab 13 pp. 1, 5, 16-17.) RAC West had no stores in South Carolina, but it licensed the use of its trademarks and trade names to RAC East, which operates retail stores in South Carolina. (R. p. 354; Attachment to RAC West's Protest Ex. 1, Tab 3 p. 2.)

RAC West filed corporate income tax returns in South Carolina apportioning its net income to South Carolina based on the standard apportionment formula for dealers in tangible personal property as expressed in S.C. Code Ann. § 12-6-2250. (R. p. 354; Attachment to RAC West's Protest Ex. 1, Tab 3 p.2.) The South Carolina Department of Revenue (Department) then audited RAC West for tax years 2003 through 2005. (R. pp. 340-41; Report of Field Audit Ex. 1, Tab 1 pp. 1-2.) The Department found that RAC West's only income in South Carolina was the royalty income that it generated through sales made in South Carolina by RAC East. (R. p. 342; Report of Field Audit Ex. 1, Tab 1 p. 3.) The Department applied an alternative apportionment method pursuant to S.C. Code Ann. § 12-6-2320(A) and on March 12, 2008 issued its Report of Field Audit assessing the taxes, interest, and penalties as follows:

Period Ended	Income Tax	Interest	Penalties	Totals
12/31/2003	$ 44,887	$ 14,018	$ 11,222	$ 70,125
12/31/2004	46,607	11,748	11,652	70,007
12/31/2005	53,477	9,322	13,369	76,168
Totals	$144,971	$ 35,084	$ 36,243	$216,300

(R. pp. 340-50; Report of Field Audit Ex. 1, Tab 1.)

On or about June 3, 2008, RAC West filed a protest of the Department's Report of Field Audit. (R. pp. 351-60.) On May 6, 2009, the Department then issued its Department Determination. (R. pp. 29-37.) When preparing its Determination, the Department adjusted the alternative apportionment method so that the apportionment formula would be in accordance with the trademark licensing agreements that RAC West had entered into with RAC East. (R. p. 31.) This change in method reduced the proposed assessment to $204,183, consisting of $130,194 in income tax, $41,440 in interest, and $32,459 in penalties. (R. pp. 29-30.)

On July 11, 2011, one month before the hearing in this case, Appellant filed amended South Carolina income tax returns in which it changed its method of apportionment from the method for dealers of tangible personal property under Section 12-6-2250 to the gross-receipts method under Section 12-6-2290. (See R. pp. 361-382; Amended Form SC 1120 for 2003, 2004, and 2005 Ex. 1, Tab 7.) An administrative hearing was held on August 10 and 11, 2011, and the Administrative Law Court (ALC) issued a Final Order and Decision (Order) on January 6, 2012. (R. pp. 3, 23.)

After Appellant's Motion for Reconsideration was denied, Appellant filed a Notice of Appeal. Subsequently this appeal was stayed pending a final ruling in CarMax Auto Superstores West Coast, Inc. v. South Carolina Department of Revenue, 411 S.C.

79, 767 S.E.2d 195 (S.C. 2014). The South Carolina Supreme Court issued its decision in CarMax on December 23, 2014. CarMax, 411 S.C. 79, 767 S.E.2d 195 (S.C. 2014).

STATEMENT OF FACTS

A. Organization and Operations of RAC West and Affiliates

Rent-A-Center, Inc. is a holding company that owns and controls at least three affiliated entities: RAC West, RAC East, and RAC Texas. (R. p. 398; Organization Chart Ex. 1, Tab 9.) The rent-to-own business model is to offer tangible consumer goods to customers pursuant to a rental purchase agreement. (R. p. 125, Tr. p. 83, lines 15-21.)

RAC West is a Delaware corporation with its principal place of business in Plano, Texas. (R. p. 30.) RAC West owns and operates retail stores on the west coast and in the middle of the country. (R. p. 415; KPMG's Analysis of RAC's Profit Distribution Ex. 1, Tab 13 p. 5.) While RAC West does not operate any retail stores in South Carolina, (R. p. 354; Attachment to RAC West's Protest Ex. 1, Tab 3 p. 2), it owns intellectual property in South Carolina (R. p. 131, Tr. p. 106, lines 3-6; Transcript Day One p. 106:3-6). It licenses "Rent-A-Center" trademarks and trade names (Intellectual Property) to RAC East and RAC Texas. (R. p. 354 (Attachment to RAC West's Protest Ex. 1, Tab 3 p. 2.); see, e.g., R. pp. 383-390 (Trademark License Agreement Ex. 1, Tab 11).) Except for Intellectual Property, RAC West has no property or payroll in South Carolina. (R. pp. 354, 364-66, 372-74, 380-82.) RAC West uses its own Intellectual Property. (R. p. 155, Tr. p. 202, lines 14-18; Transcript Day One p. 202:14-18.)

At the hearing, two of RAC West's witnesses made broad assertions of a value exchange between the Intellectual Property and retail sales in an attempt to show that RAC West's trademark and retail businesses were unitary. For example, Dawn

Wolverton, RAC Texas' Vice-President, General Counsel, and Secretary, who had responsibility over RAC West's Intellectual Property, (R. p. 154, Tr. p. 197, line 25-Tr. p. 198, line 5, Tr. p. 199, lines 12-16; R. p. 154, Tr. p. 200, line 8-R. p. 155, Tr. p. 201, line 21), testified that, as RAC West provides quality services, the value of its Intellectual Property increases, (R. p. 155, Tr. p. 202, line 7-Tr. p. 203, line 1; R. p. 155, Tr. p. 203, lines 16-19). She continued by saying that, as the retail stores in general perform better, the Intellectual Property becomes "more famous." (R. p. 155, Tr. p. 203, lines 2-8.) She also said that, as the Intellectual Property becomes more famous, the Intellectual Property may draw people into the retail stores. (R. p. 155, Tr. p. 203, lines 9-16.)

However, the Intellectual Property was not strategically placed into RAC West to enhance the value of RAC West's retail business as the Intellectual Property was already owned by the same company that owns it now when that company was acquired. (R. p. 132, Tr. p. 110, lines 16-25.) Whatever effect on value RAC West's Intellectual Property has on all of the retail operations, and vice versa, it is applicable to all retail operations of RAC West, RAC Texas, and RAC East, not merely on the retail operations of RAC West. (R. p. 155, Tr. p. 203, lines 2-24; Transcript Day One p. 203:2-24.)

RAC East is also a Delaware corporation, (R. p. 354), which operates retail stores in the eastern part of the country, including South Carolina, (R. p. 125, Tr. p. 84, lines 18-19; R. p. 128, Tr. p. 93, lines 13-15; R. p. 136, Tr. p. 125, lines 1-12; R. p. 354). Through the retail stores operated by RAC East[1], as well as the retail stores operated by RAC West

[1]RAC RR, Inc. and Rainbow Rentals also made retail sales in South Carolina during one or more of the tax years at issue and are subject to a trademark licensing agreement with Appellant. (R. pp. 346-49; Report of Field Audit Ex. 1, Tab 1 pp. 6-7.) The Department's audit report and its Department Determination include the South

and RAC Texas, these entities rent and sell tangible personal property to customers. (R. p. 125, Tr. p. 83, line 7-R. p. 126, Tr. p. 85, Line 1; R. p. 353.)

In addition to operating retail stores in Texas, RAC Texas performs various management services for RAC East and RAC West. (R., p. 125, Tr. p. 84, line 22-R. p. 126, Tr. p. 86, line 1; R. pp. 411, 427; see, e.g., R. pp. 391-97 (Mgt. Servs. Agreement Ex. 1, Tab 10).) These management services include providing the services for protecting the RAC West's Intellectual Property. (R. p. 152, Tr. p. 190, line 20-Tr. 191, line 3.) Ms. Wolverton testified that she is "responsible for maintaining the company's portfolio of trademarks and trades names" and that such work includes determining whether a desired name would be available for federal registration, filing the registration and leading the registration process, filing continuing use statements, and monitoring use of the Intellectual Property by others. (R. p. 154, Tr. p. 197, line 25-Tr. p. 198, line 5; R. p. 154, Tr. p. 199, lines 12-16; R. p. 154, Tr. p. 200, line 22-R. p. 155, Tr. p. 201, line 18.) RAC Texas operates the legal department of the RAC affiliated entities and handles all of the legal needs of the RAC affiliates. (R. p. 140, Tr. p. 143, line 16-Tr. p. 144, line 2; R. p. 142, Tr. p. 150, line 22-Tr. p. 151, line 3; R. p. 147, Tr. p. 170, line 25-Tr. p. 171, line 5; R. p. 150, Tr. p. 181, lines 1-18.) Additionally, although RAC West owns the Intellectual Property, RAC Texas is responsible for developing advertising and marketing strategies to create, maintain, and expand the RAC brand name. (R. p. 425.)

RAC West and RAC East entered into a Trademark License Agreement in 2002 under which RAC West, the owner of the Intellectual Property, granted a license to RAC

Carolina retail operations of these entities. (R. pp. 342-43; Report of Field Audit Ex. 1, Tab 1 pp. 6-7.) When the Department refers to RAC East herein, it is generally including these two entities along with RAC East.

East to use and exploit the Intellectual Property, including in South Carolina. (R. pp. 383-84; Trademark License Agreement Ex.1, Tab 11 pp.1-2.) In exchange, RAC East agreed to pay to RAC West a royalty of 3% of RAC East's net sales of licensed services. (R. p. 389; Amend. No. 1 to Trademark License Agreement Ex. 1, Tab 11 p. 1.) Licensed services are rental service(s) from home appliances, furniture, home furnishings, computer equipment, and home entertainment products. (R. p. 383.)

Rent-A-Center, Inc. engaged KPMG LLP (KPMG) to conduct a study to determine the arm's length pricing for transactions between affiliates, including the royalty payments from RAC East to RAC West for use of the Intellectual Property. (R. p. 411; KPMG's Analysis of RAC's Profit Distribution Ex. 1, Tab 13 p.1.) Specifically, in 2003 KPMG determined that an arm's length royalty payment from RAC East and RAC Texas to RAC West would be in the range of 2% to 4% of gross sales. (R. p. 442.)

The retail businesses of RAC West and RAC East receive essentially the same management services from RAC Texas. (R. p. 152, Tr. p. 190, lines 13-19.) RAC East has store managers who hire and fire employees. (R. p. 127, Tr. p. 90, lines 5-22; R. p. 129, Tr. p. 98, lines 18-25.) As a whole, the only difference between RAC West and RAC East is the fact that RAC West owns the Intellectual Property. (R. p. 152, Tr. p. 190, lines 20-23.) RAC West does not even protect its own Intellectual Property, as that task is performed by RAC Texas. (R. p. 152, Tr. p. 190, line 24-Tr. p. 191, line 3.)

Regarding whether RAC West was a unitary business, Dr. Glenn Harrison, the Department's expert on law and economics, testified that the issue of whether Appellant's retail and trademark businesses constitute a unitary business is a "red herring" because Appellant argues that if it is a unitary business then the financial

activities of the trademark business cannot be separately identified. (R. p. 275, Tr. p. 197, line 1-Tr. p. 198, line 15.) He added that it would be wrong from both an economic and an accounting perspective to assume that a business cannot separate its accounts if it is determined to be part of a unitary business. (R. p. 275, Tr. p. 197, line 10-Tr. p. 198, line 15.)

Regarding RAC West's ability to separately account for its retail and trademark businesses, Dr. Harrison also testified that he saw no evidence and heard no testimony during the administrative hearing that would lead him to believe that an economist could not separate RAC West's retail and trademark businesses and that such a division of revenues and expenses within a business is a standard activity of an economist in the field of industrial organization. (R. p. 276, Tr. p. 203, lines 4-16; R. p. 277, Tr. p. 206, lines 2-7.) He stated that companies use managerial or cost accounting when they want to determine how an operation like a retail store is performing. (R. p. 275, Tr. p. 199, line 18-R. p. 276, Tr. p. 201, line 2.) Mr. Hugh Tollack, a CPA and the Director of Tax Audits, Planning, and Research for RAC Texas, testified that one can determine whether any of their individual retail stores is profitable. (R. p. 152, Tr. p. 191, lines 23-25.) In fact, under a management agreement with RAC Texas, the retail stores are guaranteed a 4.5% profit of each store's operating expenses, and the difference between the "actual profit of the store" and the guaranteed 4.5% profit is paid to RAC Texas as a management fee. (R. p. 137, Tr. p. 130, lines 4-23; R. p. 162, Tr. p. 230, lines 5-22.) Although the Management Services Agreement entered as evidence is an agreement between RAC East and RAC Texas, (R. pp. 391, 394), RAC Texas also performs management services for RAC West, and RAC West has a similar management services

agreement with RAC Texas, (R. pp. 411-13, 415, 426-27; see also R. p. 130, Tr. pp. 103, line 25-Tr. p. 104, line 6). Additionally, KPMG separately determined an arm's length management fee based on RAC West's retail business and an arm's length royalty fee based on RAC West's trademark business. (R. pp. 409-77.)

B. Tax Returns, Audit, and Financial Information about RAC West

RAC West filed corporate income tax returns in South Carolina because it owned Intellectual Property located in South Carolina. (R. p. 131, Tr. p. 106, lines 3-16.) Mr. Tollack testified that RAC West filed income tax returns in South Carolina based on Geoffrey v. South Carolina Tax Commission, 313 S.C. 15, 437 S.E.2d 13 (S.C. 1993). (R. p. 124, Tr. p. 80, line 22-R. p. 125, Tr. p. 81, line 15; R. p. 131, Tr. 106, lines 3-13.)

RAC West initially filed its South Carolina income tax returns using a three-factor formula which included payroll, property, and sales factors. (R. p. 133, Tr. p. 116, lines 10-23; Transcript Day One p. 116:10-23.) Mr. Tollack testified that the Department's auditor informed Appellant that this method may not be correct and suggested use of the single factor gross-receipts formula. (R. p. 133, Tr. p. 116, line 24-R. p. 134, Tr. p. 117, line 10; Transcript Day One pp. 116:24-117:10.) The Department sent its audit report to RAC West on March 12, 2008 and asserted an alternative apportionment method. (R. pp. 340, 342-43; Report of Field Audit, Ex. 1, Tab 1 pp. 1, 3-4.) After making an adjustment to the alternative apportionment formula proposed by the auditor, the Department issued its determination on May 6, 2009. (R. pp. 29-30, 37; Dep't Determination, Ex.1, Tab 5 pp. 1-2, 9.) On January 7, 2009, RAC West responded by filing amended income tax

returns using the standard apportionment formula (i.e., the four-factor formula).[2] (R. pp. 364-66, 372-74, 380-82.) Then one month before the administrative hearing, RAC West filed additional amended returns for each tax year using the standard gross-receipts apportionment formula set forth in Section 12-6-2290. (R. pp. 361-63, 369-71, 377-79; R. p. 134, Tr. p. 117, lines 2-16.) The amended returns and RAC West's use of multiple standard statutory apportionment formulas did not change the issue in this case which is whether the Department's use of an alternative apportionment method for the tax years 2003 through 2005 was proper.

Regardless of the standard apportionment formula, Appellant diluted the sales/gross-receipts ratio by including the retail sales of RAC West in the denominator. (See R. p. 152, Tr. pp. 189, line 20-Tr. p. 190, line 3; see, e.g., R. p. 374 (Amended Form SC 1120 for 2004 signed on Jan. 7, 2009 Ex. 1, Tab 7, p. 3); R. p. 371 (Amended Form SC 1120 for 2004 signed on July 11, 2011 Ex. 1, Tab 7 p. 3); R. p. 478 (Apportionment Data by State Ex. 1, Tab 21); R. p. 6 (Order p. 4); R. p. 34 (Dep't Determination Ex. 1, Tab 5 p. 6)). RAC Texas' tax director, (R. p. 124, Tr. p. 80, lines 22-25; R. p. 125, Tr. p. 81, lines 14-19), testified that including retail sales in the apportionment formula only adds to the denominator, while there are no retail sales in the numerator, (R. p. 152, Tr. p. 189, line 20-Tr. p. 190, line 3). RAC West originally filed South Carolina corporate income tax returns apportioning net income to South Carolina based on a multi-factor apportionment method under Section 12-6-2250. (R. p. 133, Tr. p. 116, line 10-R. p. 134, Tr. p. 117, line 1; see, e.g., R. p. 374 (Amended Form SC 1120 for 2004 signed on Jan. 7,

[2]As distinguished from the three-factor formula, the four-factor formula uses the same three factors (i.e., payroll, property, and sales) but it double weights the sales factor. This double weighting of the sales factor creates the fourth factor.

2009 Ex. 1, Tab 7 p. 3)). Although RAC West sourced its royalty income generated from RAC East's sales and rentals in South Carolina to the numerator of the sales factor, the multi-factor apportionment ratio used by RAC West was diluted because RAC West had no property or payroll in South Carolina and included all of its retail income from western states in the denominator of the sales factor. (See R. pp. 33-34; see, e.g., R. p. 374 (Amended Form SC 1120 for 2004 signed on Jan. 7, 2009 Ex. 1, Tab 7 p. 3).)

Dr. Harrison testified that the gross-receipts ratio used by Appellant pursuant to Section 12-6-2290 (i.e., the ratio was the result of dividing royalty income from SC by the sum of total royalty income and total retail income from all states) did not provide an accurate reflection of the economic connection of Appellant to South Carolina. (R. p. 274, Tr. p. 193, line 14-Tr. p. 194, line 9.) He stated that including royalty receipts from South Carolina in the numerator of the gross-receipts ratio while including both total royalty and total retail receipts in the denominator was like putting apples in the numerator and apples and oranges in the denominator. (R. 274, Tr. p. 194, lines 10-22.) He concluded that such an apples and oranges approach diluted the gross-receipts ratio. (R. p. 274, Tr. p. 194, line 23-Tr. p. 195, line 1.)

The Department found that RAC West's sole source of income from South Carolina consisted of royalty fees received from RAC East. (R. p. 342 (Report of Field Audit Ex. 1, Tab 1 p. 3); R. p. 253, Tr. p. 111, lines 16-18; R. p. 152, Tr. p. 189, lines 10-13). The Department's auditor did not include Appellant's retail operations in the Department's alternative apportionment method because those out-of-state retail operations had "nothing" to do with Appellant's business activity in South Carolina. (R. p. 253, Tr. p. 112, lines 6-12; R. pp. 342, 345 (Report of Field Audit Ex. 1, Tab 1 pp. 3,

9).) Accordingly, the Department determined that RAC West should not be using either statutory apportionment formula because neither fairly reflected RAC West's business activity in South Carolina. (R. pp. 31-34; Dep't Determination Ex. 1, Tab 5 pp. 3-6.) The Department determined that RAC West should be apportioning its net income to South Carolina using a reasonable alternative apportionment method. (R. pp. 34-36.) The Department used an alternative method under Section 12-6-2320(A)(4) that was based on RAC West's own formula: the 3% royalty agreement that RAC West had with RAC East. (R. p. 35; see also R. p. 389.)

During the auditor's testimony, the Department focused on Appellant's financial activity in tax year 2004 to explain the Department's findings and reasoning. (R. p. 253, Tr. p. 112, line 16-R. p. 254, Tr. p. 115, line 19.) Appellant had $424,004,077 of total revenue in 2004. (R. p. 478 (Apportionment Data by State Ex. 1, Tab 21); R. p. 253, Tr. p. 112, lines 16-25; R. p. 254, Tr. p. 113, line 20-Tr. p. 114, line 6.) Only $55,221,912 of RAC West's 2004 revenues was from royalty income. (R. p. 478 (Apportionment Data by State Ex. 1, Tab 21); R. p. 254, Tr. p. 113, line 20-Tr. p. 114, line 16.) Accordingly, the auditor testified that only 13% of Appellant's total revenues were from royalties, while 87% of Appellant's total revenues were not from its trademark business and had nothing to do with Appellant's business activity in South Carolina. (R. p. 254, Tr. pp. 113, line 7-Tr. p. 115, line 9.) The auditor testified further that these 2004 percentages were roughly the same in 2003 and 2005. (R. p. 254, Tr. p. 115, lines 10-19.)

The auditor also testified that Appellant's final 2004 South Carolina amended income tax return showed gross receipts from South Carolina of $861,437, which was 0.2032% of Appellant's total 2004 revenues of $424,004,077. (R. pp. 253, Tr. p. 112,

line 13-R. p. 254, Tr. p. 113, line 6; see also R. p. 371 (Amended Form SC 1120 for 2004 signed on July 11, 2011 Ex. 1, Tab 7 p. 3).) Schedule H-2 of Appellant's 2004 amended South Carolina income tax return shows that the ratio of 0.2032% was the gross-receipts ratio that Appellant used on its final 2004 amended return to apportion net income to South Carolina. (R. p. 371.)

Appellant's final 2004 South Carolina amended income tax return also showed that Appellant had total adjusted net income of $19,840,800 and South Carolina taxable income net income of only $40,317. (R. p. 371; Amended Form SC 1120 for 2004 signed on July 11, 2011 Ex. 1, Tab 7 p. 1.) Accordingly, of the $861,437 in gross receipts from South Carolina in 2004 only 4.68% was taxed on Appellant's final 2004 amended South Carolina income tax return. (R. p. 6; Order p. 4.)

Appellant's 2003 and 2005 South Carolina amended income tax returns reflect similar results. (R. p. 254, Tr. p. 115, lines 10-19; see, e.g., R. pp. 361, 363; R. pp. 377, 379.) In 2003, only 1.53% of Appellant's 2003 gross receipts from within South Carolina of $830,247 were taxed in South Carolina. (R. p. 7; Order p. 5.) In 2005, none of Appellant's 2005 gross receipts from within South Carolina of $844,348 were taxed in South Carolina. (R. p. 7.)

Dr. Harrison stated that the Department's alternative method was economically reasonable. (R. p. 274, Tr. p. 195, line 24-Tr. p. 196, line 25.) He said that excluding the retail operations from the Department's alternative method was "absolutely essential" for the tax burden on the Appellant to fairly represent its economic nexus with South Carolina. (R. p. 274, Tr. p. 195, line 24-Tr. p. 196, line 4; R. p. 274, Tr. p. 196, lines 18-25.)

Regarding deductible expenses for Appellant's trademark business, the Department's auditor testified that Appellant did not provide the Department with proof of expenses to offset the royalty income; however, the Department would have allowed such deductions had Appellate identified and substantiated such deductions. (R. p. 254, Tr. p. 116, line 21-R. p. 255, Tr. p. 117, line 4.)

ARGUMENT

This Court should affirm the Order of the ALC because, under the applicable standard of review, the factual findings of the ALC are supported by substantial evidence, the ALC made no errors of law, the Order did not violate any of Appellant's constitutional rights, and the Order was not arbitrary or capricious or characterized by abuse of discretion. In this case, the Department met its burden for proposing an alternative apportionment method by demonstrating that the statutory apportionment methods do not fairly represent Appellant's business activity in South Carolina and that the alternative apportionment method chosen by the Department was reasonable. The Department presented and the ALC found sufficient evidence to support these conclusions. Further, although the Department used an alternative method under Section 12-6-2320(A)(4), separate accounting, as an alternative apportionment method, is statutorily permitted and reasonable in this case.

The standard of review applicable in this case is based on S.C. Code Ann. § 1-23-610(B) and applicable case law. The Administrative Procedures Act states that an appellate court's review of an ALC order "must be confined to the record" and that an appellate court "may not substitute its judgment for the judgment of the ALJ as to the weight of the evidence on questions of fact." S.C. Code Ann. § 1-23-610 (Supp. 2014).

This Court may affirm the ALC's decision, or it may reverse or modify the decision if the substantive rights of the Appellant have been prejudiced because the decision is, among others, (1) in violation of constitutional provisions, (2) affected by other error of law, (3) clearly erroneous in view of the reliable, probative, and substantial evidence on the whole record, or (4) arbitrary of capricious of characterized by an abuse of discretion. Id. "The ALC's findings are supported by substantial evidence if, looking at the record as a whole, there is evidence from which reasonable minds could reach the same conclusion the administrative agency reached." Olson v. South Carolina Dep't of Health & Envtl. Control, 379 S.C. 57, 663 S.E.2d 497 (S.C. Ct. App. 2008). "The mere possibility of drawing two inconsistent conclusions from the evidence does not prevent a finding from being supported by substantial evidence." Id.

I. THE ALC PROPERLY FOUND THAT THE STANDARD STATUTORY APPORTIONMENT FORMULA CHOSEN BY APPELLANT DID NOT FAIRLY REPRESENT THE EXTENT OF APPELLANT'S BUSINESS ACTIVITIES IN SOUTH CAROLINA AND THAT THE ALTERNATIVE METHOD OF APPORTIONMENT CHOSEN BY THE DEPARTMENT WAS REASONABLE.

The ALC properly found that the Department, as the proponent of an alternative apportionment method, satisfied its burden to prove that the statutory apportionment formulas used by Appellant did not fairly represent the extent of Appellant's business activity in South Carolina and that the Department's chosen alternative apportionment formula was reasonable. The ALC also properly found that the Department's alternative apportionment method provided a more appropriate base on which Appellant was taxed in South Carolina than the base provided by either the four-factor formula or the gross-receipts formula now used by Appellant. Accordingly, this Court should affirm the

ALC's decision because evidence in the record clearly supports the conclusion that reasonable minds could reach the same conclusions that the ALC made and because the ALC did not make an error of law.

A. The Department's Method Imposes An Income Tax On Appellant's Corporate Net Income On A Base Which Reasonably Represents The Proportion Of The Trade Or Business Carried On Within South Carolina.

Appellant's method of apportionment violated S.C. Code Ann. § 12-6-2210(B) because it did not create a tax base which reasonably represents the proportion of Appellant's trade or business carried on within South Carolina. Appellant conducted only its trademark business in South Carolina, yet it utilized an apportionment formula wherein the unrelated retail activities conducted in western and mid-western states were included in the denominator while adding nothing to the numerator. Under Section 12-6-2320, the Department attempted to satisfy the fundamental focus of South Carolina's corporate income tax scheme, which is to tax an entity's business activities that occurred within this State. Although Appellant's method violated Section 12-6-2210(B), the Department's alternative apportionment method creates a tax base which reasonably represents the proportion of Appellant's trade or business carried on within South Carolina.

South Carolina law imposes an income tax on a taxpayer who is transacting or conducting business partly within and partly without South Carolina "upon a base which reasonably represents the proportion of the trade of business carried on within this State." S.C. Code Ann. § 12-6-2210(B) (2014). This "base" is South Carolina taxable income, and for multistate corporations this base is primarily determined by applying a statutory apportionment formula to federal taxable income (plus or minus certain state

adjustments). During the tax years at issue here, a taxpayer generally would determine this base by applying one of two statutory apportionment formulas: the multi-factor formula under Section 12-6-2250 or the gross-receipts formula under Section 12-6-2290; however, when the base determined by one of the statutory apportionment formulas does not fairly represent the extent of a taxpayer's business activity in South Carolina, a reasonable alternative apportionment formula under Section 12-6-2320(A) may be used.

Appellant receives royalties from its trademark business, (see R. pp. 383-90), while generating more traditional income from sales when offering tangible consumer goods to consumers, (see R. p. 125, Tr. p. 83, line 7-R. p. 126, Tr. p. 85, line 1). Since Appellant's sole source of income in South Carolina consisted of royalty fees from RAC East, (R. p. 342; Report of Field Audit Ex. 1, Tab 1 p. 3), Appellant's base comes from its trademark business, not its out-of-state retail business. While RAC West does not operate any retail stores in South Carolina, (R. pp. 354; Attachment to RAC West's Protest Ex. 1, Tab 3 p. 2), it owns intellectual property in South Carolina, (R. p. 131, Tr. p. 106, lines 3-6), and has licensed the use of the Intellectual Property to RAC East, (R. pp. 383-390), which operates retail stores in the eastern United States, including South Carolina, (R. p. 125, Tr. p. 84, lines 18-19; R. p. 128, Tr. p. 93, lines 13-15; R. p. 136, Tr. p. 125, lines 1-12). Except for Intellectual Property located in South Carolina, RAC West has no property or payroll in South Carolina. (R. p. 354.)

Here Appellant used both the multi-factor and the gross-receipts formulas during each of the tax years at issue, but Appellant's use of the statutory apportionment formulas was improper. First, Appellant recognized that its use of the multi-factor formula under Section 12-6-2250 was not appropriate as evidenced by Appellant amending its South

Carolina income tax returns on the eve of the hearing in this case.[3] Appellant filed these additional amended income tax returns to switch from the multi-factor formula under Section 12-6-2250 to the single gross-receipts ratio under Section 12-6-2290. (R. p. 133, Tr. p. 116, line 14-Tr. p. 117, line 16; see R. pp. 361-63, 369-71, 377-79 (Form SC 1120 for 2003 through 2005 signed on July 11, 2011 Ex. 1, Tab 7).) Second, Mr. Tollack testified that RAC West filed income tax returns in South Carolina based on Geoffrey v. South Carolina Tax Commission, 313 S.C. 14, 437 S.E.2d 13 (S.C. 1993), (R. p. 124, Tr. p. 80, line 22-R. p. 125, Tr. p. 81, line 15; R., p. 131, Tr. p. 106, lines 3-13), where the Circuit Court upheld the South Carolina Tax Commission's determination that Geoffrey owed South Carolina tax on its royalty income generated from sales in South Carolina by the licensee, Toys-R-Us, Geoffrey at 17-18, 437 S.E.2d at 15. While Appellant's use of the standard gross-receipts formula under Section 12-6-2290 would generally be appropriate for its trademark business, the mixing of gross receipts from Appellant's in-state trademark business with gross receipts from its out-of-state retail business distorts the tax base that is required under Section 12-6-2210(B). Such mixing of gross receipts

[3]Appellant first used the multi-factor formula under Section 12-6-2250, which uses payroll, property, and sales factors, for the tax years at issue.[3] (R. p. 133, Tr. p. 116, lines 14-23; see R. pp. 364-366, 372-74, 380-82 (Amended Form SC 1120 for 2003 through 2005 signed on Jan. 7, 2009 Ex. 1, Tab 7).) The multi-factor formula is applicable only for taxpayers whose principal business *in this State* is manufacturing or dealing in tangible personal property. S.C. Code Ann. § 12-6-2250 (Supp. 2007) (emphasis added). However, Appellant conducts only its trademark business in South Carolina. (R. p. 342 (Report of Field Audit Ex. 1, Tab 1 p.3); R. p. 253, Tr. p. 112, lines 6-12; see R. p. 124, Tr. p. 80, line 22-R. p. 125, Tr. p. 81, line 15; R. p. 131, Tr. p. 106, lines 3-13.) Since Appellant conducts only its trademark business in South Carolina and its trademark business is engaged in neither manufacturing nor dealing in tangible personal property, the multi-factor formula is not applicable to Appellant regarding apportionment of its net income in South Carolina.

did not apply to Geoffrey because, unlike Appellant, Geoffrey did not have its own retail operations. See Geoffrey at 17-19, 437 S.E.2d at 15-16.

The gross-receipts ratio is the fraction in which the numerator is total gross receipts from within this State during the taxable year and the denominator is total gross receipts from everywhere during the taxable year. S.C. Code Ann. § 12-6-2290 (Supp. 2007). Using this gross-receipts ratio, Appellant included in the numerator only the gross receipts from royalties in its trademark business related to transactions in RAC East's South Carolina stores while including in its denominator its gross receipts from its trademark business and its retail business from all states. (R. p. 152, Tr. p. 189, line 20-Tr. p. 190, line 3.) Because Appellant conducted only its trademark business in South Carolina, Appellant's inclusion of all of its retail sales in the denominator – none of which is conducted in South Carolina – substantially dilutes the statutory gross-receipts ratio. As stated earlier, 87% of Appellant's gross receipts came from its retail business conducted in western and mid-western states, so 87% of its gross receipts came from a type of business that Appellant did not conduct in South Carolina. (R. p. 254, Tr. p. 113, line 7-Tr. p. 115, line 19.) Despite the fact that 87% of its gross receipts had nothing to do its trademark business in South Carolina, Appellant included this 87% of gross receipts in the denominator of the gross-receipts ratio but added nothing to the numerator.

Dr. Harrison, the Department's expert, confirmed this dilution of the gross-receipts ratio. He stated that Appellant is mixing apples and oranges. (R. p. 274, Tr. p. 194, lines 10-22.) As a result, Appellant significantly lessened the gross-receipts ratio because the denominator included a significant amount of gross receipts from retail sales when Appellant did not engage in any retail business in South Carolina. (R. p. 274, Tr. p.

194, line 23-Tr. p. 195, line 1.) The lowering of the gross-receipts ratio correspondingly caused a lowering of the amount of the South Carolina taxable income (or the "base"). This lower base, in violation of Section 12-6-2210(B), did not reasonably represent the proportion of Appellant's trade or business carried on within South Carolina. Appellant conducted only its trademark business in South Carolina, but its apples and oranges approach to the gross-receipts ratio created a tax base out of proportion to its trademark business carried on in South Carolina.[4]

Appellant argues that the South Carolina General Assembly could have drafted Section 12-6-2290 differently so that the denominator of the gross-receipts ratio must include gross receipts "for the same type of business activity" as the gross receipts included in the numerator. (Appellant's Brief p. 13.) Such a targeted definition of the gross-receipts ratio was not needed. The General Assembly enacted a broad alternative apportionment statute that allows an alternative method to be used to correct any situation, not solely a targeted situation as Appellant suggests, in which the statutory formula is flawed. See S.C. Code Ann. § 12-6-2320(A) (2014).

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[4]This analysis and conclusion also applies to Appellant's use of the multi-factor formula under Section 12-6-2250. Although Section 12-6-2250's multi-factor formula is not applicable to Appellant in this State because its principal and only business in South Carolina is its trademark business, the multi-factor formula does not create a base which reasonably represents the proportion of Appellant's trademark business carried on in South Carolina. Even when using the multi-factor formula, Appellant used the apples and oranges approach by including all of Appellant's retail sales in the denominator of the sales factor. In addition, Appellant reported that it had no payroll or property in South Carolina, so the payroll and property factors of the four-factor formula are zero. (R. pp. 366, 374, 382; Amended Form SC 1120 for 2003, 2004, and 2005 signed on Jan. 7, 2009 Ex. 1, Tab 7.) Having two of the four factors being zero also substantially dilutes and distorts the multi-factor formula and the tax base.

The Department's alternative apportionment method satisfies the goal of Section 12-6-2210(B) to tax the proportion of a taxpayer's business that was conducted in South Carolina. Although Appellant asserts that there is no provision in South Carolina law for the Department to consider the "type" of income, (Appellant's Brief pp 11-13), the alternative apportionment statute unambiguously states that the Department may require an alternative method, including separate accounting, "to all *or any part of* the taxpayer's business activity," S.C. Code Ann. § 12-6-2320(A) (2014) (emphasis added). Here, the Department is merely taxing the only part of Appellant's business conducted in South Carolina: its trademark business. The Department, in its alternative apportionment method, considered only royalty income, not income from retail sales. In this manner and complying with Section 12-6-2210(B), the Department taxes only Appellant's trademark business because it is the only activity that Appellant conducted in this State.

Appellant also mistakenly asserts that the Department is imposing a gross-receipts tax on Appellant's royalty income from South Carolina. If the Department's alternative method looks like a gross-receipts tax, it is only because Appellant did not identify or substantiate any deductions related to its trademark business.[5] (See R., p. 254, Tr. p. 116, line 21-R. p. 255, Tr. p. 117, line 1; Transcript Day Two pp. 116:21-117:1.) The Department's auditor testified that, had the Appellant provided and supported any such

[5]When Appellant filed its South Carolina income tax returns using the standard four-factor or gross-receipts formulas, there was no need for Appellant to specifically identify deductions applicable to its South Carolina business activities. Under a standard formula, the resulting ratio is applied to adjusted federal taxable income from which deductions have already been taken. From 2003 to 20005, the four-factor formula ranged from 0.0991% to 0.1016%, while the gross-receipts ratio ranged from 0.1981% to 0.2032%. Under the Department's alternative apportionment method, South Carolina gross-receipts from royalties were specifically identified, so related deductions also needed to be specifically identified.

deductions, the Department would have allowed the deductions as part of the alternative apportionment method. (R. p. 255, Tr. p. 117, lines 2-4; Transcript Day Two p. 117:2-4.)

Based on the above, the apportionment formula used by Appellant dilutes the Appellant's net income within South Carolina by including retail sales from other states in the denominator when Appellant does not engage in retail sales in South Carolina such that the result significantly understates the base on which Appellant is taxed in South Carolina. Accordingly, that significantly reduced base does not reasonably represent the proportion of Appellant's trademark business conducted in South Carolina. In response to the dilution caused by the statutory formulas, the Department's alternative apportionment method reasonably represents the proportion of Appellant's business conducted in South Carolina because, in calculating the tax base under Section 12-6-2210(B), the Department included only the proportion, or part, of Appellant's business that its conducts within South Carolina (i.e., the trademark business).

B. The Department Satisfied Both Requirements Necessary To Impose An Alternative Apportionment Method On Appellant.

This Court should affirm the ALC's decision because the Department met, and the ALC properly applied, the two-pronged burden on the proponent of an alternative apportionment method that was enacted through Section 12-6-2320(A) and discussed in CarMax, so there was not an error of law. CarMax, 411 S.C. at 89, 767 S.E.2d at 200. As the proponent of the alternative apportionment method in this matter, the Department satisfied both of the requirements necessary to impose an alternative apportionment method on Appellant. First, the Department proved that the statutory apportionment formulas used by Appellant did not fairly reflect Appellant's business activity in South

Carolina. Second, the Department proved that its chosen alternative method was reasonable. Additionally, this Court should affirm because sufficient evidence exists in the record for reasonable minds to make the same conclusions as the ALC (i.e., that the Department met its two-pronged burden).

Both a taxpayer and the Department may propose the use of an alternative apportionment method to replace the applicable statutory apportionment formula. South Carolina law states:

> (A) If the allocation and apportionment provisions of this chapter do not fairly represent the extent of the taxpayer's business activity in this State, the taxpayer may petition for, or the department may require, in respect to all or any part of the taxpayer's business activity, if reasonable:
> (1) separate accounting;
> (2) the exclusion of one or more of the factors;
> (3) the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in the State; or
> (4) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

S.C. Code Ann. § 12-6-2320(A) (2014). Regarding this provision, the South Carolina Supreme Court recently held:

> Accordingly, when a party seeks to deviate from a statutory formula under section 12-6-2320(A), the proponent of the alternate formula bears the burden of proving by a preponderance of the evidence that: (1) the statutory formula does not fairly represent the taxpayer's business activity in South Carolina and (2) its alternate accounting method is reasonable.

CarMax, 411 S.C. at 89, 767 S.E.2d at 200.

1. The Department Demonstrated that the Statutory Apportionment Formulas Used by the Appellant Did Not Fairly Represent Appellant's Business Activity in South Carolina.

The ALC properly found that the statutory apportionment formulas used by Appellant did not fairly represent the extent of Appellant's business activity in South Carolina. (R. p. 11; Order p. 9.)

As explained above, Appellant initially used a three-factor formula under Section 12-6-2290's to apportion its net income in South Carolina. (R. p. 133, Tr. p. 116, lines 10-23.) Appellant later filed amended returns using the four-factor formula under Section 12-5-2290. (R. pp. 364-66, 372-74, 380-82; Amended Form SC 1120 for 2003, 2004, and 2005 signed on Jan. 7, 2009 Ex. 1, Tab7.) Either multi-factor-formula method of apportionment however was not allowed for Appellant in South Carolina because Appellant conducted only its trademark business in South Carolina and its trademark business was neither manufacturing nor dealing in tangible personal property. See S.C. Code Ann. § 12-6-2250 (Supp. 2007). The ALC properly concluded that "Section 12-6-2250 is simply not applicable" to Appellant. (R. p. 12; Order p. 10.)

One month before the administrative hearing in this case, Appellant filed additional amended returns for each tax year using the gross-receipts ratio set forth in Section 12-6-2290. (R. pp. 361-63, 369-71, 377-79 (Amended Form SC 1120 signed on July 11, 2011 for 2003, 2004, and 2005 Ex.1, Tab 7); R. p. 134, Tr. p. 117, lines 2-16.) The ALC noted that Section 12-6-2290 appears on its face to be applicable to apportion the net income related to Appellant's business activity in South Carolina. (R. p. 12; Order p. 10.) However, in its gross-receipts ratio Appellant included only the South Carolina royalty receipts in the numerator but included company-wide royalty and retail sales in the denominator. (See R. p. 152, Tr. p. 189, line 20-Tr. p. 190, line 3.)

The Department's auditor and its expert in law and economics found that Appellant's gross-receipts ratio distorts Appellant's business activity in South Carolina. The Department's auditor testified that Appellant's retail sales had "nothing" to do with Appellant's trademark business in South Carolina. (R. p. 253, Tr. p. 112, lines 6-12; R. pp. 342, 345 (Report of Field Audit Ex. 1, Tab 1 pp. 3, 9). Further, the Department's expert in law and economics characterized Appellant's gross-receipts ratio as not accurately reflecting the economic connection that Appellant had with South Carolina, (R. p. 274, Tr. pp. 193, line 14-Tr. p. 194, line 9), and as mixing apples and oranges, (R. p. 274, Tr. p. 194, lines 10-22). The result of this mixture is that Appellant significantly lessens the gross-receipts ratio because the denominator includes a significant amount of gross receipts from retail sales made in other states when Appellant does not engage in retail business in South Carolina. (R. p. 274, Tr. p. 194, line 23-Tr. p. 195, line 1.)

Evidence presented demonstrated that the vast majority of Appellant's total revenues came from its non-South Carolina retail sales which have nothing to do with Appellant's South Carolina trademark business. Nationally only 13% of its revenues was generated from its trademark business. (R. p. 254, Tr. p. 114, line 4-Tr. p. 115, line 19; R. p. 478 (Apportionment Data by State Ex. 1, Tab 21).) Appellant's retail operations that generated the other 87% of its total revenues have nothing to do with its trademark business in South Carolina, which is why the Department's auditor did not include the retail sales in the Department's apportionment calculations. (R. p. 253, Tr. p. 112, lines 6-12; R. p. 254, Tr. p. 115, lines 7-9; Transcript Day Two pp. 112:6-12, 115:7-9.)

Because of this disparity, including the retail sales in the denominator diluted the gross-receipts ratio and significantly lowered the amount of net income from Appellant's

trademark business which would be taxable in South Carolina. In fact, because South Carolina taxable income was significantly reduced by the dilution of the gross-receipts ratio, only 1.53% in 2003, 4.68% in 2004, and 0% in 2005 of Appellant's South Carolina royalty income was taxed in South Carolina.[6] (R. pp. 6-7; Order pp. 4-5.)

The ALC found this evidence convincing. After stating that Appellant's retail sales, which occurred totally outside of South Carolina, are unrelated to its South Carolina trademark business, the ALC properly concluded that the "inclusion of RAC West's gross receipts from its retail operations in the denominator of the apportionment ratio would so dilute the gross receipts received from South Carolina as to distort the taxpayer's actual economic activity in this State." (R. pp. 7, 13; Order pp. 5, 11.) Therefore, the ALC properly concluded that apportioning Appellant's income using a gross-receipts ratio as stated in Section 12-6-2290 "would not accurately reflect RAC West's business in South Carolina." (R. p. 12; Order p. 10.)

Based on the above, the evidence clearly supports the conclusion that including Appellant's out-of-state retail sales in the denominator of the gross-receipts ratio (or in the denominator of the sales factor in the multi-factor formula) dilutes that ratio to the extent that the result does not fairly represent Appellant's trademark business activity in South Carolina. Additionally, the multi-factor formula as a whole does not fairly represent Appellant's business activity in South Carolina. After seeing and hearing the

[6]The above analysis focused on the dilution of Section 12-6-2290's gross-receipts factor. Although the multi-factor formula in Section 12-6-2250 is not applicable to Appellant, if it was applicable, the sales factor within the multi-factor formula would likewise be diluted. This multi-factor formula would be further diluted because Appellant's payroll and property factors would be zero in South Carolina since Appellant has no payroll of property in South Carolina, (R. p. 354; R. pp. 366, 374, 382.)

evidence presented, reasonable minds undoubtedly could conclude, as did the ALC, that the statutory formulas used by Appellant do not fairly represent the extent of Appellant's business activity in South Carolina. Therefore, this Court should affirm that the ALC's decision that the Department met the first prong of Section 12-6-2320(A).

2. The Department Demonstrated that the Alternative Apportionment Method Was Reasonable.

The ALC's decision that the Department met the second prong of Section 12-6-2320(A) – that the Department's alternative apportionment method was reasonable – was also proper. Sufficient evidence supports its decision, including the four reasons it gave for the reasonableness of the Department's alternative method of apportionment.

First, the ALC found that the Department's alternative method was reasonable because it was based on a formula created by the taxpayer itself in its trademark licensing agreements. (R. p. 14; Order p. 12.) Sufficient facts supported the ALC's finding. The alternative method used by the Department was based on RAC West's own formula: the 3% royalty agreement that RAC West had with RAC East (R. p. 35; Dep't Determination Ex. 1, Tab 5 p. 7). Unlike other apportionment cases, this case does not involve using some mathematical theory to determine the amount of gross receipts generated from within this State. Here, the amount that Appellant generated from within South Carolina is known and identifiable as the gross receipts, were earned and payable to Appellant based on a royalty agreement between Appellant and RAC East. Just before the three tax years at issue in this case began, Appellant entered into this royalty agreement in which RAC East could use Appellant's Intellectual Property in exchange for a royalty of 3% of RAC East's net sales of licensed services. (R. p. 389.) Because the formula existed in

the royalty agreement, all parties know exactly how much Appellant received from South Carolina. In other words, the parties know exactly the amount of gross receipts Appellant generated from its South Carolina activities and that is the amount (less substantiated deductions) that the Department taxed in its alternative method. This 3% license fee received by Appellant was given credibility when KPMG shortly thereafter concluded a transfer pricing study in which KPMG said that an arm's length license fee of this nature would be in the range of 2% to 4%. (R. p. 442.) Therefore, it was entirely reasonable for the Department to determine that Appellant's gross receipts from South Carolina were 3% of RAC East's net sales in South Carolina during each tax year at issue.

Second, the ALC found that the Department's alternative method was reasonable because it treats each state equally and consistently. (R. p. 14; Order p. 12.) If the Department's alternative method was applied to each of the fifty states, for apportionment purposes Appellant's retail business would not be mixed with its trademark business in any state in which Appellant does not have a retail store. Therefore, in each state in which Appellant generates royalty income (but not income from retail sales), Appellant would be taxed only on its trademark business that occurred in that state. Additionally, since Appellant does not license its Intellectual Property to itself, in states in which Appellant has retail stores, only retail sales (not royalty income) would be part of the apportionment.

Third, the ALC found that the Department's alternative method was reasonable because applying this alternative method to all states operates to apportion 100% of the royalty revenue, without any revenue being taxed twice. (R. p. 14; Order p. 12.) If, according to the Department's alternative method, each state in which Appellant conducts

its trademark business taxed only net income from the trademark business, then the sum of royalty income claimed as income in those states would be exactly 100%. Therefore, no more and no less than 100% of Appellant's royalty income would be taxed if all states applied the Department's alternative apportionment method.

Fourth, the ALC found that the Departments' alternative method was reasonable because it "does not tax more than 100% of the income generated in South Carolina, whereas RAC West's method includes income from its retail operations which is not connected to South Carolina in any way." (R. p. 14; Order p. 12.) In other words, the Department's alternative method is reasonable because it does not include retail income earned from Appellant's out-of-state retail operations when its retail operations have nothing to do with its trademark business in South Carolina. Appellant's only source of income in South Carolina is royalty income from its trademark business. (R. p. 342 (Report of Field Audit Ex. 1, Tab 1 p. 3); R. p. 253, Tr. p. 111, lines 16-18; R. p. 152, Tr. p. 189, lines 10-13.) Specifically, it was reasonable that the Department and its auditor did not include Appellant's retail operations in the Department's apportionment formula because those out-of-state retail operations had "nothing" to do with Appellant's business activity in South Carolina. (R. p. 253, Tr. p. 112, lines 6-12; R. pp. 342, 345.)

In addition to the four reasons given by the ALC, the Department's expert in law and economics also stated that the Department's alternative method was economically reasonable. (R. p. 274, Tr. p. 195, line 24-Tr. p. 196, line 25.) He said that excluding the retail operations from the Department's alternative method was "absolutely essential" for the tax burden on the Appellant to fairly represent its economic nexus with South Carolina. (R. p. 274, Tr. p. 195, line 24-Tr. p. 196, line 4; R. p. 274, Tr. p. 196, lines 18-

25.) By including the retail sales, the apportionment formula would adopt an apples and oranges approach. (R. p. 274, Tr. p. 194, line 10-Tr. p. 195, line 1.) On the other hand, the Department's method only looks at apples. In this matter, "apples" are the trademark royalties from within South Carolina, while the "oranges" represent the income from Appellant's out-of-state retail business.

Based on the above, the evidence clearly supports the conclusion that the Department's alternative apportionment method was reasonable. The ALC properly found that "the facts established that the Department's method of apportionment is reasonable." (R. p. 14; Order p. 12.) After seeing and hearing the evidence presented, reasonable minds undoubtedly could conclude that the Department's alternative apportionment method of considering only the royalty income from Appellant's sole business activity in South Carolina was reasonable. Therefore, this Court should affirm the ALC's decision that the Department met the second prong of Section 12-6-2320(A).

In conclusion on the first issue, the statutory apportionment formulas do not establish the correct "base" under Section 12-6-2210(B); however, by focusing on only the trademark business that Appellant conducts in South Carolina, the Department's alternative method established a proper tax "base." Additionally, the Department met its burden by proving that the statutory apportionment formulas did not fairly represent the extent of Appellant's business activity in South Carolina and that the Department's alternative method was reasonable. Because sufficient evidence supports these conclusions, reasonable minds could also come to these same conclusions. When combined with the facts that the ALC used the proper statutes and applied the law properly, this Court should affirm.

II. ALTHOUGH THE ALC DID NOT FIND THAT THE APPELLANT WAS NOT A UNITARY BUSINESS, SUCH A FINDING WOULD NOT REQUIRE THIS COURT TO REVERSE THE ALC'S DECISION.

The Department finds Appellant's second and third issues to be so closely linked that it is difficult to determine why Appellant separated them into two issues. The ultimate question raised by the two issues is whether separate accounting may be used in this case. The General Assembly specifically allows the use of separate accounting as an alternative apportionment method, while not precluding a unitary business' use of separate accounting. S.C. Code Ann. § 12-6-2320(A) (2014). Although the ALC did not rule whether Appellant's retail and trademark businesses were operated as a unitary business, the ALC found "that the separate accounting method employed by the Department here is appropriate." (R. p. 17.) As discussed in the first issue above, the ALC found that the Department met its two-pronged burden to impose an alternative apportionment method, including separate accounting. Accordingly, this Court should dismiss Appellant's second and third issues and affirm the ALC's decision on the basis of the first issue above and the fact that Section 12-6-2320(A) allows separate accounting.

Nonetheless, the Department will answer Appellant's second and third issues in kind. In the conclusion to its second issue, Appellant wrongly asserts that "this Court should reverse the ALC because its finding that RAC West was not operating a unitary business is contrary to South Carolina law" and erroneous in light of the evidence in this case. (Appellant's Brief p. 33.) Although the ALC discussed some of the characteristics of a unitary business, (R. pp. 7-8, 15-17.), the ALC never concluded that Appellant was not a unitary business that consisted of both its retail and trademark businesses. However, contrary to Appellant's assertion, any such finding would not require that this

Court reverse the ALC's decision. The trademark business is separable. Assuming, arguendo, that Appellant's retail and trademarks businesses were operated as a unitary business, the issue would still be whether South Carolina law allows separate accounting as an alternative apportionment method, which is Appellant's third issue.

Although the ALC did not conclude whether Appellant operated a unitary business, the ALC did address factors that would be addressed in a unitary-business analysis. The ALC stated the correct test for whether a business is unitary when it observed that a unitary business has the characteristics of unity of ownership, unity of management, and unity of operations (i.e., the "unities" definition) and the activities of the business in question contribute to or depend on the other activities of the business (i.e., the "contribution-dependence" definition). (R. p. 16; Order p. 14 (citing Eastman Kodak Co. v. South Carolina Tax Commission, 308 S.C. 415, 418 S.E.2d 542 (1992)).)

Appellant's trademark business, which is the only business that Appellant conducted in South Carolina, (R. p. 342; R. p. 253, Tr. p. 111, lines 16-18; R. p. 152, Tr. p. 189, lines 10-13), is not unitary with Appellant's primary business, its retail business. For example, unity of management does not exist within Appellant's retail business because Appellant's store managers operate the stores, (R. p. 127, Tr. p. 90, lines 5-22; R. p. 129, Tr. p. 98, lines 18-22), but employees of RAC Texas perform various management services for Appellant, (R. p. 125, Tr. p. 84, line 22-R. p. 126, Tr. p. 86, line 1; R. p. 130, Tr. p. 103, line 25-Tr. p. 104, line 6; R. p. 140, Tr. p. 143, line 16-Tr. p. 144, line 2; R. p. 142, Tr. p. 150, line 22-Tr. p. 151, line 3; R. p. 147, Tr. p. 170, line 25-Tr. p. 171, line 5; R. p. 150, Tr. p. 181, lines 1-18; R. pp. 411, 417; see, e.g., R. pp. 391-397.) Moreover unity of management does not exist between Appellant's retail and trademark

businesses. Appellant has store managers who manage the day-to-day retail operations at each store, (R. p. 127, Tr. p. 90, lines 5-22; R. p. 129, Tr. p. 98, lines 18-25), but Appellant does not manage the day-to-day operations of its trademark business, (R. p. 152, Tr. p. 190, line 24-Tr. p. 191, line 3; R. p. 154, Tr. p. 199, lines 12-16; R. p. 154, Tr. p. 200. Line 8-R. p. 155, Tr. p. 201, line 4.) RAC Texas actually provides the services for protecting, licensing, and monitoring use of Appellant's Intellectual Property. (R. p. 152, Tr. p. 190, line 20-Tr. p. 191, line 3; R. p. 154, Tr. p. 199, lines 12-16; R. p. 154, Tr. p. 200. Line 8-R. p. 155, Tr. p. 201, line 4.) Ms. Wolverton of TAC Texas is "responsible for maintaining the company's portfolio of trademarks and trades names" including determining whether a desired name would be available for federal registration, filing the registration and leading the registration process, filing continuing use statements, and monitoring use of the Intellectual Property by others. (R. p. 154, Tr. p. 197, line 25-Tr. p. 198, line 5, R. p. 154, Tr. p. 199, lines 12-16; R. pp. 154, Tr. p. 200, line 22-R. p. 155, Tr. p. 201, line 18.) Additionally, although RAC West owns the Intellectual Property, RAC Texas is responsible for developing advertising and marketing strategies to create, maintain, and expand the RAC brand name. (R. p. 425.) Appellant asserts that a unity of management exists here because a related company, RAC Texas, manages Appellant's trademark business, (Appellant's Brief p. 32.); however, this fact proves the opposite. The fact that another entity performs these aspects of Appellant's business demonstrates that Appellant is not unitary and shows that Appellant's businesses can be separated, even if they were unitary.

There are several reasons why Appellant does not meet the contribution-dependence test meaning that its trademark business is not unitary with its retail business.

First, Appellant's trademark business depends on retail sales made by its retail affiliates, not from its own retail sales. (See, e.g., R. pp. 383-390.) Unlike the retail sales of RAC East, (R. pp. 383-390), the retail sales of Appellant do not generate any royalty income for Appellant's trademark business. Second, as the ALC noted, Appellant did not prove that its retail and trademark operations have an inextricable link or that there is some type of opaque flow of value and interdependency between the two businesses. (R. p. 8.) Appellant asserted that such values existed but offered no documentary evidence to support this claim. Third, Appellant's assertions that as the service and performance of the retail stores increased the Intellectual Property become "more famous," (R. p. 155, Tr. p. 202, line 7-Tr. p. 203, line 8; R. p. 155, Tr. p. 203, lines 16-19), is irrelevant because notoriety does not necessarily cause an increase in value and Appellant certainly did not present any estimates of how much the value of the Intellectual Property increased or decreased in any year because of retail service or performance. Assuming arguendo that good retail service or performance increased the value of the Intellectual Property in any one of the tax years at issue, such an increase in the value of Intellectual Property is not a taxable event and has no relevance to Appellant's income tax returns for 2003, 2004, or 2005. The taxable event for Appellant in South Carolina is the receipt of the royalty fees from RAC East. That taxable event is the centerpiece of the Department's alternative apportionment method. Appellant could affect the taxable event, if the value of the Intellectual Property increased or decreased, by increasing or decreasing the royalty percentage in the licensing agreements with RAC East. Fourth, Appellant did not strategically acquire the Intellectual Property to enhance the value of its retail business as it already owned the Intellectual Property when that company was acquired. (R. p. 132,

Tr. p. 110, lines 16-25.) Fifth, whatever value Appellant's Intellectual Property has on its retail operations and vice versa is applicable to all retail operations of RAC West, RAC Texas, and RAC East, not merely on the retail operations of RAC West. (R. p. 155, Tr. p. 203, lines 2-24.) Therefore, Appellant's Intellectual Property equally serves the retail operations of RAC West, RAC East, and RAC Texas and does not provide any unique value to RAC West's retail business. Finally, although the retail operations of RAC East and Appellant are the same, (R. p. 152, Tr. p. 190, lines 13-23), only Appellant owns the Intellectual Property, (R. p. 152, Tr. p. 190, lines 20-23; R. p. 155, Tr. p. 202, lines 14-15). This indicates that operating the retail stores, whether by RAC East, RAC Texas, or Appellant, is not dependent on also owning the trademark business; otherwise RAC East's and RAC Texas' retail business would be failing because they do not have trademark businesses.

Still another example of Appellant's trademark business not being unitary with its retail business is the fact that Appellant's royalty income is identifiable, quantifiable, and separable. Its royalty income comes from its retail affiliates, primarily RAC East and RAC Texas, and is established through licensing agreements. (See, e.g., R. pp. 383-390.) In the agreement with RAC East, Appellant receives a royalty fee of 3% of RAC East's net sales. (R. pp. 385, 389). KMPG was able to look separately at Appellant's trademark business and determine an arm's length royalty fee. (R. p. 442.) Since the royalty fee has been quantified and KPMG separately analyzed Appellant's trademark business, Appellant's trademark business can be separated from its retail business.

Appellant cites Exxon Corp. v. South Carolina Tax Commission, 273 S.C. 594, 258 S.E.2d 93 (1993) to assert that Appellant's trademark business is unitary with its

retail business. (Appellant's Brief p. 28-33.) In Exxon, Humble Oil and Refining Company (Humble) operated a vertically integrated oil and gas company engaged in exploration and production of oil and gas, refining of crude oil, and the retail sales of petroleum products. Exxon, 273 S.C. at 596, 258 S.E.2d at 94. When filing income tax returns in South Carolina, Humble excluded from its tax base the portion of its income related to the exploration and production operations. Id. The Supreme Court affirmed the lower court's decision that Humble operated a single unitary business that included the exploration and production operations and that South Carolina income tax should be calculated by applying the apportionment ratio to Humble's entire corporate net income. Id., 273 S.C. at 595, 596, 602, 258 S.E.2d at 94, 97. The Supreme Court used the unities and contribution-dependence definitions in its Exxon analysis, but, as discussed, above, the facts of the instant case, unlike Exxon, show that unity of management and the requisite contribution-dependency between Appellant's retail and trademark businesses did not exist. Additionally and critically, Exxon does not prohibit the use of separate accounting as an alternative apportionment method inasmuch as that opinion predated the 1995 enactment of Section 12-6-2320(A) which allows separate accounting. Prior to the enactment of Section 12-6-2320(A), South Carolina law did not have a statute that authorized the use of separate accounting as an alternative apportionment method.

Based on the above, this Court should dismiss Appellant's second issue because the evidence supports the fact that Appellant is not operating a single unitary business and because, even if it was unitary, the evidence shows that Appellant can use separate accounting under Section 12-6-2320(A) because it can separately identify and quantify the financial transactions of its trademark business, its sole business in South Carolina.

III. THE ALC PROPERLY ALLOWED THE DEPARTMENT TO APPLY A SEPARATE ACCOUNTING TO APPELLANT AND FOUND THAT SUCH SEPARATE ACCOUNTING WAS REASONABLE.

This Court should affirm the ALC's decision because the General Assembly has allowed the use of separate accounting as an alternative apportionment method, the ALC did not make an error of law, and, as discussed in the first issue above, sufficient evidence confirms that the ALC properly found that the Department met its two-pronged burden of imposing such an alternative method. The ALC properly found that the Department's separate accounting method was appropriate. (R. p. 17; Order p. 15.)

Although Appellant mixes whether Appellant's trademark and retail businesses are unitary with the Department's ability to impose separate accounting on Appellant's trademark business, the South Carolina General Assembly did not mix the two together. The General Assembly allows the use of separate accounting as an alternative apportionment method, while it says nothing about a unitary business not being able to use separate accounting. S.C. Code Ann. § 12-6-2320(A) (2014). This statute was enacted in 1995 and postdates cases such as Exxon and Eastman Kodak, which are often incorrectly used to assert that a unitary business cannot use separate accounting. Had the General Assembly sought to exclude a unitary business from using separate accounting, it simply and easily could have included such language in Section 12-6-2320(A). Excluding such language demonstrates the inaccuracy of Appellant's assertions.

Although the evidence indicates that Appellant's trademark and retail businesses are not unitary, such a determination isn't the primary issue that Appellant makes it. What is relevant is whether the financial activities of Appellant's trademark business can be separately identified. Dr. Harrison agreed. He testified that the issue of whether

Appellant's retail and trademark businesses constitute a unitary business is a "red herring" because Appellant argues that, if its businesses are unitary, then it cannot separately identify the financial activities its trademark business. (R. p. 275, Tr. p. 197, line 1-Tr. p. 198, line 15.) Dr. Harrison added that it would be wrong from both an economic and an accounting perspective to assume that a business cannot separate its accounts if it is determined to be part of a unitary business. (R. p. 275, Tr. p. 197, line 10-Tr. p. 198, line 15.)

Citing a state and local tax treatise, the ALC stated that "'separate accounting' is a technique of carving out of an overall business of the taxpayer the income derived from sources within a single state and ascertaining the profits attributable to that portion of the business." (R. p. 15; Order p. 13 (citing 1 Jerome R. Hellerstein & Walter Hellerstein, State Taxation: Constitutional Limitations and Corporate Income and Franchise Taxes ¶ 8.03(3rd ed. 2000)).) This definition, like the opinion of Dr. Harrison, does not focus on unitary status, but it raises the issue of whether the financial activities related to business in a single state can be separated from the taxpayer's other financial transactions.

Although South Carolina law allows the use of separate accounting as an alternative apportionment method, it is reasonable that a prerequisite to the use of separate accounting be that the financial activities of Appellant's trademark business in South Carolina be identifiable. Here the evidence indicates that the financial activities of Appellant's trademark business can be separately identified. As discussed in the Department's second issue above, RAC East paid a fixed 3% of its South Carolina net sales to Appellant. (R. p. 389.) Since Appellant quantified its South Carolina net sales

each year on its federal income tax returns, (R. p. 31), the royalty income paid to Appellant for South Carolina sales was easily identifiable and quantified.

Just like the royalty income of the trademark business is separately identified, expenses of the trademark business must be separately identified and substantiated. The ALC found that Appellant "failed to adequately establish that it incurred expenses in conducting its trademark business." (R. p. 7; Order p. 5.) It is well established under both state and federal law that deductions from income are a matter of legislative grace rather than entitlement. See Adams v. Burts, 245 S.C. 339, 140 S.E.2d 586 (1965); Fennell v. S.C. Tax Comm'n, 233 S.C. 43, 103 S.E.2d 424 (1958). Accordingly, to deduct an expense, the taxpayer must bring himself squarely within the terms of the statute expressly authorizing the deduction. AVCO Corp. v. Wasson, 267 S.C. 581, 230 S.E.2d 614 (1976). Moreover, deduction statutes are not to be liberally construed. M. Lowenstein & Sons v. S.C. Tax Comm'n, 277 S.C. 561, 290 S.E.2d 812 (1982). The taxpayer bears the burden of substantiating every business expense that he claims. Hradesky v. Comm'r, 65 T.C. 87, 89-90 (1975), aff'd per curiam, 540 F.2d 821 (5th Cir. 1976). Furthermore, "[w]here a tax officer has disallowed a deduction, the ruling of such officer is presumed to be correct and the taxpayer has the burden of proving it to be wrong." Anonymous Taxpayers v. S.C. Dep't of Revenue, 03-ALJ-17-0366-CC (Dec. 15, 2003). Per the Department's auditor, Appellant did not provide evidence of any expenses. (R. p. 254, Tr. p. 116, line 21-R. p. 255, Tr. p. 117, line 4.) Accordingly, no allowable expenses could be deducted.

Evidence also showed that Appellant was capable of identifying and substantiating such expenses. First, Dr. Harrison testified that companies use managerial

or cost accounting when they want to determine how a component of a business is performing. (R. p. 275, Tr. p. 199, line 18-R. p. 276, Tr. 201, line 2; R. p. 276, Tr. p. 203, lines 4-16; R. p. 277, Tr. p. 206, lines 2-7.) Second, Mr. Tollack, a CPA, testified that one can determine whether any of his individual retail stores is profitable. (R. p. 152, Tr. p. 191, lines 23-25.) Third, under a management agreement with RAC Texas, the retail stores are guaranteed a 4.5% profit of each store's operating expenses, and the difference between the "actual profit of the store" and the guaranteed 4.5% profit is paid to RAC Texas as a management fee. (R. p. 137, Tr. p. 130, lines 4-23; R. p. 162, Tr. p. 230, lines 5-22.) If Appellant can determine the profitability of its retail stores and hence its entire retail business, it is common sense that it can determine the profitability, which includes expenses, of its trademark business. The difference between Appellant's total expenses and its retail expenses would be its trademark expenses. Then, as the Department's expert said, Appellant could use managerial or cost accounting techniques to determine the share of trademark expenses applicable to South Carolina.

In addition to separate accounting being lawful and available in this case, its use is also reasonable. Appellant asserts that "separate accounting is prohibited for a unitary business because it cannot produce reasonable results." (Appellant's Brief p. 38.) Although separate accounting in a unitary business *may* pose difficulties, see, e.g., Mobil Oil Corp. v. Comm'r of Taxes of Vermont, 445 U.S. 425, 438 (1980), evidence shows that Appellant's trademark and retail businesses are not unitary and, even if they were unitary, that separate accounting could produce reasonable results in this case. The ALC stated that "many of the drawbacks that usually accompany separate accounting are not present here." (R. p. 17.) In fact, Appellant's South Carolina royalty income was easily

identified and quantified for each tax year at issue, (R. p. 31 (Dep't Determination Ex. 1, Tab 5 p. 3); see R. pp. 389 (Amend. No. 1 to Trademark License Agreement Ex. 1, Tab 11, p. 1)), as demonstrated by the transfer pricing study, (R. pp. 409-477), and the licensing agreement, (R. pp. 383-390; R. p. 17 (Order p. 15)).

As further support of its reasonableness in this case, separate accounting provides a more accurate tax "base" from which to calculate Appellant's South Carolina taxable income compared to the statutory formulas that distorted Appellant's business activity in South Carolina. This distortion was discussed above. Dr. Harrison stated that the Department's alternative method was economically reasonable, (R. p. 274, Tr. p. 195, line 24-Tr. p. 196, line 25), stating that excluding the retail operations from the Department's alternative method was "absolutely essential" for the tax burden on the Appellant to fairly represent its economic nexus with South Carolina. (R. p. 274, Tr. p. 195, line 24-Tr. p. 196, line 4; R. p. 274, Tr. p. 196, lines 18-25.)

Lastly, the Department described above several reasons above why its alternative method is reasonable, and the ALC noted at least four of these reasons, (R. p. 14).

Based on the above, South Carolina law clearly permits the Department to use separate accounting as an alternative apportionment method. Separate accounting not only is a reasonable method for taxing Appellant's South Carolina activities but also it provides reasonable results. For these reasons, this Court should affirm the ALC's decision that separate accounting is appropriate in this case.

IV. THE ALC PROPERLY CONCLUDED THAT THE DEPARTMENT DID NOT VIOLATE APPELLANT'S CONSTITUTIONAL RIGHTS BY APPLYING SEPARATE ACCOUNTING TO A UNITARY BUSINESS.

This Court should affirm the ALC's findings that the Department's method of taxing Appellant's South Carolina income is not barred by the Commerce Clause and that the tax does not violate the Due Process Clause because it fairly relates to the services provided by South Carolina. (See R. p. 20; Order p. 18.)

As an initial matter, Appellant asserts that the Department violated its constitutional rights "by applying separate accounting to a unitary business." (Appellant's Brief p. 39.) Since evidence demonstrates that Appellant's trademark business was not unitary with its retail business and that separate accounting is lawful and reasonable, the Department did not violate Appellant's constitutional rights.

Turning to the broader constitutional issues, Appellant does not dispute the ALC's recitation of the law concerning whether a tax will survive a challenge under the Commerce Clause. Both cite the four-part test in Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977). (R., p. 18; Appellant's Brief p. 40.) Under this four-part test, a tax will survive a Commerce Clause challenge if the tax (1) is applied to an activity with a substantial nexus with the taxing state, (2) is fairly apportioned, (3) does not discriminate against interstate commerce, and (4) is fairly related to the services provided by the State. Complete Auto at 279. Appellant wrongly claims that the tax, as applied, fails to meet the last three prongs of the above four-part test. (Appellant's Brief p. 41.)

Regarding the first prong at issue, the tax imposed by the Department is fairly apportioned. To be fairly apportioned, a tax must be both internally and externally consistent. Travelscape, LLC v. South Carolina Dep't of Revenue, 391 S.C. 89, 107, 705 S.E.2d 28, 37038 (S.C. 2011). An income tax is internally consistent where it is structured such that if it were applied by every state, it would result in no more than all of

the business's income being taxed. Container Corp. of Am. V. Franchise Tax Bd., 463 U.S. 159, 169 (1983). To meet the external consistency test, the state's tax must not reach beyond that portion of value that is fairly attributable to economic activity within the taxing State." Oklahoma Tax Comm'n v. Jefferson Lines, Inc., 514 U.S. 175, 185 (1995). This means that a state can tax "only that portion of the revenues from the interstate activity which reasonably reflects the in-state component of the activity being taxed." Goldberg v. Street, 488 U.S. 252, 262 (1989).

The Department's tax on Appellant meets the internal consistency test. Appellant wrongly claims otherwise asserting that (1) not allowing a deduction for Appellant's expenses associated with the royalty income in all states will result in more than 100% of Appellant's net income being taxed and (2) the tax on net royalty income applied to all states would have no relationship to the income of the unitary business and may cause multiple taxation. (Appellant's Brief p. 42.) Appellant is incorrect on the first item because the Department did not disallow a deduction for expenses. Appellant merely failed to provide the Department with proof of expenses to offset the royalty income; however, the Department would have allowed such deductions had Appellate identified and substantiated such expenses. (R. p. 254, Tr. p. 116, line 21-Tr. p. 117, line 4; R. p. 21 (Order p. 19).) Appellant is also incorrect on the second item because by applying the Department's method only income generated in each taxing state would be taxed in that taxing state. By using Appellant's own trademark licensing formula, (R. p. 35), the Department is only taxing in South Carolina the royalty income generated from within South Carolina. Therefore, the Department's method when applied in all applicable states has a direct relationship with the income generated in each state. Under the

Department's method, in each state that RAC East or RAC Texas operates a retail store that generates royalties for RAC West, only the net royalty income based on separate accounting would be taxed in that state. In each case, the only business that Appellant conducted in that state would be its royalty business. Appellant wants to combine Appellant's out-of-state retail operations in the tax calculations for the royalty states, so it is Appellant's method that results in the tax applied to all states from which Appellant received royalties having a distorted relationship with the taxing state.

The Department's tax on Appellant also meets the external consistency test. Appellant wrongly claims otherwise asserting that the Department's "separate accounting method on gross receipts fails to account for the unitary nature of the RAC West business." (Appellant's Brief p. 42.) Appellant continues to assert that the Department's method is a tax on gross receipts and not an income tax. If the Department's alternative method looks like a gross-receipts tax, it is only because Appellant did not provide or support any deductions related to its trademark business. (See R. p. 254, Tr. p. 116, line 21-R. p. 255, Tr. p. 117, line 1.) Had Appellant identified and substantiated any such deductions, the Department would have allowed the deductions. (R. p. 255, Tr. p. 117, lines 2-4.)

Regarding the second prong at issue, the tax imposed by the Department does not discriminate against interstate commerce. Appellant makes the same argument here that it did to argue that the Department failed the external consistency test. For the same reasons discussed immediately above, Appellant's argument has no merit. Also the Department's separate-accounting method does not discriminate between states because it taxes net royalty income in the state in which it was earned.

Regarding the third prong at issue, the tax imposed by the Department is fairly related to the services provided by the State. There is a fair relationship between the tax imposed on Appellant and the services it received in South Carolina. By taxing the net royalty income generated in South Carolina, the Department is taxing only net income related to South Carolina activities. The State of South Carolina and its local governments have provided many services that allow Appellant to earn an income in this State. The ALC properly relied on Geoffrey. In Geoffrey, and in the instant case, an out-of-state owner of trademarks and trade names licensed the use of that intangible property to a retailer operating in South Carolina. Geoffrey, 313 S.C. at 16-17, 437 S.E.2d at 15. The S.C. Supreme Court said that the foreign owner of property licensed for retail use in South Carolina benefited from the State-provided services and that the South Carolina tax on royalty income was "rationally related" to those benefits. Geoffrey, 313 S.C. at 21-22, 437 S.E.2d at 17. The Supreme Court stated that South Carolina provided Geoffrey with an "orderly society" in which to conduct business so that it could earn income from its royalty agreement with the South Carolina retail operation. Id., at 22, 437 S.E.2d at 18. A few examples of the benefits that Appellant received from South Carolina are police protection and the courts which allow people to move freely and confidently engage in commerce, roads on which inventory – which is later sold to customers generating the royalty fee – is delivered to the retail stores in South Carolina, and the regulation and provision of utilities to the retail stores that can make royalty-generating sales and to customers who can plug in and watch a television obtained at a retail store.

Turning to the Due Process Clause, Appellant asserts that the Department's method of taxing Appellant violates the Due Process Clause, but Appellant neither

explains nor makes another mention of the alleged due process violation. The Due Process Clause requires some minimum connection between a state and the person, property, or transaction it seeks to tax and income attributed to the tax must be rationally related to the taxing state. Geoffrey, 313 S.C. at 18, 437 S.E.2d at 16. Here, Appellant has the minimum contacts with South Carolina because it purposefully directed its activities toward this State through the licensing agreement, (R. p. 383-390), and owned Intellectual Property located in South Carolina, (R. p. 131, Tr. p. 106, lines 3-6; Transcript Day One p. 106:3-6). Also, the income attributed to the tax is rationally related to this State because of the benefits that this State has provided to Appellant, as explained above. Additionally, like in Geoffrey, the real source of Appellant trademark income is RAC East's South Carolina customers. Geoffrey, 313 S.C. at 22, 437 S.E.2d at 18.

CONCLUSION

For the foregoing reasons and for any other reason appearing in the Record on Appeal, the South Carolina Department of Revenue respectfully requests that the decision of the ALC in this matter be affirmed.

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THE STATE OF SOUTH CAROLINA
In the Court of Appeals

APPEAL FROM THE ADMINISTRATIVE LAW COURT

The Honorable Ralph King Anderson, III, Chief Administrative Law Judge

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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.

RESPONDENT'S CERTIFICATE OF COMPLIANCE

The undersigned certifies that this Final Brief complies with Rule 211(b) of the South Carolina Appellate Court Rules.

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