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S.C. Supreme Court

**THE STATE OF SOUTH CAROLINA
In The Supreme Court**

APPEAL FROM THE ADMINISTRATIVE LAW COURT

Ralph K. Anderson III, Administrative Law Judge

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

Duke Energy Corporation.....Petitioner,

v.

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

APPENDIX FOR PETITION FOR A WRIT OF CERTIORARI

VOLUME V

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Tanya A. Gee
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October 23, 2012

BY HAND DELIVERY

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

Re: Duke Energy Corp. v. S.C. Dept. of Revenue
10-ALJ-17-0270-CC

Dear Ms. Kitchings:

Charleston
Charlotte
Columbia
Greensboro
Greenville
Hilton Head
Myrtle Beach
Raleigh

After we filed our Notice of Appeal in the above-captioned matter, Judge Anderson issued an Order Denying Motion for Reconsideration in Part and Granting Reconsideration in Part as well as an Amended Summary Judgment Order. Accordingly, I am filing an Amended Notice of Appeal to reflect our intent to appeal from these orders. As stated in the cover letter to our original Notice of Appeal, we file this appeal in the abundance of caution and recognize that the Orders from which we are appealing may not be immediately appealable pursuant to *Charlotte-Mecklenburg Hospital Authority v. S.C. Department of Health & Environmental Control*, 387 S.C. 265, 267, 692 S.E.2d 894, 895-96 (2010) (finding that the appealability rules of S.C. Code Ann. § 14-3-330 are not applicable to appeals from the Administrative Law Court, where the APA limits appeals to final judgments).

In addition to our Supplemental Notice of Appeal, I have enclosed a proof of service and a copy of the orders that are being challenged on appeal. Please return one clocked copy of the documents to me via our courier.

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The Honorable Jenny Abbott Kitchings
October 23, 2012
Page 2

Very truly yours,


Tanya A. Gee

cc: The Honorable Ralph K. Anderson III
Harry Hancock
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THE STATE OF SOUTH CAROLINA
In The Court of Appeals

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APPEAL FROM THE ADMINISTRATIVE LAW COURT

SC Court of Appeals

Ralph K. Anderson III, Administrative Law Judge

Case No. 10-ALJ-17-0270-CC

Duke Energy Corporation..... Appellant,
v.
South Carolina Department of Revenue..... Respondent.

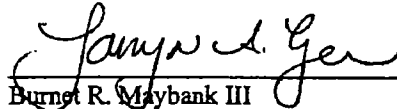
AMENDED NOTICE OF APPEAL

Duke Energy Corporation (hereinafter "Appellant") previously appealed from the following two orders of the Honorable Ralph K. Anderson III of the Administrative Law Court ("ALC"): (1) Final Order and Decision filed on August 9, 2012 ("Final Order"), a copy of which is attached hereto as Exhibit A; and (2) The ALC's deemed denial of Appellant's Motion for Reconsideration ("Motion") which was filed on August 20, 2012, a copy of which is attached as Exhibit B.

The ALC did not act upon Duke Energy's Motion for Reconsideration within 30 days after its filing. Pursuant to ALC Rule 29(D)(2), Duke Energy's Motion For Reconsideration was deemed denied on September 19, 2012. Thus, the original notice of appeal was served and filed within 30 days of the deemed denial of the Motion for Reconsideration.

The ALC has since filed an Order granting in part and denying in part the motion for reconsideration and an Amended Summary Judgment Order, both dated October 11, 2012. Accordingly, the Appellant amends its original Notice of Appeal to include these two orders, which are attached.

RESPECTFULLY SUBMITTED,



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**STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT**

Duke Energy Corporation,	)	
	)	Docket No. 10-ALJ-17-0270-CC
Petitioner,	)	
	)	ORDER DENYING MOTION FOR
vs.	)	RECONSIDERATION IN PART AND
	)	GRANTING RECONSIDERATION
South Carolina Department of Revenue,	)	IN PART
	)	
Respondent.	)	
	)	

Appearances:

For the Petitioners: Burnet R. Maybank, III, Esq.; Eric S. Tresh, Esq.; Jeffrey A. Friedman, Esq.; and Maria M. Todorova, Esq.

For the Respondent: Tracey C. Green, Esq.; John W. Roberts, Esq.; Harry Hancock, Esq.; and J. Abraham Gutting, Esq.

This matter was initially before the Administrative Law Court (ALC or Court) upon a Motion for Summary Judgment filed by Respondent Department of Revenue (Department) and a Cross-motion for Partial Summary Judgment filed by Petitioner Duke Energy Corporation (Duke Energy). The underlying case arises from the Department's denial of amended corporate income tax returns filed by Duke Energy in 2002 for income tax years 1978-2001. On August 9, 2012, the Court issued an Order in which it granted the Department's Motion for Summary Judgment as to the timeliness of Duke Energy's amended refund claims for tax years ending 1978-1993; denied the Department's Motion for Summary Judgment as to whether Duke Energy is considered a "manufacturer" under the applicable apportionment statute; and granted the Department's Motion for Summary Judgment as to Duke Energy's inclusion of the return of principal in its apportionment formula and denied Duke Energy's Cross-Motion for Partial Summary Judgment on this issue.

On August 20, 2012, Duke Energy filed a Motion for Reconsideration of the Court's Order Granting the South Carolina Department of Revenue's Motion for Summary Judgment as to the Waiver and Gross Receipts Issues. The Department filed its Memorandum in Opposition to Duke Energy's Motion for Reconsideration on September 14, 2012. Some of the arguments warrant reconsideration and clarification of the original Order. Accordingly, I am issuing an

FILED

October 11, 2012

SC ADMIN. LAW COURT

Amended Order Granting Summary Judgment in Part and Denying Summary Judgment in Part in this case addressing those issues. The remaining arguments will be addressed below.¹

DISCUSSION

In its Memorandum in Opposition to the Department's Motion for Summary Judgment and in Support of its Cross-Motion for Partial Summary Judgment, Duke Energy argues that in 2007, the South Carolina Legislature made a "drastic" change in the law when it specifically excluded from its definitions of "sales" and "gross receipts" the principal from bonds, loans, or similar marketable instruments. See 2007 S.C. Laws Act 110 § 51.A (enacted as S.C. Code Ann. § 12-6-2295(B)(1)) (Setting forth that "[t]he terms 'sales' as used in Section 12-6-2280 and 'gross receipts' as used in Section 12-6-2290 do not include: (1) repayment, maturity, or redemption of the principal of a loan, bond, or mutual fund or certificate of deposit or similar marketable instrument."). According to Duke Energy, the addition of that exclusion created a material change to the law, and thus "there is a presumption that the Legislature intended to change the existing law rather than to clarify its original intent." It is true that "[w]hen the Legislature adopts an amendment to a statute, th[e] Court recognizes a presumption that the Legislature intended to change the existing law. Nonetheless, a subsequent statutory amendment may also be interpreted as clarifying original legislative intent." Duval v. South Carolina Budget and Control Bd., 377 S.C. 36, 659 S.E.2d 125 (2008) (Internal citations omitted) (emphasis added).

In its Motion for Reconsideration, Duke Energy further explained that: "Presumably, the South Carolina Legislature was troubled by the inclusion of the principal in the sales factor, which led to its changing the statute to exclude receipts." (Emphasis added). I find no support for such a presumption. If the Legislature was so troubled by an interpretation that would allow inclusion of principal in the sales factor, it is just as likely, if not more so, that this troublesomeness would motivate the Legislature to clarify the existing law so as to avoid an application that it never intended. Duke Energy instead relies on an unsupported statutory

¹ The Court notes that Duke Energy filed an appeal of the Court's original decision granting partial summary judgment "out of an abundance of caution." Following Duke Energy's filing of a Motion to Reconsider, this Court issued an Order staying its decision granting partial summary judgment. Therefore, there was no valid decision regarding the issues addressed in the parties' cross motions for Summary Judgment until the issuance of the Amended Order Granting Summary Judgment In Part and Denying Summary Judgment in Part entered simultaneously with this Order on October 11, 2012.

interpretation premised on the notion that because principal is excluded in S.C. Code Ann. §12-6-2295 (2007) (effective for tax years beginning after 2006), then principal must necessarily have been included in the gross receipts/sales factor prior to the enactment of this statute. On the contrary, the Department asserts that it has had a longstanding interpretation that principal was not included in gross receipts, an assertion that Duke Energy did not dispute. In light of the reasons discussed in the Amended Order Granting Summary Judgment in Part and Denying Summary Judgment in Part as to why the return of principal was excluded from the apportionment formula prior to the enactment of Section 12-6-2295, as well as the Department's longstanding policy of excluding principal from the apportionment formula,² it is clear that the Legislature intended Section 12-6-2295 to clarify the existing law.

However, Duke Energy further contends in its Motion for Reconsideration that this Court, presumably to avoid inconsistency, must interpret Section 12-6-2295 as reflecting a change in the existing law, not clarification of it, since "the Department (and this Court) allowed the sales of Duke Energy securities to be included at net – not excluded all together [sic] as the statutory regime now requires." The problem with this argument is that it misinterprets Section 12-6-2295, the current "statutory regime," as excluding the sales of Duke Energy's securities altogether from the definitions of "sales" and "gross receipts." Though Duke Energy did not in its Motion for Reconsideration cite to a specific subsection to support its position, it clarified in a written response, dated September 21, 2012, to a question posed by this Court that it was

² Duke Energy asserts in its responses to the inquiries presented by the Court on September 19, 2012 that the Department "recently abandoned" its position that it had a long-standing policy "to require only the inclusion of the net gain or interest from short-term investment transactions in the calculation of the apportionment formula," citing the Department's Memorandum in Support of Its Motion for Summary Judgment at 33. The Court finds no such abandonment by the Department – indeed, quite the opposite. On page 33 of the Department's Memorandum in Support of Its Motion for Summary Judgment, the Department states in the heading for section 3, in bold-face type, the following:

Because the Department's long-standing administrative policy excluding the return of principal from short-term investment transactions in the calculation of a taxpayer's apportionment formula is a reasonable application of the legislative intent and the allocation and apportionment statutes, Duke Energy is prohibited from including the return of principal from short-term investment transactions in the calculation of its sales factor or gross receipts factor.

Moreover, the very first sentence of the discussion under this heading states the following: "It has been the long-standing administrative policy of the Department to require only the inclusion of the net gain or interest from short-term investment transactions in the calculation of the apportionment formula regardless of whether a taxpayer files using the three-factor formula or the single factor gross receipts formula." The remainder of the Department's discussion is consistent with this position.

referring to Section 12-6-2295(B)(1).³ Also in its written response, Duke Energy likened the inclusions and exclusions set forth in Section 12-6-2295 to the amended language of S.C. Code Ann. § 12-50-150 (2000), which the South Carolina Supreme Court, in Key Corporate Capital, Inc. v. County of Beaufort, considered to be a change in the law, rather than a clarification. 373 S.C. 55, 644 S.E.2d 675 (2007). As Duke Energy correctly points out, the Court in Key Corporate Capital held that the subsequent amendment of the statute at issue, which added “plus interest in the amount actually earned by the county on the amount refunded” to “the amount paid” in determining the total amount refunded to a successful bidder when a tax sale is voided, constituted a change in the statute, not a clarification. The Court reasoned that the plain meaning of the original statute included only “the amount paid” in the refund, and that the “plus interest” language that was added “materially changed the terminology of the statute, [and that] a departure from existing law [, therefore,] clearly was intended, rather than a clarification of original intent.”

Unlike the Court in Key Corporate Capital, which “s[aw] no reason not to apply the presumption[,]” this Court has set forth in its Amended Order reasons not to apply the presumption but instead finds that Section 12-6-2295(B)(1) was “a subsequent statutory amendment . . . clarifying original legislative intent.”⁴ Key Corporate Capital, 373 S.C. at 60, 644 S.E.2d at 678 n.3 (quoting Stuckey v. State Budget and Control Bd., 339 S.C. 397, 401, 529 S.E.2d 706, 708 (2000)). An amendment to the language of a law does not necessarily mean a change in the meaning of that law, for an amendment may also be interpreted as a clarification by the legislature of its original intent. See Duvall, 377 S.C. at 46, 659 S.E.2d at 130 (“[A] subsequent statutory amendment may also be interpreted as clarifying original legislative intent.”). Rather, the Court must look at whether an amendment to the language of a statute alters the meaning of the statute to determine whether a change, rather than a mere clarification, was intended by the Legislature.

³ In its Motion for Reconsideration, Duke Energy made the following statement: “This legislative change made clear that the sales of securities are excluded from the factor entirely.” In response to this statement, the Court posed two questions to the parties: “(1) To which subsection of 12-6-2295 is ‘legislative change’ referring? (2) How, specifically, does this subsection exclude Duke Energy’s sales of securities, e.g. municipal bonds and commercial paper?”

⁴ The Court quite agrees that parts of Section 12-6-2295(B) reflect changes made by the Legislature to prior law, such as subsections (7) and (9), which respectively exclude from “sales” and “gross receipts” pension reversions and income from forgiveness of indebtedness, both of which had not been so excluded before.

The amendment to the statute in Key Corporate Capital constituted a clear change in the meaning of the statute at issue in that case by adding interest to "the amount paid" in calculating the total amount refunded to a successful bidder when a tax sale is voided. As a result of the new statutory language, the successful bidder would be refunded a higher amount than he/she originally paid, and therefore would receive more under the new statute than under the old statute, which only refunded the amount paid and did not include interest. Thus, because the meaning of the statute was altered by the "material[] change[s to] the terminology of the statute," the Court held that "a departure from existing law clearly was intended, rather than a clarification of original intent. . . ." 373 S.C. at 61, 644 S.E.2d at 678. In the present case, however, Section 12-6-2295(B)(1) merely follows the existing law in South Carolina with regard to the treatment of principal, specifically that principal is excluded from "sales" and "gross receipts," as has been previously discussed. Section 12-6-2295(B)(1) thus simply clarifies that exclusion of principal from "sales" and "gross receipts" for purposes of the apportionment formula applies to "repayment, maturity, or redemption of the principal of a loan, bond, or mutual fund or certificate of deposit or similar marketable instrument[.]" (Emphasis added).

Nevertheless, Duke Energy argues in its responses to the Court's inquiries dated September 19, 2012 that the language of Section 12-6-2295(B)(1) "does not exclude the 'sales' of securities," only "the repayment, maturity or redemption of a security," and that the Department's auditor, Joe Southard, created an ambiguity by stating in his deposition testimony that the exclusion did apply to the sales of securities. (Emphasis omitted). It must be noted from the outset that Duke Energy's position that Section 12-6-2295(B)(1) does not exclude the sales of securities stands in complete contradiction to the position that Duke Energy took in its Memorandum in Support of Its Motion for Reconsideration, in which it stated: "This legislative change [set forth in S.C. Code Ann. § 12-6-2295(B)(1)] made clear that **the sales of securities are excluded from the factor entirely.**" (Emphasis added). Because Duke Energy's initial argument was that the sales are excluded by the "change" Section 12-6-2295, and Duke Energy confirmed that it was relying on subsection (B)(1) when referencing that change, Duke Energy cannot now argue that sales of securities are **not** excluded by Section 12-6-2295(B)(1). See Cothran v. Brown, 357 S.C. 210, 215, 592 S.E.2d 629, 631 (2004) (citations omitted) ("Judicial estoppel is an equitable concept that prevents a litigant from asserting position inconsistent with, or in conflict with, one the litigant has previously asserted in the same or related proceeding. The

purpose of the doctrine is to ensure the integrity of the judicial process, not to protect the parties from allegedly dishonest conduct by their adversary.”).

In response to Duke Energy’s initial argument, this Court finds that “sales” of securities are not subject to the exclusion under 12-6-2295(B)(1), but only to the extent of the net gains from those sales; the principal from those sales is excluded. The Court also disagrees with Duke Energy’s statement that “th[e] exclusion is limited to the repayment, maturity or redemption of a security,” because this statement excludes a key phrase in the language of the statute: “the principal of.” The statutory exclusion under (B)(1) applies only to “repayment, maturity, or redemption of the principal of a loan, bond, or mutual fund or certificate of deposit or similar marketable instrument[.]” (Emphasis added).⁵ Hence, the exclusion only applies to the extent of the principal of the securities that have been repaid, have matured, or have been redeemed. Indeed, this was the understanding that the Department’s auditor had, as reflected in his response that only the net amount from the repayment, maturity, or redemption of the principal of a marketable instrument falling under (B)(1) would be included in the sales factor, not the principal. Thus, the auditor’s deposition testimony cited by Duke Energy in footnote 3 of its responses to the Court’s inquiries dated September 19, 2012 does not create an ambiguity, but rather echoes the Department’s long-standing policy of excluding principal from “sales” and “gross receipts” in the apportionment formula.

Finally, Duke Energy argues that “principal” in Section 12-6-2295(B)(1) modifies only “a loan, bond or mutual fund” and does not modify “certificate of deposit” and “similar marketable instrument.” Section 12-6-2295(B)(1) excludes from the definitions of “sales” and “gross receipts” “repayment, maturity, or redemption of the principal of a loan, bond, or mutual fund or certificate of deposit or similar marketable instrument.” Duke Energy maintains that “the word ‘or’ is a disjunctive particle [sic] and its use before ‘certificate of deposit’ and before ‘similar marketable instrument’ signifies an alternative.” Thus, “principal” modifies only “a loan, bond, or mutual fund.”

As an initial matter, because Duke Energy admits that “[t]he statute requires the exclusion of the ‘principal’ of ‘a loan, bond, or mutual fund,’” and admits that it “purchased and

⁵ According to Duke Energy’s letter dated July 17, 2012 in response to inquiries issued by the Court, the securities that Duke Energy purchased and sold as a part of its business included municipal bonds, loan repurchase agreements, and commercial paper.

sold securities[,] including municipal bonds . . .,” Duke Energy essentially concedes that the principal of at least some of the securities that it sold is excluded from “sales” and “gross receipts” in the apportionment formula under Section 12-6-2295(B)(1). However, as discussed in this Court’s Amended Order, the principal from the sales of securities was likewise excluded from the “sales” or “gross receipts” factor of the apportionment formula prior to the enactment of Section 12-6-2295(B)(1). Therefore, no change took place with respect to the exclusion of principal from the sales of securities under the “sales” or “gross receipts” factors of the apportionment formula. This stands in contradiction to Duke Energy’s contention that the apportionment formula was substantially changed based upon the language of Section 12-6-2295(B)(1) enacted by the Legislature in 2007.⁶

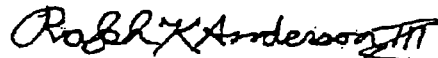
As to Duke Energy’s statutory interpretation of Section 12-6-2295(B)(1), the Court agrees that the “or” is a logical disjunction, coordinating conjunction, or disjunctive conjunction or disjunctive participle that signifies an alternative between the phrases “loan, bond, or mutual fund”; “certificate of deposit”; and similar marketable instrument.” See Garris v. Governing Bd. of the S.C. Reinsurance Facility, 333 S.C. 432, 440, 551 S.E.2d 48, 52 (1998) (recognizing “where a statute contains two clauses which prescribe its applicability and the clauses are connected by the disjunctive ‘or,’ application of the statute is not limited to cases falling within both clauses, but applies to cases falling within either”); Brewer v. Brewer, 242 S.C. 9, 14, 129 S.E.2d 736, 738 (1963) (holding the word “or” used in a statute or regulation is a disjunctive participle marking an alternative). However, the use of “or” here does not limit the application of “the principal of” to the first phrase – “loan, bond, or mutual fund.” Rather, “the principal of” modifies all three phrases in subsection (B)(1). The controlling language of this subsection is the first part of the subsection – “repayment, maturity, or redemption of the principal of.” “The principal” cannot be separated from “repayment, maturity, or redemption,” as the “repayment, maturity, or redemption” is “of the principal.” Likewise, the latter part of the subsection “a loan, bond, or mutual fund or certificate of deposit or similar marketable instrument” cannot be separated from the controlling, first half of the subsection – “repayment, maturity, or redemption

⁶ Duke Energy infers that a distinction there exist between the sale of securities, and the repayment, maturity, or redemption of securities. I find no such distinction evident from the language of Section 12-6-2295(B)(1). Moreover, as explained above, Duke Energy in both its Memorandum in Support of its Cross-Motion for Partial Summary Judgment and in its Motion for Reconsideration contends that the sales of securities are excluded from the apportionment formula of Section 12-2-2295 entirely.

of the principal of.” Had the Legislature intended “certificate of deposit” and “similar marketable instrument” to be interpreted as separate items that were not modified by “repayment, maturity, or redemption of the principal of,” then the Legislature would have listed “certificate of deposit” and “similar marketable instrument” as separate, enumerated items, as it did in subsections (B)(2)-(10). Rather, the Legislature clearly put these various terms under one subsection because they were “similar marketable instrument[s].” Hence, each of the terms, “loan,” “bond,” “mutual fund,” “certificate of deposit,” and “similar marketable instrument” are all singular, all being modified by the same indefinite article “a.” Furthermore, from a practical standpoint, to adopt Duke Energy’s interpretation would be to endorse the absurd notions that the net gain from certificates of deposit or similar marketable instruments is excluded from “sales” and “gross receipts” for purposes of tax apportionment, and that certificates of deposit should be treated differently from bonds. The Legislature could hardly have intended such an absurd application. Therefore, this Court rejects Duke Energy’s interpretation of Section 12-6-2295(B)(1).

IT IS THEREFORE ORDERED that that the Petitioners’ Motion for Reconsideration is denied, in part, and granted, in part, in keeping with this Order.

AND IT IS SO ORDERED.



Ralph King Anderson, III
Administrative Law Judge

October 11, 2012
Columbia, South Carolina

**STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT**

Duke Energy Corporation,	)	
	)	
Petitioner,	)	Docket No. 10-ALJ-17-0270-CC
	)	
vs.	)	AMENDED ORDER GRANTING
	)	SUMMARY JUDGMENT IN PART AND
South Carolina Department of Revenue,	)	DENYING SUMMARY JUDGMENT
	)	IN PART
Respondent.	)	
	)	

Appearances:

For the Petitioners: Burnet R. Maybank, III, Esq.; Eric S. Tresh, Esq.; Jeffrey A. Friedman, Esq.; and Maria M. Todorova, Esq.

For the Respondent: Tracey C. Green, Esq.; John W. Roberts, Esq.; Harry Hancock, Esq.; and J. Abraham Gutting, Esq.

This matter is before the Administrative Law Court (ALC or Court) upon a Motion for Summary Judgment filed by Respondent Department of Revenue (Department) and a Cross-motion for Partial Summary Judgment filed by Petitioner Duke Energy Corporation (Duke Energy). The underlying case arises from the Department's denial of amended corporate income tax returns filed by Duke Energy in 2002 for income tax years 1978-2001.¹ In its Motion for Summary Judgment, the Department contends that prior to the effective date of the Revenue Procedures Act (RPA), August 1, 1995, it lacked authority to extend the limitation period during which a taxpayer could file a refund claim and therefore, as a matter of law, the Forms FS-43 executed by Duke Energy and the Department prior to that time were ineffective in extending the refund-claim filing periods, rendering Duke Energy's filing of amended corporate income tax returns for tax years ending 1978-1993 untimely.² The Department also contends that Duke Energy, as a matter of law, is a "manufacturer" under the applicable apportionment statute and must therefore use a multi-factor apportionment formula, consisting of property, sales, and

¹ These are the tax periods at issue in this case.

² Both parties stipulate that Duke Energy's amended return for tax year 1994 was timely filed.

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SC ADMIN. LAW COURT

payroll factors, not a single-factor gross-receipts formula.³ The Department further contends that as a matter of law, Duke Energy cannot, in its calculation of corporate income tax owed to South Carolina, include in the apportionment formula the return of principal from its sales of securities and other investment transactions. Finally, Duke Energy, in its Cross-Motion for Summary Judgment, argues that it was required to include in the apportionment formula the return of principal from its sales of securities and other investment transactions.

A hearing regarding these motions was held before this Court on June 26, 2012, in Columbia, South Carolina. On August 9, 2012, the Court issued an Order in which it granted the Department's Motion for Summary Judgment as to the timeliness of Duke Energy's amended refund claims for tax years ending 1978-1993; denied the Department's Motion for Summary Judgment as to whether Duke Energy is considered a "manufacturer" under the applicable apportionment statute; and granted the Department's Motion for Summary Judgment as to Duke Energy's inclusion of the return of principal in its apportionment formula and denied Duke Energy's Cross-Motion for Partial Summary Judgment on this issue. On August 20, 2012, Duke Energy filed a Motion for Reconsideration of the Court's Order Granting the South Carolina Department of Revenue's Motion for Summary Judgment as to the Waiver and Gross Receipts Issues. The Department filed its Memorandum in Opposition to Duke Energy's Motion for Reconsideration on September 14, 2012. After careful consideration of the arguments made by both parties, the Court has amended its August 9, 2012 Order accordingly below.⁴

FACTUAL BACKGROUND

The Department began auditing Duke Energy's corporate income taxes for income tax year ending 1978. That audit was extended a number of times, over a period of years due to the

³ Between the tax years ending 1978-1993, taxpayers whose principal business in South Carolina was "(a) manufacturing or a 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," were required to apportion their income based on a multi-factor apportionment formula, consisting of property, sales, and payroll factors. S.C. Code Ann. § 12-6-2250 (applicable to tax years after 1995); S.C. Code Ann. § 12-7-1120 (applicable to tax years prior to 1996). In this case, no party argued that Duke Energy engaged in collecting, buying, assembling, or processing of goods and materials within South Carolina, or that Duke Energy engaged in selling, distributing, or dealing in tangible personal property within South Carolina. Therefore, the Court will only focus its discussion on whether Duke Energy was a manufacturer for purposes of Section 12-6-2250.

⁴ The Court notes that Duke Energy filed an appeal of the Court's original decision granting partial summary judgment "out of an abundance of caution." Following Duke Energy's filing of a Motion to Reconsider, this Court issued an Order staying its decision granting partial summary judgment. Therefore, there was no effective decision regarding the issues addressed in the parties' cross motions for Summary Judgment until the issuance of this decision.

pending results of an audit of Duke Energy by the Internal Revenue Service (IRS), and also due to the health issues experienced by the Department's auditor and changes in the Department's personnel. These extensions were approved by Forms FS-43, each entitled "Field Services Division – Consent to Extend the Time to Assess Tax." The first Form FS-43, executed in August 1988, pertained to the income tax years ending December 31, 1983 and 1984. Significantly, the income tax years ending December 31, 1978 through December 31, 1982 were incorporated into the executed Forms FS-43 in May 1996. Additional Forms FS-43 periodically were executed and additional income tax years added until the execution of the final Form FS-43 in June 2002.

In December 2002, Duke Energy filed amended corporate tax returns for the income tax years 1978-2001 seeking a total refund of \$126,240,645 plus interest.⁵ Duke Energy sought to change the apportionment formula – the mechanism for determining how much income is associated with Duke Energy's South Carolina's business activities – to the single-factor gross-receipts apportionment formula instead of the three-factor formula that it had previously used. It also sought to include the gross receipts, including the return of principal, from its sales of securities and other capital investments in the denominator of the gross-receipts formula for tax years 1978-1999.⁶ However, on February 4, 2010, the Department denied Duke Energy's refund claims, after which Duke Energy filed a request for a contested case hearing with this Court on March 3, 2010.

STANDARD OF REVIEW

Rule 68 of the Administrative Law Court Rules provides that "[t]he South Carolina Rules of Civil Procedure . . . may, in the discretion of the presiding administrative law judge, be applied in proceedings before the Court to resolve questions not addressed by these rules." ALC Rule 68. Rule 56(c) of the South Carolina Rules of Civil Procedure states that summary judgment is properly granted when the "pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to

⁵ This is the amount set forth by the Department. However, Duke Energy stated in its Memorandum in Opposition to the Department's Motion for Summary Judgment and in Support of Duke Energy's Cross-Motion for Partial Summary Judgment that the Department's refund calculations in its Memorandum were incorrect, and that damages would need to be resolved should the Court find in the Department's favor on any issue.

⁶ For 2000 and 2001, Duke Energy's original tax returns included receipts from sales of securities in the sales factor in the denominator of the three-factor formula.

any material fact and that any party is entitled to a judgment as a matter of law." Rule 56(c), SCRCP.

"The purpose of summary judgment is to expedite disposition of cases which do not require the services of a fact finder." George v. Fabri, 345 S.C. 440, 452, 548 S.E.2d 868, 874 (2001). "In determining whether summary judgment is proper, the court must construe all ambiguities, conclusions, and inferences arising from the evidence against the moving party. Byers v. Westinghouse Elec. Corp., 310 S.C. 5, 7, 425 S.E.2d 23, 24 (1992). Because it is a drastic remedy, summary judgment should be cautiously invoked to ensure that a litigant is not improperly deprived of a trial on disputed factual issues. Helena Chem. Co. v. Allianz Underwriters Ins. Co., 357 S.C. 631, 644, 594 S.E.2d 455, 462 (2004). However, "when plain, palpable, and indisputable facts exist on which reasonable minds cannot differ, summary judgment should be granted." Bayle v. S.C. Dep't of Transp., 344 S.C. 115, 120, 542 S.E.2d 736, 738 (Ct. App. 2001).

S.C. Code Ann. § 1-23-600(A) (Supp. 2010) grants jurisdiction to the ALC to hear contested cases under the Administrative Procedures Act. Additionally, Section 12-60-460 grants the ALC the authority to conduct contested case hearings in matters concerning tax assessment and refunds.

DISCUSSION

I. Timeliness of Duke Energy's Amended Income Tax Return Filings

The Department asserts that Duke Energy did not timely file its request for tax refunds for tax years ending 1978-1993 and therefore this case should be summarily dismissed. Undisputedly, in every instance Duke Energy's amended tax returns for tax years ending 1978-1993 do not meet the statutory deadline to file its amended tax returns. Duke Energy nevertheless argues that its amended tax returns for the disputed tax years were timely filed because the Forms FS-43 extended the statutory deadlines for filing claims for tax refunds and waived any refund limitation periods. In this case, there is no dispute that both parties executed a number of Forms FS-43 periodically between the years 1988 and 2002. The parties also stipulated in their respective memoranda regarding the motions for summary judgment and in the

hearing held before this Court on June 26, 2012 that the Form FS-43 executed on December 19, 1997 for the tax year ending 1994 effectively extended the period for filing a refund claim.⁷

Duke Energy argues that the execution of the Forms FS-43 covering the income tax years ending 1978-1993 extended the deadlines for filing claims for tax refunds and waived any refund limitation periods. Duke Energy also argues that because the Department could order a refund if it discovered that a taxpayer had overpaid a tax, a penalty, or interest, even after a refund limitation period, this allows Duke Energy to file a claim for a refund after the limitation period. The analysis of Duke Energy's arguments is addressed in three parts: A) Did S.C. Code Ann. § 12-54-80 grant authority to the Department to extend the time to file an amended tax return; B) did S.C. Code Ann. § 12-54-30 authorize Duke Energy to file an amended tax return requesting a refund beyond the statutorily-prescribed timeframe; and C) did the language in the Form FS-43 executed by the Department extend the time for Duke Energy to file an amended tax return?

A. Statutory Authority to Extend the Time to File an Amended Tax Return

Duke Energy contends that Section 12-54-80 authorizes a taxpayer to request a refund once an extension is granted pursuant to that provision. Section 12-54-80, which applied to the tax periods prior to August 1, 1995 (the enactment date of the Revenue Procedures Act (RPA)), provided:

If, before the expiration of the time prescribed in this section for the mailing of a notice of assessment, the taxpayer has consented in writing to the mailing of the notice after the time, notice of assessment may be mailed at any time prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

S.C. Code Ann. § 12-54-80 (1978) (repealed in 1995) (emphasis added).

In general, when interpreting a statute, the sole function of the Court is to determine and give effect to the intent of the legislature. Hodges v. Rainey, 341 S.C 79, 85, 533 S.E.2d 578, 581 (2000). The starting point in doing so should always be the text of the statute itself. Id. (holding that "[w]hat a legislature says in the text of a statute is considered the best evidence of

⁷ Pursuant to S.C. Code Ann. § 12-47-440 (****), which applied to the tax years ending 1990-1994, the period for filing a refund claim was three years. Moreover, S.C. Code Ann. § 12-6-4970(B), which was also applicable during these years, allowed a three-year time period for filing a refund claim for the tax year ending 1994 which would have begun on March 15, 1995. Therefore, because the filing of the Form FS-43 for the year 1994 was executed on December 19, 1997- after the enactment of the RPA and, and thus before March 15, 1998 - the period for filing a refund claim was still open. Consequently, the extension of the deadline was effective.

the legislative intent or will"); Wigfall v. Tideland Utils., Inc., 354 S.C. 100, 110, 580 S.E.2d 100, 105 (2003). In interpreting the text, the plain meaning rule requires that "words must be given their plain and ordinary meaning without resort to subtle or forced construction to limit or expand that statute's operation." State v. Leopard, 349 S.C. 467, 471, 563 S.E.2d 342, 344 (Ct. App. 2002). Finally, "[w]here the statute's language is plain and unambiguous, and conveys a clear and definite meaning, the rules of statutory interpretation are not needed and the court has no right to impose another meaning." Hodges, 341 S.C. at 85, 533 S.E.2d at 581.

Moreover, in considering this issue, this Court is further bound by the rules of statutory construction relating to tax law. For instance "[a] refund of taxes is solely a matter of governmental grace, . . . and any person seeking such relief must bring himself clearly within the terms of the statute authorizing the same. . . ." Asmer v. Livingston, 225 S.C. 341, 344, 82 S.E.2d 465, 466 (1954) (internal citations omitted); Guar. Bank & Trust Co. v. S. Carolina Tax Comm'n, 254 S.C. 82, 173 S.E.2d 367 (1970) ("A refund of taxes is solely a matter of governmental or legislative grace and any person seeking such relief must bring himself clearly within the terms of the statute authorizing the same."). The Court's analysis in Guaranty Bank also offers guidance in this case. In Guaranty Bank, the taxpayer claimed it was entitled to recover income tax paid on gain from an involuntary conversion of property. However, the law at the time prescribed a specific timeframe in which the proceeds from the converted property must be reinvested. In construing whether the taxpayer's claim was timely the Court held that the "statutory language creating exemption from taxation will not be strained or liberally construed in favor of the taxpayer claiming an exemption, and he must, in order to be entitled to such exemption, clearly bring himself within the exemption on which he relies." 254 S.C. at 89, 173 S.E.2d at 370.⁸ Furthermore, in making that determination, the Court recognized its previous holding that "a taxpayer who seeks to take advantage of a tax deduction must meet the conditions of the statute creating such." Id.

Here, the plain language of Section 12-54-80 does not establish any authority to extend a taxpayer's right to seek a refund but rather allowed the Department, with the taxpayer's consent, to extend the time for it to mail its assessment of the tax owed by the taxpayer. Clearly, when

⁸ The court in Guaranty Bank, likewise held that "in order for a taxpayer to avail himself of a deduction in the calculation of a tax, he must bring himself squarely within the terms of the statute expressly authorizing it." 254 S.C. at 89-90, 173 S.E.2d at 370.

speaking of mailing an assessment, the statute is speaking to an action by the Department. Thus, the plain language of the form extends the timeframe for the Department to mail an assessment to the taxpayer.

Moreover, Section 12-54-80 does not use the word "refund" anywhere within that provision. As explained below, the legislature set forth specific provisions expressing the timeframe to seek a refund for tax years ending 1978-1993. In Spectre, LLC v. S.C. Dep't of Health & Envtl. Control, 386 S.C. 357, 372, 688 S.E.2d 844, 852 (2010), the South Carolina Supreme Court held that: "Where there is one statute addressing an issue in general terms and another statute dealing with the identical issue in a more specific and definite manner, the more specific statute will be considered an exception to, or a qualifier of, the general statute and given such effect." Here, it is incredulous that the legislature intended to grant an exception to the timeframe to seek a refund without even mentioning the term.

The Court nevertheless recognizes that the application of Section 12-54-80 could result in a refund of taxes paid by the taxpayer, but clearly such a refund would occur within the context of fulfilling the purpose of the statute. The purpose of Section 12-54-80 is to provide an option for the Department to extend the time during which the "notice of assessment may be mailed." If, after the extension of time to make its determination, the Department decided that a taxpayer owed additional taxes, it would notify the taxpayer of that assessment and seek payment based upon that assessment. Conversely, if the Department's assessment of the taxes owed was less than the taxes proffered by the taxpayer, the taxpayer would be refunded the difference.⁹ However, there is simply no language in Section 12-54-80 that provides that if the Department requests to extend its time to mail a notice of assessment—or determination of the taxes owed—this request, in turn, creates a right for a taxpayer to amend its previous filing and seek a refund upon its revised request.

This Court cannot simply by implication extend the time to file a refund request. Duke Energy must establish a statutory right to make that claim. To the contrary, Duke Energy failed to meet the required timeframes to request a refund for tax years 1978 to 1993. The timeframes for making those refund requests fell into two distinct regulatory periods: 1) 1978 to 1989; and 2) 1990 to 1993.

⁹ As addressed more fully below, S.C. Code Ann. § 12-54-30 (****) granted the Department the authority to issue a refund under those circumstances.

1. Income Tax Years Ending 1978-1989

The South Carolina Supreme Court set forth in Bass v. State that Section 12-47-440 only applied to property taxes and that "the exclusive remedy for contesting an alleged erroneous assessment of *income taxes* [is] by payment under protest of the tax claimed as illegal and a suit at law for recovery of the sum so paid, in accordance with Sections 65-2661 and 65-2662 of the Code. [predecessors of §§ 12-47-210 and 12-47-220]." 307 S.C. 113, 117, 414 S.E.2d 110, 112 (1992), (internal quotation marks omitted) (emphasis in the original), cert. granted, judgment vacated on other grounds by Bass v. South Carolina, 509 U.S. 916 and abrogated by Harper v. Virginia Dep't of Taxation, 509 U.S. 86 (1993); see also Perpetual Bldg. & Loan Ass'n of Columbia v. S.C. Tax Comm'n, 255 S.C. 523, 527, 180 S.E.2d 195, 197 (1971). Thus, the timeliness of Duke Energy's refund claims for the years 1978-1989 is governed by S.C. Code Ann. §§ 12-47-210 and 12-47-220 (****).¹⁰

Sections 12-47-210 and 12-47-220 required a taxpayer who sought to receive a refund of amounts paid to the state to expressly pay the taxes under protest and then institute an action in circuit court within 30 days after payment of the taxes. See S.C. Nat. Bank v. S.C. Tax Comm'n, 297 S.C. 279, 282, 376 S.E.2d 512, 514 (1989). Failure to pay the taxes under protest was fatal to a refund claim. See, e.g., City of Columbia v. Glens Falls Ins. Co., 245 S.C. 119, 139 S.E.2d 529 (1964). Here, there is no evidence that any of the payments for these years were made under protest. And even if the payments were made under protest, no action was filed in circuit court within 30 days after the payment was made. Rather, the refund claims were filed in the ALC well after the 30-day period expired.¹¹ Therefore, none of the refund claims filed for Duke

¹⁰ (****) is used in this order in lieu of statutory years because this case involves numerous tax years, and therefore the years of the applicable statutes are equally numerous and varying, and the law applicable during many years was unchanged. The statutory law can be divided into two yearly ranges: 1978-1995 and 1996-2001, as the law regarding this issue did not change during the first range, and then did not change during the second range after the RPA changes in 1995.

¹¹ There is also an additional reason for concluding the purported extensions of the corporate income tax years 1978-1982 are untimely. These years appeared for the first time on the face of the executed Form FS-43 effective May 30, 1996. Obviously, under either the modern era provisions or the pre-1995 provisions, these extensions were executed well after the refund periods had closed. See S.C. Code Ann. § 12-54-85 (three years from date return filed or two years after date of payment); S.C. Code Ann. §§ 12-47-210, -220 (pay under protest and file claim for refund within 30 days). The only available avenue for reviewing the taxable income of the years 1978-1982 therefore would have been the statutory provisions regarding an assessment based on a determination issued by the IRS. See S.C. Code Ann. § 12-54-85(D)(1); cf. S.C. Code Ann. § 12-54-80 (prior law). However, Duke Energy did not establish that the IRS issued a final determination within 180 days of May 30, 1996. Moreover, any extension attributable to an IRS determination in that circumstance would have been limited to the tax issues raised by the IRS. Because the allocation and apportionment issues raised by the taxpayers could not have been at issue in an IRS

Energy's 1978-1989 tax years were timely. I thus conclude that the refund claims for the tax years 1978-1989 also are barred from consideration by this Court.

2. Income Tax Years Ending 1990-1994

As explained above, in 1992 the South Carolina Supreme Court in Bass held that Section 12-47-440 only applied to property taxes and that the exclusive remedy for obtaining a refund of income taxes was Sections 12-47-210 and 12-47-220 (****). Id. However, the General Assembly thereafter amended Section 12-47-440 to expressly apply to income tax refund claims, but only for tax years beginning in 1990 and later. See Act No. 464, 1994 S.C. Acts, Section 3(B).

Section 12-47-440 provides for a three-year period of limitation in which to file a refund claim. Therefore, for the 1990-1994 tax years, Duke Energy was required to file its claims for refund within three years after its corporate income tax return was originally due. It is undisputed that Duke Energy filed its corporate income tax returns based on a calendar year. Thus, the returns and payment originally were due without regard to any extension on March 15th of the following year. S.C. Code Ann. §§ 12-6-4970(B) (effective for tax years beginning after 1995); 12-7-1640 (effective for tax years prior to 1996). The refund periods applicable to Duke Energy under Section 12-47-440 for the income tax years 1990-1994 were therefore as follows:

Income Tax Years	Return Originally Due	Close of Refund Period
1990	March 15, 1991	March 15, 1994
1991	March 15, 1992	March 15, 1995
1992	March 15, 1993	March 15, 1996
1993	March 15, 1994	March 15, 1997
1994	March 15, 1995	March 15, 1998

B. Section 12-54-30

In its Post-Trial Brief, Duke Energy nevertheless argues that during the tax years at issue S.C. Code Ann. § 12-54-30 (****) provided a different "mechanism" by which it could file an amended tax return requesting a refund. Section 12-54-30 provided in relevant part that: "If the commission discovers on examination of a return or otherwise that the tax, penalty, or interest paid by any person is in excess of the amount legally due, the commission may order a refund or give credit for the overpayment." The plain language of Section 12-54-30 permitted the

determination, the purported extensions of the 1978-1982 tax years are untimely for purposes of the issues before this Court.

Department to refund amounts discovered on examination of a return. See Anders v. S.C. Parole & Cmty. Corr. Bd., 279 S.C. 206, 305 S.E.2d 229 (1983) (“[T]he Court’s primary function in interpreting a statute is to ascertain the intention of the legislature, and when the terms of the statute are clear and unambiguous, the Court must apply them according to the literal meaning.”). Section 12-54-30 does not reference whatsoever the timeframe for a taxpayer to file a request for a refund. To the contrary, as set forth above, there were specific statutes that articulated the timeframe in which a taxpayer could file for a refund for tax years 1978 to 1993. As aforementioned, the statute which deals with an issue in a more specific and definite manner prevails over a statute which addresses the issue in general terms, Spectre, 688 S.E.2d 844. Furthermore, “[w]hen construing statutory language, the statute must be read as a whole, and sections which are part of the same general statutory law must be construed together and each one given effect.” Duvall v. S.C. Budget and Control Bd., 377 S.C. 36, 42, 659 S.E.2d 125, 127 (2008).

Thus, Section 12-54-30 allowed the Department to grant relief to a taxpayer if it discovered an overpayment on examination of a return or otherwise, even if a claim for refund would be untimely. It did not, however, change the fact that the taxpayer had to strictly comply with the provisions of the refund statutes if it wanted to file a claim for refund that would be subject to judicial review. See Hodges v. Rainey, 341 S.C. 79, 533 S.E.2d 578 (2000) (“The canon of construction ‘*expressio unius est exclusio alterius*’ or ‘*inclusio unius est exclusio alterius*’ holds that ‘to express or include one thing implies the exclusion of another, or of the alternative.’”). The logic of this interpretation of Section 12-54-30 was reflected in Argent Lumber Co. v. Query, 178 S.C. 1, 182 S.E. 93 (1935), overruled on other grounds by McCall by Andrews v. Batson, 285 S.C. 243, 329 S.E.2d 741 (1985). The Court in Argent Lumber held that under a statute similar to the one in the present case, the taxpayer had no right to judicial review of the Tax Commission’s refusal to grant the taxpayer a refund notwithstanding the Commission’s discovery of overpaid taxes and the Commission’s authority to grant refunds at the time of the tax periods at issue. The reason for this, aside from a lack of statutory authority at the time to compel the Commission to issue a refund of overpaid taxes, was that the taxpayer had failed to comply with the refund statute but instead waited more than ten years after the overpayment and almost four years after the amount of the claim was ascertained to bring suit. Id. at 94-95.

C. Form FS-43

In light of the statutory timeframes for filing an amended return requesting a refund, Duke Energy's case centers upon the implications of the Department's Form FS-43. Duke Energy contends that the Forms FS-43 executed in this case allowed it additional time to file a claim for a refund, an extension that would run for more than twenty years in some cases. At the outset, I do not find that the Forms FS-43 authorized a party to seek a refund after the statutory time for filing such a request.

The language contained in the Form FS-43 prior to August 1, 1995 was as follows:

This agreement extends the time for mailing the notice of assessment or refund of the above tax pursuant to the provisions of Section 12-54-80 of the 1976 South Carolina Code of Laws, as amended.

(Emphasis added).

Clearly, when referencing the mailing of the notice of an assessment or refund, Form FS-43 is speaking to an action by the Department. Thus, the plain language of the form extends the timeframe for the Department to mail the notice of a refund or assessment to the taxpayer in keeping with Section 12-54-80. That purpose is reflected by the title of the Form FS-43: "Consent to Extend the Time to Assess Tax." The purpose also logically flows from the operation of the tax laws. Because a notice of assessment is issued and mailed by the Department, it necessarily follows that Form FS-43 applies only to extend the time in which the Department may issue and mail a notice of assessment or refund that it determines is due. Thus, the refund language in Form FS 43 refers not to allowing a taxpayer additional time in which to file a claim for a refund—which, as explained above, the statutory provisions did not permit—but to affording the Department additional time to review the taxpayer's records and issue a notice of assessment or refund, as it determines appropriate based on a review of the taxpayer's records.

Furthermore, Form FS-43 does not infer that a taxpayer has a right to amend its previous tax filing and seek a refund upon alternative grounds. Duke Energy's proposition is not supported by a specific statutory grant of the authority to extend the timeframe to file an amended request for a refund. Rather, Duke Energy reasons that the use of the term "refund" in the Form FS-43 language infers the grant of an extension to file its request for a refund. However, Form FS-43 reflects its limited purpose by referencing the time an assessment or refund is allowed "pursuant to the provisions of Section 12-54-80." As explained above, Section

12-54-80 does not authorize a taxpayer to file a request for a refund outside of the statutes that specifically set forth that timeframe.

Duke Energy nonetheless contends that since the Department agrees that Form FS-43 had that effect for 1995 and later, it must have had that effect before 1995. Duke Energy avers that since the "refund" language is absent in S.C. Code Ann. § 12-54-85(C)(5) (****)— the section with which the RPA supplanted Section 12-54-80 as of August 1, 1995 — that indeed Section 12-54-80 must have also have granted it the right to file an amended tax return seeking a refund.¹² Indeed, Form FS-43 now operates to extend the time for both assessment and refunds for 1995 and later. The language contained in the Form FS-43 following August 1, 1995 is the same except that instead of reference to "Section 12-54-80," it makes reference to "Section 12-54-85(C)(5)." The language contained in Section 12-54-85(C)(5) provides the following:

Taxes may be determined after the thirty-six month limitation if:

* * *

(5) the person liable for any taxes consents in writing, before the expiration of the time prescribed in this section for assessing taxes due, to the assessment of the taxes after the time prescribed by this section.

Duke Energy's argument, however, ignores the substantial and wholesale changes that were enacted as part of the RPA. As with Section 12-54-80, the provisions addressing the authority and timeframes within which to seek a refund were addressed in separate statutory provisions. The RPA added S.C. Code Ann. § 12-60-470 (****), which states that "[a] taxpayer may seek a refund of any state tax by filing a written claim for refund with the [D]epartment. . ." and that a "claim for refund is timely filed if filed within the period specified in Section 12-54-85" The RPA also added S.C. Code Ann. § 12-60-40 (****), which allows the Department to grant extensions of any tax-related time limitations. "It will be presumed that the Legislature in adopting an amendment to a statute intended to make some change in the existing law." Vernon v. Harleyville Mut. Cas. Co., 244 S.C. 152, 155, 135 S.E.2d 841, 844 (1964). It is therefore clear that the General Assembly intended to grant the Department, through the RPA, the authority to

¹² Duke Energy also pointed out that the Forms FS-43 executed by the Department and Duke Energy from 1996 to 1999, well after the redesignation of Section 12-54-80 as Section 12-54-85, continued to make reference to Section 12-54-80, a statute that no longer existed. And the Forms FS-43 executed by the Department and Duke Energy from 2000 through 2002 incorrectly cited to subsection (C)(5) of S.C. Code Ann. § 12-54-85 instead of subsection (C)(4). Those arguments carry no legal value, but are probative as to the apparent shoddy fashion in which the Forms FS-43 were executed.

extend the period for filing of refund claims, an extension of power which the General Assembly had theretofore limited to the deadline for mailing notices of assessment.

Moreover, "[a]n administrative agency has only the powers conferred on it by law and must act within the authority created for that purpose." SGM-Moonglo, Inc. v. S.C. Dep't of Revenue, 378 S.C. 293, 295, 662 S.E.2d 487, 488 (Ct. App. 2008). In fact, "[a]ny action taken by [the Department] outside of its statutory and regulatory authority is null and void." Triska v. Dep't of Health & Envtl. Control, 292 S.C. 190, 194, 355 S.E.2d 531, 533 (1987). Thus, even if Form FS-43 inferred that a taxpayer has a right to extend the timeframe to request for refund, the Department cannot exceed its statutory authority based upon that form.

In its Memorandum of Law in opposition to the Department's Motion for Summary Judgment, Duke Energy further argues that because Form FS-43 does not reference Section 12-54-30, that statute does not apply to the Department's determination in this matter. Putting aside the application of Section 12-54-30 in this case, the fallacy of Duke Energy's assertion is referred to as "the fallacy of denying the antecedent" and is illustrated in a hypothetical syllogism as:

If A, then B.

Not A.

Therefore, not B.

Ruggero J. Aldisert, Logic for Lawyers: A Guide to Clear Legal Thinking 160 (National Institute for Trial Advocacy 3d ed. 1997); see also Irving M. Copi, Introduction to Logic 295 (5th ed. 1978).

Stated in terms of syllogism, Duke Energy's arguments proceed as follows:

If Form FS-43 had referenced Section 12-54-30, then that section would be applicable to determining the timeframe for a refund pursuant to Form FS-43.

Form FS-43 did not reference Section 12-54-30.

Therefore, Section 12-54-30 is not applicable to determining the timeframe for a refund pursuant to Form FS-43.

Other courts have also found this reasoning to be faulty. For instance, in Crouse-Hinds Co. v. InterNorth, Inc., 634 F.2d 690, 703 (2d Cir. 1980), the court held that:

The proposition that "A implies B" is not the equivalent of "non-A implies non-B," and neither proposition follows logically from the other. The process of inferring one from the other is known as "the fallacy of denying the antecedent."

634 F.2d at 703 (cited in Logic for Lawyers).

Moreover, logic dictates a conclusion contrary to Duke Energy's assertion. The failure to reference a provision that governs when the Department may issue a refund upon its own initiative does not suggest it is inapplicable. Nevertheless, the failure to reference any statute (including Section 12-54-30) that addresses the authority of the Department to issue refunds profoundly suggests that Form FS-43 was not addressing a taxpayer's authority to amend its tax returns and seek a refund, or the Department's authority to extend the timeframe within which a refund claim could be filed. If Form FS-43 was granting the authority to extend the time to make refund claims, it would not only reference the statute upon which that authority was granted, but would presumably do so with clarity rather than making the reference: "mailing of notice of assessment or refund." To the contrary, Form FS-43 was based upon Section 12-54-80, which governs the time period in which the Department could assess taxes – a provision that says nothing about refunds or extensions of time to file refund claims.

Waiver of a Statute of Limitations

Duke Energy also contends that the Department "waived" the "statute of limitations" for filing a refund. Duke Energy bases its contention upon the language of Form FS-43; upon the alleged grant by Department employees of an extension of the time during which to file a request for a refund; and upon Duke Energy's belief that the Department's Revenue Procedures reflected that right. Duke Energy contends that "[f]or years, the Department advised taxpayers that it had in place a policy to execute waiver agreements extending the statute of limitations for both assessments and refunds."¹³

However, the phrase "statute of limitations" invokes specific case law that is not applicable to this matter. Obviously, this case does not involve a "cause of action" in which the Court must first determine when the statute of limitations begins to run. In other words, it does not involve parties who possess the discretion to control when a cause of action may properly accrue. Rather, this case involves a determination of when the State of South Carolina grants a right to seek a refund pursuant to the existing tax laws. In Dep't of Conservation v. Co-De Coal Co., 388 S.W.2d 614 (Ky. 1965), the court aptly explained the distinction between a statute of

¹³ In its post-hearing brief, Duke Energy alleges that the Department had respected the "waiver" agreements it had with Duke Energy for tax years 1978-1994 by agreeing, in 2002, to offset refunds of its South Carolina corporate income tax for tax years 1978-1994 against the corporate income, license, and sales taxes for those same years, resulting in a net refund owed to Duke Energy. However, this allegation was based on an affidavit referred to as the "Monroe Affidavit," designated as "Exhibit A," that was not submitted prior to, or during, the hearing. Therefore, this Court will not consider this information in rendering its decision.

limitations and a statutory timeframe for filing a request for refund from a state. The court noted: "whereas a statute of limitations neither creates nor extinguishes any rights, but merely places a limitation upon the remedy (which can be waived or tolled), a limitation such as the one in question is a condition essential to the existence of the right." Co-De Coal, 388 S.W.2d at 617 (internal citations omitted). The court added: "The bringing of the action within the limited time is a condition to the exercise of the right, and, if the condition is not complied with, there is neither right nor remedy." Id. (internal citation and quotation marks omitted).

Indeed, this concept is supported by South Carolina case law. In Labruce v. City of N. Charleston, 268 S.C. 465, 234 S.E.2d 866 (1977), the appellants instituted an action to recover business license taxes paid under protest. The Court recognized that at that time, Section 65-2661 et seq., Code of Laws, 1962, provided the exclusive remedy for the recovery of contested taxes and held that "[s]trict compliance with the conditions precedent is prescribed when one invokes the statutory remedy." 234 S.E.2d at 867. See also 4 S.C. Jur. Action § 13 ("One who invokes a statutory remedy must bring himself within the statute and comply with the conditions prescribed therein. Moreover, the Court of Appeals recently reiterated this principle, noting that a nonclaim statute (the sort at issue in the present case)¹⁴ differs from a statute of limitations in that a nonclaim statute creates no enforceable right of action "[u]nless the claim is filed within the prescribed time set out in the statute," whereas a statute of limitations "creates a defense to an action brought after the expiration of the time allowed by law for the bringing of such an action." Phillips ex rel. Barnett v. Quick, Op. No. 5003, 2012 WL 2913296 (S.C. Ct. App. filed July 18, 2012) (citing Estate of Decker v. Farm Credit Servs. Of Mid-Am. ACA, 684 N.E.2d 1137, 1138-39 (Ind. 1997).

As a general rule, when a statute creates a new right and at the same time prescribes a remedy for enforcing the right, the prescribed statutory course must be followed by anyone claiming the right."); 72 Am. Jur. 2d State and Local Taxation § 996 ("Strict compliance with conditions precedent is required to invoke the statutory remedy for recovery of contested taxes."). When a statute both creates a cause of action and includes a time limit for its commencement, compliance with the time limit is a condition precedent to the maintenance of

¹⁴ A nonclaim statute is one that creates a right of action and provides a time limit on exercising that right. It imposes a condition precedent, as the time element is part of the right of action. 54 C.J.S. Limitation of Actions §33 (updated May 2012).

the action. 54 C.J.S. Limitations of Actions § 31 (updated October 2010). "Such a statutory time limit conditions the existence of the right of action, thereby creating a substantive, rather than procedural, limitation on the right. Bringing suit within the prescribed time is a condition of liability itself, not of the remedy alone." Id.

Thus, the statutes that grant a South Carolina taxpayer a right to seek a refund are not statutes of limitations but rather conditions precedent to obtain a right to a refund. Accordingly, the courts have not adopted the doctrine of waiver involving tax claims. To the contrary, a refund of taxes is considered "solely a matter of governmental grace, . . . and any person seeking such relief must bring himself clearly within the terms of the statute authorizing the same." Asmer v. Livingston, 225 S.C. 341, 344, 82 S.E.2d 465, 466 (1954) (internal citations omitted); see also C.W. Mathews Contracting Co., Inc. v. S.C. Tax Comm'n, 267 S.C. 548, 554, 230 S.E.2d 223, 226 (1976); Guar. Bank & Trust Co. v. S.C. Tax Comm'n, 254 S.C. 82, 173 S.E.2d 367 (1970) (holding that the circuit court erred in extending the time periods under the statute because that is a legislative and not a judicial function). Therefore, the South Carolina Supreme Court held in TNS Mills, Inc. v. S.C. Dep't of Revenue 331 S.C. 611, 623, 503 S.E.2d 471, 478 (1998) that the Department employee's erroneous interpretation of a statute was not binding on the courts, and that Department employees cannot make changes in the refund procedure established by the General Assembly or exceed the authorization granted by a statute. See also Argent Lumber Co., 182 S.E. at 95 ("[T]he agent of the tax commission could not alter, amend, or change the statute law of this state, either orally or by written agreement . . ."). The United States Supreme Court further explained that an employee of the government has no authority to waive or extend a refund period except to the extent authorized by the governing statute. U.S. v. Garbutt Oil Co., 302 U.S. 528 (1938) (Officers of the government have no power to waive statutes of limitations; and Commissioner cannot consider untimely filed returns); see also Dickow v. United States, 740 F. Supp. 2d 231, 237 (D. Mass. 2010) aff'd, 654 F.3d 144 (1st Cir. 2011) cert. denied, 132 S. Ct. 1046 (2012) ("The Executor cannot rely upon the IRS' failure to advise him of the denial to justify his purported conclusion that his second request had been granted where, as here, the IRS clearly did *not* have the authority to issue such extension.").

The only case cited by Duke Energy that involved a refund claim was Anonymous Taxpayer v. S.C. Dep't of Revenue, 377 S.C. 425, 661 S.E.2d 73 (2008). However, the relief sought by the taxpayer in that case was based on the contention that the taxpayer's right to

retirement benefits was in the nature of a contract. The Supreme Court's discussion of the statute of limitations in Anonymous Taxpayer was predicated upon the taxpayer's argument that there "was a contract providing for continuing performance, thus the limitations period began anew each year." The Court noted long ago that statutes of limitations could be waived with respect to actions based on contract. See Heyward v. S.C. Tax Comm'n, 240 S.C. 347, 351, 126 S.E.2d 15, 17 (1962) ("We have held that the State may be subject to the doctrine of estoppel in its contractual relations."). Nevertheless, the Court did not hold that refund claims are in the nature of a contract and, in fact, has held the opposite. See id.; see also C. W. Matthews Contracting Co., 267 S.C. at 554, 230 S.E.2d at 226 (a tax refund claim is created by statute and is not in the nature of a debt collection claim).

In sum, since no employee or agent of the Department has any authority to waive the authorization granted by Section 12-54-80, Form FS-43 could grant no more rights than those permitted by this statute. Thus, any statement made by a Department employee, either verbally or in writing, agreeing to waive the time to request a refund, which was inconsistent with Section 12-54-80, was outside of that employee's authority. Consequently, I conclude that the Forms FS-43 executed before August 1, 1995, and any other statements, written or oral, given by DOR's employees, were ineffective in extending the statutory filing period for Duke Energy's refund claims or in waiving that period.

Moreover, even under section 12-54-85(F)(1), with the exception of situations where there are changes made to taxable income reported to the IRS, or when the IRS changes a corporation's taxable income, "claims for . . . refund must be filed within three years of the time the return was filed, or two years from the date of payment, whichever is later. If no return was filed, a claim for refund must be filed within two years from the date of payment." S.C. Code Ann. § 12-54-85(F)(1) (1995). Also, "[a] claim for refund can be amended prior to, but not after, the expiration of the time for filing the claim for refund under Section 12-54-85(F)." Id. § 12-60-470(H). Read together, these sections lead to the conclusion that once a refund period expires under the terms set forth by the legislature, that period of time cannot be revived by the consent of the Department or otherwise; rather, any amendments must be made prior to the expiration of the statutory period for filing refund claims. See Am. Legion Post 15 v. Horry County, 381 S.C. 576, 582, 674 S.E.2d 181, 183-84 (Ct. App. 2009) (holding in part that the three-year limitations period under section 12-54-85(F)(1) barred a taxpayer's action seeking a refund). Thus, even

after the RPA took effect on August 1, 1995, and the Department received its new power to extend the period for filing refund claims, the Department was unable to use this power to revive refund claims periods that had expired due to the close of the three-year limitations period applicable to the income tax years ending 1990 through 1994 or due to failure to pay under protest and file a claim for a refund within thirty (30) days for the tax years ending prior to 1990.

Equitable Estoppel

Duke Energy similarly asserts that the Department should be estopped from asserting its "statute of limitations." The basis for this contention is that the Department employees purportedly viewed Form FS-43 as waiving the statutory refund limitations period, and that Duke Energy "agreed to the waivers because the Department represented verbally and in writing that the statute of limitations was extended for both tax assessments and tax refund claims."

As with waiver of a statute of limitations, the courts have recognized that the estoppel doctrine is limited in reviewing tax claims. As a general rule, "the doctrine of estoppel will not be applied to deprive the government of the due exercise of its police power, or to effect public revenues or property rights, or to frustrate the purpose of its laws or thwart its public policy." Heyward v. S.C. Tax Comm'n, 240 S.C. 347, 351, 126 S.E.2d 15, 17 (1962) (emphasis added). In the only South Carolina appellate decision touching upon taxation issues and equitable estoppel, the Court of Appeals held that equitable estoppel did not apply to bar a county from asserting the statute of limitations as a defense to refunding admissions fees paid in connection with bingo games. Am. Legion Post 15, 381 S.C. at 583, 674 S.E.2d at 184.

Also, to invoke estoppel in this case, the Department employees must be authorized to change the procedure for obtaining a refund. However, in Texaco, Inc. v. Wasson, the South Carolina Supreme Court explained that the Department was not estopped from assessing additional taxes based on the use of an improper accounting method even though Department employees had expressly and in writing authorized the taxpayer to use that method "until such time as the South Carolina Tax Commission grants permission to change such method." 269 S.C. 255, 264-65, 237 S.E.2d 75, 79 (1977). Similarly, in TNS Mills, Inc., the taxpayer contended that the Department had the authority to grant a property tax exemption retroactively. Its contention was based in part on a memorandum prepared and issued by a Department employee opining that a recently-enacted statute gave the Department authority to accept exemption applications at any time. The South Carolina Supreme Court rejected that contention,

holding instead that “[a]lthough [the employee] believed the Department had the authority to grant retroactive exemptions, and exemptions may have been granted under this erroneous view, neither the Commission nor the courts are bound by his erroneous interpretation.” 331 S.C. at 621-22, 503 S.E.2d at 477; see also S.C. Coastal Council v. Vogel, 292 S.C. 449, 357 S.E.2d 187 (Ct. App. 1987) (“The public cannot be estopped ... by the unauthorized or erroneous conduct or statements of its officers or agents which have been relied on by a third party to his detriment.”).

In addition, the authority that Duke Energy itself cited supports a conclusion that the Department is not estopped from rejecting actions taken by its employees that are not authorized by statute. Duke Energy cited Quail Hill, LLC v. County of Richland and quoted the following language from that case: “A governmental body is not immune from the application of the doctrine of estoppel where its officers or agents act within the proper scope of their authority.” 387 S.C. 223, 236, 692 S.E.2d 499, 506 (2010) (italics omitted). However, Duke Energy only quoted the first part of the pertinent language. The entire relevant passage was quoted by the Court as follows:

A governmental body is not immune from the application of the doctrine of estoppel *where its officers or agents act within the proper scope of their authority ... The public cannot be estopped, however, by the unauthorized or erroneous conduct or statements of its officers or agents which have been relied on by a third party to his detriment.*

Quail Hill, 387 S.C. at 236, 692 S.E.2d at 506 (italics in original) (quoting DeStefano v. City of Charleston, 304 S.C. 250, 257-58, 403 S.E.2d 648, 653 (1991)). That passage followed the Court’s recognition at the beginning of the paragraph: “As a general rule, estoppel does not lie against the government to prevent the due exercise of its police power or to thwart the application of public policy.” Id. (quotation marks omitted).

Following the above precedents, the Court ultimately held that: “For reasons ... discussed [in the opinion], we believe the Court of Appeals erred in reversing the circuit court’s grant of summary judgment to County as to Quail Hill’s claim of equitable estoppel.” Id., 387 S.C. at 237, 692 S.E.2d at 506. In other words, the Supreme Court in Quail Hill affirmed that the government was not estopped from contesting erroneous statements made by its staff. See id., 387 S.C. at 238, 692 S.E.2d at 507 (“[W]e agree with County’s argument that the RU zoning classification was a mistaken statement of law and, thus, could not be used to estop County from enforcing it.”). That holding is entirely consistent with the holdings of Texaco, Heyward, and

TNS Mills and, in fact, relies on the same rationale stated by the Court in Heyward – that the government cannot be estopped from exercising its police power. Compare id., 387 S.C. at 236, 692 S.E.2d at 506 (discussing police power rationale for not applying estoppel to governmental entities) with Heyward, 240 S.C. at 351, 126 S.E.2d at 17 (holding that “estoppel will not be applied to deprive the government of the due exercise of its police power, or to effect public revenues or property rights”).

Thus, I conclude that the Department is not estopped from invoking the correct refund limitations period, even if Department employees believed they had the authority to allow the taxpayer to extend the time in which a claim for refund could be filed. This court clearly does not wish to shield a governmental agency from the doctrine of equitable estoppel where its agents act within the scope of their authority. Rather, this Court recognizes that however Duke Energy seeks to characterize the evidence presented in response to the Department’s summary judgment motion, the Department’s employees did not have the authority to create an unauthorized refund procedure. Moreover, execution of Forms FS-43 by Department employees can provide the taxpayer with no greater remedies than those provided by the governing statutes for refund claims and the like. It is upon these principles that the court in Phillips held that “[w]hile equitable principles may extend the time for commencing an action under statutes of limitation, nonclaim statutes impose a condition precedent to the enforcement of a right of action and are not subject to equitable exceptions.” Supra (citing Estate of Decker, 684 N.E.2d at 1139) (emphasis added).

In fact, even if estoppel was applicable here, Duke Energy failed to set forth a genuine issue of material fact as to its meeting those requirements. “To prove estoppel against the government, the relying party must prove: (1) the lack of knowledge and of the means of knowledge of the truth of the facts in question; (2) justifiable reliance upon the government’s conduct; and (3) a prejudicial change in position.” S.C. Dep’t of Transp. v. Horry County, 391 S.C. 76, 83, 705 S.E.2d 21, 25 (2011). Furthermore, “[o]nce the party moving for summary judgment meets the initial burden of showing the absence of a genuine issue as to any material fact, the nonmoving party may not simply rest on the mere allegations contained in the pleadings.” Grant v. Mount Vernon Mills, Inc., 370 S.C. 138, 142, 634 S.E.2d 15, 17 (Ct. App. 2006). “Rather, the nonmoving party must come forward with specific facts showing there is a genuine issue for trial.” Id. (quoting Peterson v. W. Am. Ins. Co., 336 S.C. 89, 94, 518 S.E.2d

608, 610 (Ct.App.1999)). Here, there is no dispute that Duke Energy could have referenced the governing refund statutes and learned that Department employees cannot extend the time periods set forth in the applicable refund statutes. See Am. Legion Post 15, 381 S.C. at 583, 674 S.E.2d at 184. Moreover, I do not find that the Form FS-43 misinformed Duke Energy that it could file an amended tax return requesting a refund after the statutory timeframe.

Equitable Tolling

Duke Energy contends that the Department should be equitably tolled from requiring Duke Energy to comply with the statutory time frame within which to file a refund because the Department's employees induced Duke Energy to file belatedly. In support of this remedy, Duke Energy contends that it agreed to the waivers because the Department represented that the statute of limitations was extended for both tax assessments and tax refund claims.

"[T]he doctrine of equitable tolling may be applied to toll the running of the statute of limitations." Hooper v. Ebenezer Sr. Servs. & Rehab. Ctr., 386 S.C. 108, 115, 687 S.E.2d 29, 32 (2009) (quoting 54 C.J.S. Limitations of Actions § 115 (2005)). As explained above, however, the statute requiring that refunds be filed within specific timeframes creates a condition precedent to seeking that remedy and thus is not subject to the equitable remedies for statutes of limitations. See Phillips, supra. Thus, equitable tolling is not a proper remedy in this case. Cf. United States v. Brockamp, 519 U.S. 347 (1997) (holding that the statutory limitations period on tax refund claims under the applicable provision of the Internal Revenue Code does not authorize equitable tolling).

Even if, arguendo, equitable tolling could apply here, in Hooper, the South Carolina Supreme Court explained that "equitable tolling is a doctrine that should be used sparingly and only when the interests of justice compel its use." 386 S.C. at 117, 687 S.E.2d at 33. Here, however, in an attempt to invoke this extraordinary remedy, Duke Energy submitted affidavits and deposition testimony that reference the belief by Department employees that Duke Energy could seek a "refund" based upon extensions granted by the executed Forms FS-43. However, those affidavits do not contain an averment by any Department employee that he or she specifically stated to a Duke Energy representative that Duke Energy's time to seek a "refund" was extended by Form FS-43. More importantly, there is no reference that any Department employee stated that Duke Energy could file an amended tax return seeking a refund based upon

a new basis. Nor is there any sworn testimony by a Duke Energy representative that he or she was misdirected by a Department employee.

Therefore, I conclude that equitable tolling does not lie in this case.

Conclusion

Finally, the context of Duke Energy's request is important in recognizing the proper resolution of this issue. Duke Energy asserts that there are disputed facts regarding this issue because some of the Department's employees viewed Form FS-43 as extending the period during which a taxpayer could seek a refund. However, statements to that effect do not answer the issue in this case. This case is not simply about whether Duke Energy can seek a refund based upon a tax review that had been held open pending the Department's determination of the proper tax to assess. Rather, Duke Energy originally filed as a manufacturer using the three-factor formula. Now, it seeks a refund, not based upon the initial filing, but based upon an amended tax return using the single-factor gross-receipts apportionment formula – an entirely different basis. Duke Energy's amended return also now includes the gross receipts from the sale of its securities and other capital investments, which further includes the principal.

Duke Energy interprets Form FS-43 as not only allowing it to question its initial filing but as allowing it to file a new (amended) tax return and claim an entirely new basis for a refund. The plain reading of the tax statutes and review of the affidavits and deposition testimony submitted by Duke Energy fail to establish a genuine issue of material fact regarding the request of Duke Energy. In other words, though there are statements regarding the right of Duke Energy to seek a refund, no evidence was presented that any Department employees interpreted Form FS-43 as allowing a taxpayer to file an amended return on an entirely different basis than the original return and then seek a refund based on that amended return.¹⁵ Therefore, the Department's Motion for Summary Judgment as to the issue of the timeliness of Duke Energy's amended income tax return filings is granted.

II. Apportionment Method

The next issue is whether Duke Energy is a "manufacturer" and therefore required to use the multi-factor apportionment formula pursuant to S.C. Code Ann. § 12-6-2250 (****)

¹⁵ Review of the record does not even establish the validity of the Form FS-43 agreements for tax years 1978 through 1983. In fact, Duke Energy has even conceded that it has not located the executed Form FS-43 agreements for tax years 1978 through 1983.

(applicable to tax years after 1995)/ Section 12-7-1140 (applicable to tax years prior to 1996); or whether Duke Energy was required to use the single-factor gross-receipts formula pursuant to Section 12-6-2290 (****) (applicable to tax years after 1995)/ Section 12-7-1190 (applicable to tax years prior to 1996). Duke Energy argues that it is not a manufacturer, even though it filed its original corporate income tax returns under this status. Duke Energy contends that it is actually a seller of services, and therefore amended its tax return filing using the single-factor gross receipts formula.

During the tax periods at issue, taxpayers whose principal business in South Carolina was "(a) manufacturing . . . goods and materials within this State . . ." had to apportion their income using a three-factor formula composed of property, payroll, and sales. S.C. Code Ann. § 12-6-2250 (applicable to tax years after 1995); S.C. Code Ann. § 12-7-1140 (applicable to tax years prior to 1996). All other taxpayers (except certain specific industries not relevant here) had to apportion their income using a single-factor gross-receipts apportionment formula. S.C. Code Ann. § 12-6-2290 (applicable to tax years after 1995); *Id.* § 12-7-1190 (applicable to tax years prior to 1996). "Manufacturing" is not, and was not during the tax periods at issue, statutorily defined for South Carolina apportionment law purposes.¹⁶

Based on the record, I find that genuine issues of material fact exist necessitating an evidentiary hearing as to whether Duke Energy, based on its activities within the State, falls under Section 12-6-2250 as a "manufactur[er]," or whether Duke Energy is a seller of services, or otherwise falls under none of the above-categories, and is therefore required to apportion its income to South Carolina based on the single-factor gross-receipts apportionment formula pursuant to Section 12-6-2290 (applicable to tax years after 1995)/ Section 12-7-1190 (applicable to tax years prior to 1996). Accordingly, the Court denies the Department's Motion for Summary Judgment with respect to this issue.

III. Gross Receipts

The final issue is whether Duke Energy was allowed, in its calculation of corporate income tax owed to South Carolina, to include in the apportionment formula the return of

¹⁶ "Manufacturing" is not statutorily defined, but it is discussed in Columbia Ry., Gas & Elec. Co. v. S.C. Tax Comm'n, 134 S. C. 319, 132 S.E. 611 (1926), a case in which the South Carolina Supreme Court held that a company engaged in the business of generating electricity was properly considered a "manufacturer" for purposes of a particular statute that imposed a corporate income tax on "a corporation engaged in the business of manufacturing."

principal from its sales of securities and other capital investments. Duke Energy argues that "gross receipts" in the gross receipts factor of the denominator of the single-factor gross-receipts apportionment formula and "sales" in the sales factor of the denominator of the three-factor apportionment formula include the entire amount of return capital from a sale of securities or other capital investments, including the return of principal. The Department, however, argues that gross receipts and sales include only the net proceeds from sales of securities or other capital investments.

South Carolina law provides that a taxpayer required to apply the single-factor gross-receipts apportionment formula must do so "using a fraction in which the numerator is gross receipts from within this State during the taxable year and the denominator is total gross receipts from everywhere during the taxable year." See S.C. Code Ann. § 12-6-2290 (****) (applicable for tax years beginning after 1995); see also *id.* § 12-7-1190 (****) (applicable for tax years prior to 1996).¹⁷ "Gross receipts" was not defined for South Carolina apportionment law purposes during the tax periods at issue.

For purposes of the multi-factor apportionment formula¹⁸ the sales factor consists of "[t]he ratio of sales made by such taxpayer during the income year which are attributable to this State to the total sales made by such taxpayer everywhere during the income year" S.C. Code Ann. § 12-7-1170 (****) (for tax years prior to 1996).¹⁹ The term "sales" includes: "(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." *Id.*²⁰

¹⁷ Even though the Court finds as a matter of law that Duke Energy's filings of tax refund claims for tax years ending 1978-1993 were untimely, and thus will not be considered here, the filing for tax year 1994 was timely, and thus statutes applicable to tax years prior to 1996 will be discussed.

¹⁸ Section 12-6-2250 (applicable to tax years after 1995) and Section 12-7-1140 (applicable to tax years prior to 1996).

¹⁹ For tax years after 1995, S.C. Code Ann. § 12-6-2280 (****) similarly provides that: "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."

²⁰ For tax years after 1995, S.C. Code Ann. § 12-6-2280 (B) (****) similarly provides that the term "'sales in this State' includes sales of goods, merchandise, or property received by a purchaser in this State. The place where goods are received by the purchaser after all transportation is completed is considered the place at which the goods are

"The language of a tax statute must be given its plain ordinary meaning in the absence of an ambiguity therein. . . [I]f a legislative intent is clearly apparent from the language of the statute there is no occasion for resort to the rule of statutory construction." Beach v. Livingston, 248 S.C. 135, 139, 149 S.E.2d 328, 330 (1996) (internal citation omitted). "If the statute is ambiguous, however, courts must construe the terms of the statute." S.C. Energy Users Comm. v. S.C. Pub. Serv. Comm'n, 388 S.C. 486, 491, 697 S.E.2d 587, 590 (2010) (internal citation omitted). "A statutory provision should be given a reasonable and practical construction consistent with the purpose and policy expressed in the statute." Lockwood Greene Eng'rs, Inc. v. S.C. Tax Comm'n, 293 S.C. 447, 449, 361 S.E.2d 346, 347 (Ct. App. 1987). "When faced with an undefined statutory term, the term must be interpreted in accordance with its usual and customary meaning." Id. at 492, 697 S.E.2d at 590 (internal citation omitted). "Courts should not merely consider the language of the particular clause being construed, but the undefined word and its meaning in conjunction with the purpose of the whole statute and the policy of the law." Id. Finally, "[s]tatutes should not be construed so as to lead to an absurd result." Kennedy v. S.C. Ret. Sys., 345 S.C. 339, 351, 549 S.E.2d 243, 249 (2001) (internal citation omitted).

Here, there is no genuine issue of material fact with regard to the Gross Receipts Issue. The sole question of law is whether Duke Energy could include the return of principal from its sales of securities and other investment transactions as part of the sales or gross receipts factors in the apportionment formula. This is a novel question in South Carolina, but is not unprecedented in some of our sister States.

The first approach to this issue was taken by New Jersey in Am. Tel. and Tel. Co. v. Dir., Div. of Taxation, 194 N.J. Super. 168, 476 A.2d 800 (App. Div. 1984). In that case, the New Jersey Supreme Court concluded that the inclusion of gross or full revenues from the short-term sale or redemption of investment paper in the denominator of the receipts fraction of the apportionment formula would lead to "absurd results" in that such inclusion would greatly distort the amount of business the taxpayer did within and without New Jersey and would thus defeat the intent and purpose of the apportionment statute. Id. at 172, 476 A.2d at 802. Both Indiana and Arizona have adopted similar rationales to the one used by the New Jersey court. See

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."

Sherwin-Williams Co. v. Ind. Dept. of State Revenue, 673 N.E.2d 849 (Ind. Tax 1996) (holding that “‘gross receipts’ for the purpose of the sales factor includes only the interest income, and not the rolled over capital or return of principal, realized from the sale of investment securities”); Walgreen Ariz. Drug Co. v. Ariz. Dep’t of Revenue, 209 Ariz. 71, 97 P.3d 896 (App. 2004) (holding that the return of principal from the type of short-term investments at issue was not includable in the sales factor denominator).

The other approach to this issue was taken by Tennessee and California.²¹ In Sherwin-Williams Co. v. Johnson, 989 S.W.2d 710 (Tenn. App. 1998), the chancellor had followed the same reasoning employed by the New Jersey and Indiana courts (and later the Arizona court), holding that “to include the principal in the sales factor denominator would distort the extent of Sherwin-Williams’ business activities in Tennessee and other states in which it does business and defeat the intent and purpose of the [apportionment] statute. . .” and that “the amount of return of principal on the sale or redemption of interest bearing securities related to its, [sic] working capital investments should not be included in the denominator of the sales factor.” *Id.* at 714. The Tennessee Court of Appeals, though finding the chancellor’s holding “logical and appealing,” nevertheless decided not to follow the “absurd result standard.” The court instead concluded that:

An absurd result is not necessary, for in spite of the plain language of the [sales factor statute], the commissioner may opt for a different scheme of assessment whenever the resulting apportionment does not fairly represent the taxpayer’s business in this state. The very absurdity of the result sought . . . lays a sound basis for the implementation of [the alternative apportionment method statute].

Id. at 714-15.

The California Supreme Court, in Microsoft Corp. v. Franchise Tax Bd., quoted this passage with approval as it went on to hold that “gross receipts” is not limited to net proceeds. 39 Cal.4th 750, 763, 139 P.3d 1169, 1177 (2006). Referencing California’s alternative apportionment method, the court concluded that “[t]he UDITPA contains an equitable relief provision so that, in cases where application of the statutory sales definition results in excessive distortion, an ‘absurd result’ may be avoided.”

²¹ South Carolina’s apportionment provisions, like those in New Jersey, Indiana, Arizona, Tennessee, and California, are based on the Uniform Division of Income for Tax Purposes Act (UDITPA).

After considering the two lines of reasoning set forth by our sister States, I conclude that the law of South Carolina favors the view expressed by the courts in New Jersey, Indiana, and Arizona.

As the Tennessee Court of Appeals correctly noted, “[i]f the words of a statute plainly mean one thing they cannot be given another meaning by judicial construction.” Johnson, 989 S.W.2d at 714-15 (internal citation omitted); see also Denman v. City of Columbia, 387 S.C. 131, 138, 691 S.E.2d 465, 468 (2010) (“Under the plain meaning rule, it is not the Court’s place to change the meaning of a clear and unambiguous statute.”). However, to rearrange the order of the court’s sentences, “This sound rule . . . is met by the equally well settled rule that: . . . ‘It is presumed that the legislature enacting a statute did not intend an absurdity, and such a result will be avoided by this court if the terms of the statute admit of it by reasonable construction.’” Johnson, 989 S.W.2d at 714 (internal citations omitted).

Logical Definition of Gross Receipts

The term “gross receipts” does not plausibly include the return of principal from the sale of securities and other capital investments. In examining the meaning of “gross receipts” it is helpful to start first with a consideration from a macro perspective of the known interpretation of the meaning of “gross income.” “Gross income”, at least in the context of self-employment or self-owned businesses, is defined as “gross receipts minus ordinary and necessary expenses required for self-employment or business operation. . . .” Spreeuw v. Barker, 385 S.C. 45, 65, 682 S.E.2d 843, 853 (Ct. App. 2009) (citing S.C. Code Ann. Regs. 114-4720(A)(4) (Supp. 2008)). This definition logically applies to other types of businesses, too. Based on the implication of this definition, it logically flows that gross receipts equal gross income plus ordinary and necessary expenses of business operations. The South Carolina Supreme Court in Roper v. S.C. Tax Comm’n, Title 65-Section 251 of the 1952 Code of Laws of South Carolina also defined “gross income” as: “the income of a taxpayer derived from . . . interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit” 231 S.C. 587, 598, 99 S.E.2d 377, 382 (1957) (emphasis added); see also S.C. Code Ann. § 12-7-415 (****) (adopting the Internal Revenue Code’s (I.R.C.) determination of gross income with modifications specified in Section 12-7-430 (which are not relevant here)); I.R.C. § 61(a) (****) (generally defining corporate gross income as “all income from whatever source derived” and

covering many of the same categories mentioned in Roper²²; S.C. Code Ann. § 12-6-1110 (****). The Court went on to point out that “the word ‘income’ as used in a tax statute, is to be taken in its ordinary sense of gain or profit.” Id. (reaffirmed as “well-settled” in Scott v. S.C. Tax Comm’n, 262 S.C. 144, 148, 202 S.E.2d 854, 856 (1974)). Here, too, we find the same deductive reasoning that because gross income includes “all income,” and income, being gain or profit, excludes principal, then gross income necessarily excludes principal.

The U.S. Supreme Court also followed this reasoning in U.S. v. Forest Lumber Co., 429 U.S. 32 (1976). In that case, the Court found that the inclusion of “gains derived from dealing in property” as part of “all income from whatever source derived” in the definition of gross income under I.R.C. Section 61(a) (****) meant that taxable income, which includes gross income according to Section 63(a),²³ also therefore included capital gains as well as ordinary income, in the absence of a specific exclusion of capital gains. 429 U.S. at 37. The Court’s inclusion of capital gains impliedly excludes principal from gross income (and taxable income). Because, as mentioned earlier, gross receipts equal gross income plus the amount spent for ordinary and necessary business expenses, and gross income includes only the capital gains from sales of securities, then gross receipts can only include capital gains from sales of securities, which necessarily excludes principal. Therefore, the only remaining question is whether “ordinary and necessary expenses of business operations” includes principal.

Principal, by definition, cannot be an expense of a business operation. Since ordinary and necessary business expenses are subtracted from gross receipts to yield gross income, and neither business expenses nor gross income include principal, it is impossible for gross receipts to include principal. Put another way, because gross receipts are equivalent to gross income plus

²² Nowhere in South Carolina’s statutory law or in the federal statutory law adopted by South Carolina is principal from investments listed as part of gross income. In fact, principal would later be excluded in S.C. Code Ann. § 2295(B)(1) (2007), which became effective for tax years after 2006. Also, it is worth noting that even in the context of child support, gross income does not include principal in the return from the sale of investments. Indeed, the inclusion of “capital gains” in the list of items considered part of gross income for child support purposes necessarily implies the exclusion of principal from the return of investment sales. See S.C. Code Ann. Regs. 114-4720(A)(2) (2012).

²³ Generally, the taxable income of a business is its gross income minus any deductions that are allowed by state law. I.R.C. § 63(a) (****).

ordinary and necessary business expenses, and neither gross income nor business expenses include principal, gross receipts, being the sum of those two parts, cannot include principal.²⁴

Logical Definition of Sales

It is equally implausible to include principal from the sale of securities and other capital investments in the definition of "sales" for purposes of the standard apportionment formula. A major difference between the Tennessee case and the present case is that Tennessee's standard apportionment statute defined "the term 'sales' to include all gross receipts of the taxpayer not otherwise allocated under the Excise Tax Law." Johnson, 989 S.W.2d at 713 (emphasis in original). Likewise, the California standard apportionment statute included "all gross receipts" in the definition of "sales." South Carolina's standard apportionment statute defines the term "sales," but this definition does not include "gross receipts."²⁵ Instead, under its definition of "sales," "[i]f the income-producing activity is performed partly within and partly without this State, sales are attributable to this State to the extent the income-producing activity is performed within this State." S.C. Code Ann. § 12-6-2280(C)(2) (****) (formerly 12-7-1170 (****)) (emphasis added).²⁶ This phrase "income-producing" is used to modify "activity" several other times in the definition of "sales." "Income" means "an actual gain or actual increase of wealth."

²⁴ For examples in the I.R.C. of exclusion of principal from gross receipts, see I.R.C. § 165(g)(3)(B) (****) (in the context of determining whether a corporation is affiliated with a taxpayer, "in computing gross receipts for purposes of [calculating the percentage of gross receipts that have come from particular sources], gross receipts from sales or exchanges of stocks and securities shall be taken into account *only to the extent of gains therefrom*." (emphasis added); *id.* § 1362(d)(3) (in the context of a small business corporation's termination of its election to be an S corporation, where its passive investment income exceeds twenty-five percent of gross receipts for three consecutive taxable years and the corporation has accumulated earnings and profits at the close of each of those years, when capital assets (other than stocks or securities) are disposed of, "gross receipts from such dispositions shall be taken into account *only to the extent of the capital gain net income therefrom*[:]; and in the case of sales or exchanges of stock or securities, gross receipts shall be taken into account *only to the extent of the gains therefrom*." (emphasis added); and *id.* § 1244 (in the context of calculating the percentage of gross receipts from particular sources for determining whether "stock" means stock in a domestic corporation for determining losses on small business stocks, "gross receipts from the sales or exchanges of stock or securities shall be taken into account *only to the extent of gains therefrom*." (emphasis added).

²⁵ "Sales" and "gross receipts" were later further defined together by S.C. Code Ann. § 12-6-2295 (2007) (effective for tax years beginning after 2006). However, the years at issue here are 1978-2001. Further, because the Court finds as a matter of law that the refund claims filed for tax years ending 1978-1993 are untimely, the only years that will be considered for the gross receipts issue will be tax years ending 1994-2001.

²⁶ Duke Energy states in its Motion for Reconsideration that "[t]he concept of income-producing activity has no bearing on the definition of 'total sales' and whether the principal from sales of securities should be included in the sales factor denominator." However, the Legislature clearly intended to specify what kind of activity would be used to measure "sales" for purposes of the apportionment formula, and did so by including the modifying phrase "income-producing."

See Scott v. S.C. Tax Comm'n, 262 S.C. 144, 148-49, 202 S.E.2d 854, 856 (1974) (Bussey, J., dissenting) (citing 85 C.J.S. Taxation 1096, p. 730). This emphasis on income production suggests that principal is excluded from the definition of "sales."²⁷ Moreover, this limitation of "sales" to the net income derived therefrom is not a novel interpretation. Indeed, our own Supreme Court has approved of an apportionment formula "whereby [a business's] sales, payroll, and property in South Carolina were divided by its national net sales, payroll, and property." See Eastman Kodak Co. v. S.C. Tax Comm'n, 308 S.C. 415, 416, 419, 418 S.E.2d 542, 542, 544 (1992) (holding in part that safe harbor lease transactions that were part of a corporation's business "were properly included in the denominator of the apportionment formula in computing [that corporation's] national net income from payroll, property, and sales.") (emphasis added). Using this interpretation and limiting the sales factor in the denominator of the three-part apportionment formula to net income is the more sound application of the apportionment formula.

The conclusion in this case is further supported by the fact that in the context of consolidated returns filed by multiple corporations conducting business within and without the State, the returns included in the sales factor of the standard apportionment formula must "contain such other information necessary to compute the net income of each taxpayer properly attributable to the state so that South Carolina can impose a tax on the taxpayers concerned." Emerson Elec. Co. v. Wasson, 287 S.C. 394, 396-97, 339 S.E.2d 118, 120 (1986) (discussing S.C. Code Ann. § 12-7-1570 (****) (for tax years prior to 1996), the predecessor of § 12-6-5020 (****) (for tax years after 1996)) (emphasis altered). This infers that when a single corporation also conducts business within and without the State, its net income only, and not principal, is included in the sales factor for purposes of apportioning the amount of corporate income taxes the State could impose on that corporation. See, e.g., Eastman Kodak Co., 308 S.C. at 416, 418 S.E.2d at 542 (Kodak included only the net income in the sales factor in the denominator of the apportionment formula).²⁸

²⁷ Though Duke Energy is a nonresident corporation, it is worth noting that South Carolina taxable income for nonresident individuals, nonresident trusts, nonresident estates, and nonresident beneficiaries include only amounts attributable to, among other things, "income from intangible personal property, including annuities, dividends, interest, and gains that is derived from property employed in a trade, business, profession, or occupation carried on in this State." It is interesting that nowhere is "principal" mentioned as an inclusion in taxable income.

²⁸ In its Motion for Reconsideration, Duke Energy attempted to analogize this case with S.C. Dep't of Revenue v. Blue Moon of Newberry, Inc., 397 S.C. 256, 725 S.E.2d 480 (2012) to support its proposition that "the Court should

Alternative Apportionment Method

The Tennessee and California opinions rely upon the presupposition that "an absurd result is not necessary" because the Department "may opt for a different scheme of assessment whenever the resulting apportionment does not fairly represent the taxpayer's business in this State." Microsoft, 39 Cal.4th at 763, 139 P.3d at 1177 (quoting Johnson, 989 S.W.2d at 715). South Carolina indeed has a similar provision. S.C. Code Ann § 12-6-2320(A) (2002) provided that:

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.

(Emphasis added).

not restrict the meaning of 'gross receipts' and 'total sales' when the language of the statute does not contain or require any limitations." In Blue Moon of Newberry, a case involving a regulation that restricted the sale of alcoholic beverages by nonprofit organizations to "bona fide members and bona fide guests of members of such organizations," the South Carolina Supreme Court rejected the Department's view that "bona fide implie[d] that the guest have some degree of familiarity or camaraderie with the member," because "the plain language of the regulation contain[ed] no support of this, and the ordinary definition of bona fide d[id] not require it." Id. at 258, 263-64, 725 S.E.2d at 482, 484-85. Rather, the regulation clearly defined "bona fide guests" as those "who accompany a member onto the premises or for whom the member has made prior arrangements with the management of the organization." Id. at 258, 725 S.E.2d at 482. In the present case, however, the term "gross receipts," unlike "bona fide guests" in Blue Moon of Newberry is not defined for South Carolina apportionment law purposes during the tax periods at issue. Therefore, this Court must determine whether principal was included in the components of gross receipts (gross income and ordinary and necessary expenses of business operations). For the reasons given above, state and federal law establishes that principal is excluded from the components of gross receipts. Indeed, it is the inclusion of principal that has no foundation whatsoever in South Carolina or federal tax law. Though "sales" is defined for South Carolina apportionment law purposes, the ordinary meaning of the terms comprising its definition do not support, let alone require, the inclusion of principal, for the reasons explained above. Also, this Court's purpose in excluding the return of principal from the definitions of "gross receipts" and "sales" is the same as the Court's in Blue Moon of Newberry - to preserve the purpose of the apportionment statutes and prevent the production of an absurd result. Contrary to Duke Energy's assertion, the Court's opposition to "artificially inflat[ing] the denominator of either the sales factor or gross receipt factor and thereby decreas[ing] the amount of income subject to tax in South Carolina" is not based upon a belief that taxpayers should be required to "pay the most taxes." Rather, the Court's opposition is based upon the belief that taxpayers are required to pay the correct amount of taxes owed to this State, which is the amount that "fairly represents the taxpayer's business activity in this State." Indeed, this is the whole purpose of the apportionment statutes.

I nevertheless find that the California and Tennessee cases, in relying upon this statutory option, miss an important distinction between the court's roles of statutory construction and application of the alternative apportionment provision. Though the alternative relief provision exists as a mechanism to correct problems caused by the application of the standard apportionment statutes (see Media Gen. Commc'ns v. S.C. Dep't of Revenue, 388 S.C. 138, 694 S.E.2d, 525 (2010)), the standard application statutes should not be so construed as to encourage excessive distortion simply because the alternative relief provision exists to remedy that distortion. In applying the principles of statutory construction, the court's function is, in part, to construe statutory law to avoid an absurd result. Ventures S.C., LLC v. S.C. Dep't of Revenue, 378 S.C. 5, 9, 661 S.E.2d 339, 341 (2008) ("[T]he Court will reject the plain meaning of the words used in a statute if it would lead to an absurd result. . ."). If, as here, the proposed construction of a statute reaches an absurd result, our courts should recognize that absurdity and end the inquiry.

On the other hand, the function of the alternative apportionment provision is quite different. The alternative apportionment provision should be utilized only when the standard apportionment statute does not operate sensibly in a given case. As the Florida Supreme Court pointed out in Roger Dean Enters, Inc. v. State, "[t]here is a very strong presumption in favor of normal three-factor apportionment and against the applicability of the relief provisions. . . Departures from the basic formula should be avoided except where reasonableness requires." 387 So.2d 358, 363 (internal citations omitted). Further, in St. Johnsbury Trucking Co. v. New Hampshire, the New Hampshire Supreme Court, in addressing very similar statutory language, held that:

The statutory provisions require that the three-factor formula will be used for apportioning business profits, and an alternative formula may be used if the statutory method of apportionment "does not fairly reflect the extent of the business activities of a business organization within this state." The legislature has, therefore, specified that an alternative formula is the exception, and the party who wants to use an alternative formula accordingly has the burden of showing that the alternative is appropriate.

118 N.H. 209, 212, 385 A.2d 215, 217 (1978) (emphasis added).²⁹

²⁹ The following states have followed the holding in St. Johnsbury Trucking: Idaho - Union Pac. Corp. v. Idaho State Tax Comm'n, 83 P.3d 116, 120 (Idaho 2004); and Kentucky - Ruby Const. Co., Inc. v. Dep't of Revenue, 578 S.W.2d 248, 253 (Ky. Ct. App. 1978).

In this case, to interpret the standard apportionment formula to include the return of principal in either the sales factor or gross-receipts factor of the denominator would engender an absurd application of the standard apportionment statute simply because another statute exists which allows for another means of accounting when the standard apportionment statute does not "fairly represent the extent of the taxpayer's business activity in this State." In other words, such an interpretation would create the very absurdity that courts are to avoid in their statutory construction. Rather than having Section 12-6-2320(A) available as a remedial back-up, a corporation would have nothing to lose and everything to gain by adding the return of principal to the denominator and thereby reducing the amount of taxes owed to South Carolina, regardless of whether the numbers accurately reflected the corporation's business activity within and without the State. As a result, the alternative apportionment statute, which was intended to be a remedy held in reserve for the relatively infrequent occasion that the standard formula did not result in a fair representation, would then become a standard follow-up to the application of the standard apportionment statute. Indeed, both statutes would become standard, because distortion of business activity representation would be fostered on the front end (through the principal-inclusive standard apportionment formula) so that it could, and necessarily would, be dealt with on the back end (through the alternative apportionment formula).³⁰

This potential for abuse by corporations and the futility of going through this extra-step process needlessly is reflected in a finding by the Arizona Court of Appeals that in most of the cases that the taxpayer cited to support the inclusion of the return of principal in the sales factor denominator of the standard apportionment formula, the courts "nonetheless approved exclusion of the principal from the sales factor denominator pursuant to their states' version of UDITPA's 'relief provision' [i.e., alternative apportionment method]." Walgreen, 209 Ariz. at 901-02, 97 P.3d 896 at 76-77 (citing Union Pac. Corp. v. Idaho State Tax Comm'n, 139 Idaho 572, 83 P.3d 116, 122 (2004); Am. Tel. & Tel. Co. v. State Tax Appeal Bd., 241 Mont. 440, 787 P.2d 754, 757-58 (1990); Johnson, 989 S.W.2d at 715). Microsoft, which was decided two years after Walgreen, can be added to this list, as it applied California's alternative apportionment method

³⁰ In its Memorandum in Opposition to the Department's Motion for Summary Judgment and in Support of its Cross-Motion for Partial Summary Judgment, Duke Energy argues that the definitions of "sales" and "gross receipts" set forth in S.C. Code Ann. § 12-6-2295 (2007) (effective for tax years beginning after 2006), shows the Legislature's intent to make a "drastic" change to the existing law based on its various inclusions in, and exclusions from, the definitions of "sales" and "gross receipts" that had previously not existed. This Court's response to that argument is set forth in its Order Denying Motion For Reconsideration in Part and Granting Reconsideration in Part.

statute to "fairly represent the extent of the taxpayer's business activity in this state" after the court included principal in the sales denominator of its standard apportionment formula.³¹

Criticism of the "Absurd Results Standard"

The California Supreme Court in Microsoft criticized the proponents of the "absurd results standard," in part, because "[i]n each case, the same language governs both sales of off-the-shelf products and sales of securities. *AT&T* [(the New Jersey case)] and its progeny offer no explanation why in one instance that language should require inclusion of gross proceeds and in the other require inclusion of only net proceeds." 39 Cal.4th at 763, 139 P.3d at 1177.³² Nevertheless, the resolution of this issue has been clarified in South Carolina by the Supreme Court's holding in Hay v. Leonard, 212 S.C. 81, 46 S.E.2d 653 (1948).

Hay involved a challenge to the validity of Charleston County's levying an annual license tax for the privilege of engaging in each and every business and occupation in Charleston County, except in the City of Charleston. In reaching its decision, the South Carolina Supreme Court explained the reason why merchandise, or "off-the-shelf products," includes gross proceeds in its taxation, and the Court's reasoning suggests why the sale of securities would not include gross proceeds. The Court explained: "the [license] tax is not on the property itself; it is on the **privilege of dealing with it**. The value of such privilege is measured by the gross receipts therefrom, and this is a familiar and valid method of ascertaining such value." *Id.* at 97, 46 S.E.2d at 660 (emphasis added). A merchant is required to possess a license in order to have the privilege of dealing in merchandise; and the tax is on this privilege, not on the merchandise. This is why "[t]he sale of all merchandise includes previous taxation" *Id.*; see also State ex rel. Roddey v. Byrnes, 219 S.C. 485, 514, 66 S.E.2d 33, 45 (1951) ("In general, the sales tax [a form of excise tax], is [like a license tax] an imposition upon the privilege of the business of selling at retail and measured by the amount of business done . . ."). The sale of securities is

³¹ Paradoxically, the court went on to justify this decision to apply the alternative method statute because it was "unable to accept, even for a moment, the notion that more than 11 percent of [taxpayer's] entire unitary business activities should be attributed to *any* single state solely because it is the center of working capital investment activities that are clearly only an incidental part of one of America's largest, and most widespread, businesses." This rationale highlights the precise reason why principal from the sale of securities and other capital investment activities should not be included in the standard apportionment formula in the first place: the inclusion of principal causes distortions as to the amount of business activity actually performed in a State, which, in turn, have to be remedied.

³² This is the first of the "two problems" that the California Supreme Court had with the "absurd results" cases. The second problem will be discussed in the immediately-following paragraph.

altogether different in that a license is not required to purchase or sell securities,³³ and no sales tax is imposed upon the sale of securities.³⁴ Therefore, here there exist no "privilege" grounds upon which to include principal in the gross receipts, as the value received from the sales of the securities for tax purposes would be measured by the capital gains, not by the principal. The principal would consist of the business's "idle cash" that would presumably have been taxed already.

Conclusion

This Court hereby follows New Jersey, Indiana, and Arizona in adopting the "absurd results" approach to interpreting South Carolina's standard apportionment statute and therefore rejects Duke Energy's attempt to include the return of principal in the denominator of the standard apportionment formula. In sum, the alternative apportionment formula exists to remediate any nonsensical application of the standard apportionment formula. However, that remediation should not be the result of a court's addition, through its failure to apply the rules of statutory interpretation, of a component to the standard apportionment formula that neither exists in the statute nor was intended by the Legislature. The absurdity that the alternative apportionment formula is intended to remediate is when a taxpayer follows the standard apportionment formula but the result is nevertheless an unfair representation of the extent of the taxpayer's business activity in the State. Construing the purpose of the alternative provision to avoid an absurd use of the standard apportionment statute clearly could open the door to the abuse of the standard apportionment statute and an excessive need to apply Section 12-6-2320(A). Furthermore, to use the alternative apportionment provision as a means to avoid absurdity resulting from an interpretation of the standard apportionment provision that is not envisioned by the tax laws places upon the State a burden of policing tax returns that simply should not exist.

Importantly, it is not the amount of distortion that determines absurdity here. If it was, then there would exist an issue of material fact in this case, and indeed in every such case, as to the amount of distortion that would result from the inclusion of principal, and a hearing would be necessary to obtain facts whereby the degree of distortion could be measured so as to determine

³³ This statement does not include securities brokering.

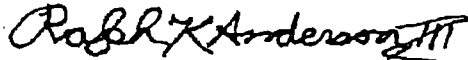
³⁴ Capital gains tax is imposed upon the sale of securities (assuming a profit is made from the sale). This tax is imposed on the profit, or "gains," made on the capital originally invested, not on the returned principal.

whether the results of principal inclusion would be absurd in this case. But such a case-by-case determination is not necessary where, as here, principal cannot, as a matter of law, be included in sales or gross receipts for purposes of the standard apportionment formula. Thus, no hearing is necessary on the gross receipts issue, and the Department's Motion for Summary Judgment as to this issue is therefore granted for the reasons set forth above.

ORDER

THEREFORE, IT IS HEREBY ORDERED that: (1) the Department's Motion for Summary Judgment with respect to the Timeliness Issue is **GRANTED**; (2) the Department's Motion for Summary Judgment with respect to the Apportionment Method Issue is **DENIED**; and (3) the Department's Motion for Summary Judgment with respect to the Gross Receipts Issue is **GRANTED**, and Duke Energy's Cross-Motion for Partial Summary Judgment as to this same issue is therefore **DENIED**.

IT IS SO ORDERED.



Ralph K. Anderson, III
Chief Administrative Law Judge

October 11, 2012
Columbia, South Carolina

STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

COPY

DUKE ENERGY CORPORATION,

Petitioner,

vs.

SOUTH CAROLINA DEPARTMENT OF
REVENUE,

Respondent.

Docket No.: 10-ALJ-17-0270-CC

DUKE ENERGY'S MOTION FOR
RECONSIDERATION OF THE COURT'S
FINAL ORDER AND DECISION

INTRODUCTION

Pursuant to Rule 29(D) of the Rules of Procedure for the South Carolina Administrative Law Court and Rule 59(e) of the South Carolina Rules of Civil Procedure, Duke Energy Corporation ("Duke Energy") respectfully requests that this Court reconsider its Final Order and Decision of November 2, 2012 ("Final Order"), which ruled that during the tax years 1994 through 2001 ("Periods at Issue") Duke Energy was not entitled to apportion its income to South Carolina based on the single-factor apportionment method and affirmed the South Carolina Department of Revenue's ("Department") Determination with respect to the same issue. A copy of the Final Order is attached as Exhibit A. This motion is based on the grounds that this Court failed to consider certain evidence and arguments presented, and overlooked, misinterpreted, or failed to apply South Carolina law.

FACTUAL AND PROCEDURAL BACKGROUND

In 2002, Duke Energy filed South Carolina amended corporate income tax returns for the Periods at Issue. On its original returns, Duke Energy erroneously apportioned its income to South Carolina based on the multi-factor apportionment method applicable to taxpayers dealing

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in tangible personal property. On the amended returns, Duke Energy corrected that error and apportioned its income based on the single-factor gross-receipts apportionment methodology applicable to service providers. The amended returns resulted in refund claims.

The South Carolina Department of Revenue ("Department") issued a Determination denying Duke Energy's refund claims and Duke Energy appealed the Department's Determination by filing a request for a contested case hearing before this Court.

Subsequently, the Department filed a Motion for Summary Judgment ("Department's Motion") asking this Court to rule, *inter alia*, that Duke Energy is not entitled to use the single-factor gross-receipts apportionment method because the South Carolina Supreme Court has held that Duke Energy manufactures electricity. Duke Energy filed a Reply to the Department's Motion ("Duke Energy's Reply") asking the Court to deny the Department's Motion because Duke Energy is not a manufacturer and rule, *inter alia*, that there were material facts in dispute regarding whether electricity is a service or tangible personal property.

A hearing on the Department's Motion and Duke Energy's Reply was held on June 26, 2012. At the hearing, each party presented arguments in support of its position regarding the issue.

On August 9, 2012, the Court entered its Order in the summary judgment proceeding denying the Department's Motion and concluding that:

Based on the record, I find that genuine issues of material fact exist necessitating an evidentiary hearing as to whether Duke Energy, based on its activities within the State, falls under Section 12-6-2250 as a "manufactur[er]," or whether Duke Energy is a seller of services, or otherwise falls under none of the above-categories, and is therefore required to apportion its income to South Carolina based on the single-factor gross-receipts apportionment formula pursuant to Section 12-6-2290 (applicable to tax years after 1995)/ Section 12-7-1190 (applicable to tax years prior to 1996).

On August 27, 2012, the parties filed pre-trial briefs. A hearing was held before this Court on September 5 and 6, 2012. On October 10, 2012, each party submitted a proposed final order and decision. On November 2, 2012, this Court entered its Final Order denying Duke Energy's claims for refund of corporate income taxes for the Periods at Issue and affirming the Department's Determination that Duke Energy cannot apportion its income based on the single-factor gross-receipts apportionment method.

For the reasons discussed below, Duke Energy respectfully moves this Court to vacate its Final Order and issue an order ruling that Duke Energy is entitled to apportion its income based on the single-factor gross-receipts method and granting Duke Energy's claims for refund of South Carolina corporate income taxes for the Periods at Issue.

STANDARD OF REVIEW

Rule 29(D) of the Rules of Procedure for the South Carolina Administrative Law Court and Rule 59(e) of the South Carolina Rules of Civil Procedure, provide that the Court may grant a motion for reconsideration as a means to correct alleged errors, reconsider a possible misapprehension of an earlier argument, or revisit a previously raised argument. *Elam v. S. Carolina Dep't of Transp.*, 361 S.C. 9, 22, 602 S.E.2d 772, 779 (2004). As set forth below, this motion should be granted.

ARGUMENT AND CITATION OF AUTHORITY

This Court has failed to consider certain fact and arguments, made erroneous factual findings, failed to make certain factual findings, and misinterpreted or misapplied South Carolina law as follows:

1. The Court correctly concluded that “[c]learly, providing electricity is Duke Energy’s ‘primary business.’” (Final Order at 4.) However, the Court erred in finding that Duke Energy “*further*s its primary business by owning and operating transmission and distribution assets in South Carolina and North Carolina.” *Id.* (Emphasis added.) Indeed, Duke Energy has introduced sufficient evidence that shows that its primary business *includes* the generation, transmission and distribution of electricity and the Court failed to make a factual finding to that effect. In fact, the Court itself acknowledges that the generation, transmission,

and distribution processes are interconnected.” (Final Order at 6, 10 fn11.)
2. The Court improperly disregarded factual evidence that during the Periods at Issue Duke Energy was subject to the regulation of the South Carolina Public Services Commission which “regulates the rates and *services*” of public utilities. (Duke Energy’s Pre-Trial Brief at 3.)
3. The Court improperly disregarded factual evidence that during the periods at Issue Duke Energy was subject to the regulation of the Federal Energy Regulatory Commission which is responsible for the “rates and *services*” of public utilities. (Duke Energy’s Pre-Trial Brief at 3.)
4. The Court improperly disregarded the fact that Duke Energy’s annual reports filed with the Securities and Exchange Commission provide that Duke Energy’s primary operations in South Carolina consist of its franchise electric *service* business and that Duke Energy conducts itself as a *service* provider. (Duke Energy’s Pre-Trial Brief at 19.)
5. The Court erred in finding that the profits from the flat-rate and capacity charges were not a significant portion of Duke Energy’s profit from the sale of electricity during the Tax Periods

at Issue, when in fact, Duke Energy presented evidence that a significant portion of Duke Energy's receipts consist of capacity charges. (Final Order at 4.)

6. The Court erred in finding that the process of generating electricity is the same process employed since the early 20th century, when in fact, both Duke Energy's and the Department's expert witnesses agreed that that process has changed. (Final Order at 5, 15).
7. The Court erred in finding that Duke Energy's generation of electricity using natural gas, wind and solar, "appear to be much less significant" than other methods. (Final Order at 5, fn 5.)
8. The Court erred in finding that Duke Energy's purchase of electricity from other electric utilities "appear[s] to be much less significant," when in fact, Duke Energy has presented evidence that doing so is an integral and necessary part of its primary business. (Final Order at 5, fn. 5.)
9. The Court improperly ignored that the Department had conceded, in its Determination denying Duke Energy's refund claims, and its Pre-Hearing Statement, that Duke Energy provides a service. (Duke Energy's Pre-Trial Brief at 4, 5.)
10. The Court failed to consider the legislative history of Sections 12-6-2250 (and its predecessor Section 12-7-1120) and 12-6-2290 (and its predecessor Section 12-7-1190), as well as guidance issued by the Department on the same topic, brought to the Court's attention in Duke Energy's Pre-Trial Brief, which clearly state that to be a manufacturer, a taxpayer needs to be dealing in tangible personal property. (Duke Energy's Pre-Trial Brief at 6.) Specifically, the statutes' legislative history and the Department's guidance provide that the multi-factor apportionment formula is designed for taxpayers dealing in tangible personal property (such as manufacturers) whereas the single-factor gross-receipts formula is designed

for taxpayers who do not deal in tangible personal property, such as service businesses.

(Duke Energy's Pre-Trial Brief at 6.)

11. The Court erred in disregarding the testimony of Duke Energy's expert witness, Prof.

Papapolymerou, regarding whether one can feel electricity. (Final Order at 7.) Indeed, the Court acknowledges that "Duke Energy presented valid instances in which a person may not feel electricity;" however the Court erroneously concludes that "it is possible to feel electricity, and that electricity can be touched," without pointing to any evidence in support

for its conclusion. *Id.*

12. The Court erred in finding that Duke Energy produces electrical charge, when in fact, Duke Energy's expert witness testified that electrical charge is the physical property of matter, such as an electron, and both the Department's and Duke Energy's expert witnesses agree that Duke Energy does not create electrons, as they simply exist in the conductors (metal). (Final Order at 7.) The Department's and Duke Energy's expert witnesses also agree the Duke Energy does not provide electrons to its customers.

13. The Court failed to consider both parties' expert witnesses' testimony that Duke Energy does not create the electrons residing in the power lines, and that the provision of electricity is not the transfer of electrons to the customers. (Duke Energy's Proposed Final Order and Decision at 11.)

14. The Court erred in making a factual finding that electricity can be created, felt, stored or consumed and is a tangible product with identifiable physical characteristics, when in fact, Duke Energy has presented evidence to the contrary, the Department has conceded that Duke Energy is a service provider and both the Department's and Duke Energy's experts agree that electricity is a service. (Final Order at 7, 23.)

15. The Court erred in disregarding Duke Energy's expert witness's testimony regarding the nature of electricity.
16. The Court erred in disregarding the Department's expert witness's testimony that Duke Energy provides a service.
17. The Court erred in holding that "No other electrical utilities challenged that position [that electric utilities were manufacturers]" when there was no evidence in the record to that effect. (Final Oder at 8.)
-
18. The Court erroneously concluded that the Department has a longstanding policy of treating electric utilities as manufacturers for purposes of corporate income tax apportionment, when in fact, the only evidence presented by the Department is an audit manual which was never published or otherwise distributed outside of the Department, and the Department's auditor testified that the Department has never issued a memorandum or other guidance, or promulgated a rule or regulation, evidencing the Department's alleged long-standing policy of treating power companies as manufacturers for South Carolina corporate income tax purposes. (Final Order at 10.)
19. The Court gave improper deference to the Department's alleged long-standing policy of treating electric utilities as manufacturers for South Carolina income tax purposes and failed to consider Duke Energy's argument that a court should give no such deference when there has been no prior known interpretation and when such interpretation is entirely contrary to the statute or regulation. (Final Order at 9-10)
20. The Court gave improper deference to the Department's alleged long-standing policy of treating electric utilities as manufacturers for South Carolina income tax purposes and failed to consider Duke Energy's argument that the audit manual – the only document that

memorializes the so-called long-standing policy – is a mere agency guideline, and the South Carolina Supreme Court recently ruled that an agency guideline is entitled to no deference. (Final Order at 9-10) (Duke Energy's Proposed Final Order and Decision at 22.)

21. The Court erroneously concluded that because Duke Energy filed its tax returns using the multi-factor apportionment formula over the course of 23 years, "the returns were filed in accordance with the policies and filing requirements promulgated by the Department."

(Final Order 10-11). Duke Energy presented evidence that in filing its original corporate

income tax returns, it incorrectly used the multi-factor apportionment formula. Duke Energy also presented evidence that it occasionally has to amend its state income tax returns to correct errors that may be omitted or report federal income tax adjustments.

22. The Court erroneously concluded that *Columbia Ry., Gas & Elec. Co. v. Query*, 134 S.C. 319, 132 S.E. 611 (1926), was decided in the income tax context, when in fact, the case involved the South Carolina Manufacturer's Tax Act and the Court itself acknowledges that the tax at issue in the case "was a license tax." (Final Order at 11, 14.)

23. The Court erred in holding that the Department, in S.C. Tax Comm'n Decision P-D-532, 1985 WL 192777 (Apr. 11, 1985), ruled that the property tax assessment ratio for electric utilities should be 6% (as opposed to 10.5% applicable to the personal property of non-manufacturing entities) when Section 12-43-220(a)(1) clearly states that "[a]ll real and personal property owned by or leased to manufacturers *and utilities* and used by the manufacturer or *utility* in the conduct of business must be taxed on an assessment equal to ten and one-half percent of the fair market value of the property." (Final Oder at 11.) (Emphasis added.)

24. The Court erred in concluding that the terms "goods and materials" contained in Section 12-6-2250(a) "reflect[] that the Legislature intended to cover not just manufacturing but all activities that a business could perform in regards to a *product* prior to making that *product* available to its customers," when in fact, (1) Section 12-6-2250(a) has no mention of the term "product;" (2) both parties' experts agree that electricity is not a material; (3) Duke Energy presented ample evidence showing that electricity is not tangible personal property or a good; and (4) the Department has not presented any evidence to show that electricity is a good or material. (Final Order at 12, 17, 21.)
25. The Court improperly applied the Webster's definitions of "manufacturing" and erroneously concluded that Duke Energy "makes" or "produces" "something," when in fact, Duke Energy's expert testified that electricity cannot be created or destroyed and the Department has not presented any evidence to the contrary. (Final Order at 13).
26. The Court erred in finding that "the evidence in this case establishes that Duke Energy is a manufacturer," when in so concluding the Court defined "manufacturing" as "the act or process of producing something" and when Duke Energy has presented evidence that it is not producing anything because electricity cannot be created or destroyed. (Final Order at 16.)
27. The Court improperly considered cases from other states decided in tax contexts *other than income tax* holding that the generation of electricity is manufacturing, while, at the same time, it failed to consider *more recent* decisions from other jurisdictions decided in the *corporate income tax context* which hold that the provision of electricity is a service and not manufacturing. (Final Order at 15, fn 19.)
28. The Court erred in making a factual finding that Duke Energy "cannot produce or deliver electricity to consumers in the absence of any one of these parts [- generation, transmission,

and distribution,]" when in fact, Duke Energy presented evidence that, as a necessary part of its business, it routinely purchases electricity from other electric utilities which it then provides to its customers. (Final Order at 16, 17.)

29. The Court erroneously reasoned that because electricity can be measured, generating electricity is manufacturing, when in fact, Duke Energy presented evidence that it also provides electricity on a fixed-fee basis and the Department's expert testified that electricity provided on a fixed-fee basis is a service. (Final Order at 17.) In any event, as stated in Duke energy's Pre-Trial Brief and Proposed Order, measurability is not an indication of whether electricity is manufacturing (time and IQ can be measured).

30. The Court erroneously concluded that Duke Energy cannot "provide" electric service "without the existence of electricity, and the electricity that Duke Energy provides cannot exist without first being produced, or manufactured," when Duke Energy's expert witness testified that electricity cannot be created or destroyed, and therefore cannot be produced. (Final Order at 18.)

31. The Court failed to consider testimony by Duke Energy's witness that the Standard Industry Classification System, which was the predecessor of the North American Industry Classification System (NAICS) and was in effect during the Periods at Issue, classified electric utilities and manufacturers in two separate categories, having two different codes, and that as an electric utility, Duke Energy was required to use the code applicable to the electric utilities classification, i.e., 4911. (Final Order at 19.)

32. The Court made an erroneous finding that "services typically are not measured by the quantity of the product consumed and are not delivered to or measured by mathematical calculations regarding the nature of the services." (Final Order at 19.) Telecommunications

providers provide services and measure the quantity of their product – telephone minutes or units of data (Internet). Telecommunications providers and law firms provide their services based on mathematical calculations (minutes/hours of service).

33. The Court made an erroneous finding when it concluded that “any electromagnetic field results from the electric current created by the generator.” (Final Order at 20.) As Duke Energy’s witness testified, electric current is the intensity of the electromagnetic field – it is one of the several properties of the electromagnetic field – and thus cannot be produced.
-
34. The Court made an erroneous finding and failed to consider evidence presented by Duke Energy when it concluded that “substantially all, if not all, of the electricity provided by Duke Energy is priced at some level based on quantity.” (Final Order at 20). Duke Energy presented ample evidence showing that it provides part of its services on a fixed-fee basis which is not measured or quantified before it is provided to its customers.
35. The Court improperly discounted the similarities between the electricity provided by a telecommunications company and the electricity provided by Duke Energy, when in fact, both provide the same electricity.
36. The Court failed to consider the definition of “manufacturing” in other contexts of the South Carolina Income Tax, as brought to the Court’s attention in Duke Energy’s Pre-Trial Brief (Duke Energy’s Pre-Trial Brief at 16), in interpreting the meaning of manufacturer for corporate income tax apportionment purposes, while it relied on the definition of “tangible personal property” for sales tax purpose in determining whether electricity is tangible personal property in the income tax context. (Final Order at 22-23.)
37. The Court improperly ignored the definition of “manufacturing” contained in the Income Tax Act, Jobs Tax Credit provisions, Section 12-6-3360(M)(8), which defines a “manufacturing

facility" as "an establishment where *tangible* personal property is produced or assembled."

(Final Order at 13.) (Duke Energy's Pre-Trial Brief at 16.)

38. The Court erred in holding that "manufacturing" is defined as "the act of processing or producing something." (Final Order at 16.) Law firms which produce legal work would be considered a manufacturer under this definition.

39. The Court erred in holding that Duke Energy is a manufacturer because it charges its customers based on quantity and cannot produce unlimited quantities. (Final Order at 17.)

Law firms charge based upon quantity (hours worked) and cannot produce unlimited quantities.

40. The Court's construction of "manufacturer" for income tax purposes violates the "cardinal rule of statutory construction ... [that] where the statute's language is plain, unambiguous, and conveys a clear, definite meaning, the rules of statutory construction are not needed and the court has no right to impose another meaning," and if any ambiguities exist, "the taxpayer should receive the benefit in case of doubt." (Duke Energy's Pre-Trial Brief at 11.)

41. The Court erred in finding that the generation of electricity is a form of processing raw materials used to create energy when Duke Energy presented uncontroverted evidence that electricity (or energy) cannot be created. (Final Order at 22.)

42. The Court erred in concluding that it must look to Section 12-36-60 which addressed "tangible personal property" for sales tax purposes in order to interpret the term "corporeal" used in the definition of "tangible property" codified in Section 12-6-30(11) for income tax purposes because the sales tax definition has no mention of the term "corporeal." (Final Order at 22.)

43. The Court erred in relying on the sales tax definition of "tangible personal property" in Section 12-36-60 in determining whether electricity is tangible or a service for income tax purposes because the South Carolina Income Tax Act contains a specific definition of "tangible property." (Final Order at 22.) Moreover, the Court's analysis violates the "cardinal rule of statutory construction ... [that] where the statute's language is plain, unambiguous, and conveys a clear, definite meaning, the rules of statutory construction are not needed and the court has no right to impose another meaning," and if any ambiguities exist, "the taxpayer should receive the benefit in case of doubt." (Duke Energy's Pre-Trial Brief at 11.)
44. The Court erred in concluding that electricity is tangible personal property based on the first sentence of the sales tax definition of "tangible personal property" in Section 12-36-60, because the second sentence of the definition specifically states that the term "tangible personal property" includes "intangibles or services including ... electricity." (Final Order at 23.) The Court's interpretation of the definition renders the second part of the definition of the term meaningless in violation of the South Carolina's canons of statutory construction.
45. The Court misinterpreted the sales tax definition of "tangible personal property" in Section 12-36-60, because there the South Carolina Legislature specifically chose to define "services and intangibles, including ... sales of electricity" as tangible personal property, something the Legislature did not do in the income tax context. (Final Order at 23.)
46. The Court misinterpreting *Consolidated Hydro S.E., Inc. v. S.C. Dep't of Revenue & Taxation*, No. 95-ALJ-17-0634, 1996 WL 909155 (S.C. Admin. L.J. Div. May 13, 1996). *Consolidated Hydro* simply held that a company engaged in the provision of electricity, similar to Duke Energy, is engaged in the provision of a service. The *Consolidated Hydro*

court recognized that for sales tax purposes, the Legislature specifically chose to define sales of electricity as "tangible personal property." However, the court did not apply the sales tax definition of that term in the license tax context because the Legislature had not defined "services and intangibles, including ... sales of electricity" as "tangible personal property" for license tax purposes. (Final Order at 24.)

47. The Court erred in relying on Section 16-13-380, regarding the theft of electrical services, when there is similarly a criminal statute for stealing trade secrets, Sections 39-8-20, et. seq.,

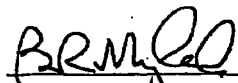
and cable TV services, Sections 16-11-810 et. seq. (Final Order at 24, fn. 29.) The Theft of Cable Television Service Act includes no less than six separate criminal provisions (Sections 16-11-820, -825, -830, -835, -840, -845) for the theft of "cable television *service*," which defined in Section 16-11-815. Section 39-8-90 makes it a crime to steal or wrongfully appropriate trade secrets, which are defined in Section 39-8-20(5) as information including a formula, pattern, compilation, method, system, or process which derives economic value from not being generally known to the public and are subject to efforts to maintain its security. Trade secrets clearly include pure intangibles.

48. The Court erred in holding that electricity is a tangible product because it can be measured, felt, stored and consumed, when in fact intangibles such as sunlight, wind, and gravity are all subject to the same. (Final Order at 25.)
49. The Court erroneously concluded that Duke Energy's evidence was insufficient to establish that more than 50 percent of its gross receipts were derived from activities not covered in Section 12-6-2250, when in fact, Duke Energy presented ample evidence to make such a showing. (Final Order at 26-27).

50. The Court fails to consider Duke Energy's argument that Duke Energy's 1977 Restated Charter is of little use in deciding whether Duke Energy is engaged in manufacturing. (Pre-trial Brief at 22.)

For all of the above reasons, and for the reasons stated in Duke Energy's Pre-trial Brief and Proposed Final Order and Decision, which are hereby incorporated by reference, Duke Energy respectfully moves this Court to vacate its Final Order and issue an order ruling that Duke Energy is entitled to apportion its income based on the single-factor gross-receipts method and granting Duke Energy's claims for refund of South Carolina corporate income taxes for the Periods at Issue.

RESPECTFULLY SUBMITTED,



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Attorneys for Petitioner Duke Energy Corporation

Exhibit A

**STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT**

Duke Energy Corporation,	)	
	)	Docket No. 10-ALJ-17-0270-CC
Petitioner,	)	
	)	
vs.	)	FINAL ORDER AND DECISION
	)	
South Carolina Department of Revenue,	)	
	)	
Respondent.	)	

Appearances:

For the Petitioners: Burnet R. Maybank, III, Esq.; Eric S. Tresh, Esq.; Jeffrey A. Friedman, Esq.; and Maria M. Todorova, Esq.

For the Respondent: Tracey C. Green, Esq.; John W. Roberts, Esq.; Harry Hancock, Esq.; and J. Abraham Gutting, Esq.

STATEMENT OF THE CASE

This matter comes before the Administrative Law Court (ALC or Court) following Duke Energy Corporation's (Duke Energy) request for a contested case hearing under S.C. Code Ann. § 12-60-460 (Supp. 2006). Duke Energy is contesting the Determination of the South Carolina Department of Revenue (Department) denying Duke Energy's claim for a refund of South Carolina corporate income taxes for the tax years 1994 through 2001 (Tax Periods at Issue).¹ Duke Energy asserts that it is a service provider and thus is required to apportion its income to South Carolina on the basis of the single-factor gross-receipts apportionment formula. A hearing was held before this Court on September 5 and 6, 2012.

LEGAL ISSUES RAISED

The following issue is raised in this proceeding: Whether Duke Energy, based on its activities within the State of South Carolina, falls under Section 12-6-2250 as a "manufactur[er]" or some other category listed in 12-6-2250, or whether Duke Energy is required to apportion its

¹ Duke Energy originally sought refunds for the tax years 1978 through 2001. On October 11, 2012, this Court ruled that Duke Energy's refund claims for the tax years 1978 through 1993 are untimely. Thus, Duke Energy's refund claims for 1978-1993 are not before the Court at this time.

FILED

November 2, 2012

SC ADMIN. LAW COURT

income to South Carolina based on the single-factor gross-receipts apportionment formula pursuant to Section 12-6-2290.²

STIPULATIONS OF FACT

At the hearing into this matter and pursuant to ALC Rule 25(C), the parties entered the following written stipulations of fact into the Record:

Preliminary Definitions

1. "Gross-receipts apportionment formula" refers to South Carolina's method of income apportionment prescribed under S.C. Code Ann. § 12-6-2290 and former S.C. Code Ann. § 12-7-1190.
2. "Multi-factor apportionment formula" refers to South Carolina's method of income apportionment prescribed under S.C. Code Ann. § 12-6-2250 and former S.C. Code Ann. § 12-7-1140.
3. "Petitioner" means Duke Energy Corporation (formerly known as Duke Power Company) and any predecessor or successor and any other entity owned by Duke Energy Corporation.
4. "Respondent" means the South Carolina Department of Revenue.
5. "1978-2001 tax periods" means the Petitioner's tax years 1978 through 2001, all of which were reported on a calendar-year basis.

The Parties

6. Respondent is an administrative Cabinet-level agency of the State of South Carolina responsible for administering and enforcing the State's revenue laws.

² In my Amended Order Granting Summary Judgment in Part and Denying Summary Judgment in Part, I stated the issue presently before the Court as follows: "whether Duke Energy, based on its activities within the State, falls under Section 12-6-2250 as a "manufactur[er]," or whether Duke Energy is a seller of services, or otherwise falls under none of the above-categories, and is therefore required to apportion its income to South Carolina based on the single-factor gross-receipts apportionment formula" This statement of the issue contains the conclusory phrase "is a seller of services, or otherwise falls under none of the above categories." This phrase erroneously presupposes that a seller of services could not be included in Section 12-6-2250. However, as will be discussed in more detail later, sales of electricity, though considered a service for certain tax purposes, has also been considered "tangible personal property," for those same tax purposes. Therefore, electricity could be considered a service and still be tangible personal property under Section 12-6-2250. The error of excluding "seller of services" from Section 12-6-2250 in the statement of the issue, however, did not affect the need to have a hearing on the present issue because there is a genuine issue of material fact as to the nature of Duke Energy's status for purposes of Sections 12-6-2250, -2290 based on its business activities.

7. Petitioner is, and was during the 1978-2001 tax periods, engaged in the generation, transmission, distribution, and sale of electricity in portions of North Carolina and South Carolina.
8. The Parties stipulated to Petitioner's restated corporate charters filed with the North Carolina Secretary of State on July 26, 1977, October 6, 1993, and June 18, 1997.
9. The Parties stipulated to Petitioner's Form 10-Ks for the 1978-2001 tax periods.
10. During the 1978-2001 tax periods, Petitioner was regulated by the South Carolina Public Service Commission (Commission) as an "electric utility" pursuant to Title 58-27-10(7).

Procedural History

11. Petitioner timely filed its South Carolina corporate income tax returns (including license tax returns) for the 1978-2001 tax periods.
12. On its originally-filed South Carolina corporate income tax returns for the tax periods 1978-2001, Petitioner filed using the multi-factor apportionment formula.
13. On December 12, 2002, Petitioner filed South Carolina amended corporate income tax returns for the 1978-2001 tax periods seeking a refund of corporate income taxes plus applicable interest ("1978-2001 Refund Claims").
14. The Parties stipulated to Petitioner's South Carolina amended corporate income tax returns filed on December 12, 2002 for the 1978-2001 tax periods.
15. The 1978-2001 Refund Claims reflected use of the gross-receipts apportionment formula to apportion Petitioner's income to South Carolina.
16. On February 12, 2003, Respondent denied Petitioner's 1978-2001 Refund Claims.
17. On March 13, 2003, Petitioner timely appealed from the denial of its 1978-2001 Refund Claims.
18. On February 4, 2010, Respondent issued a Determination denying Petitioner's refund claims for tax periods 1978-2001.
19. On March 3, 2010, Petitioner timely filed a Request for Contested Case Hearing with the Clerk's Office of the South Carolina Administrative Law Court in Columbia, South Carolina contesting the Determination.
20. Petitioner and Respondent timely filed their Prehearing Statements and Amended Prehearing Statements.

FINDINGS OF FACT

Having observed the witnesses and exhibits presented at the hearing and taking into consideration the burden of persuasion and the credibility of the witnesses, I make the following additional findings of fact by a preponderance of the evidence:

Duke Energy Business Operations

Duke Energy is engaged in the business of generation, transmission, distribution, and sale of electricity in portions of both North Carolina and South Carolina. Clearly, providing electricity is Duke Energy's "primary business." Duke Energy also furthers its primary business by owning and operating transmission and distribution assets in South Carolina as well as in North Carolina.

Duke Energy sells electricity on both a metered and flat-fee basis. Under the flat-fee plan, Duke Energy provides electricity for outdoor lighting at a fixed price.³ The metered service plan is based on usage, i.e., the electricity provided by Duke Energy is read by a meter and billed to the customer on the basis of usage during the billing period. Regardless of the service plan, a portion of each Duke Energy customer's service charge recovers Duke Energy's costs associated with maintaining the infrastructure that Duke Energy uses to provide electric service. This charge is known as a capacity charge and is billed to the customer as part of the monthly service charge, even if the customer does not use electricity in a given month. Nevertheless, however the profits from the flat-rate or capacity charges are perceived, those charges were not a significant portion of Duke Energy's profit from the sale of electricity during the Tax Periods at Issue.⁴

Production of Electricity

Duke Energy operates plants in both South Carolina and North Carolina to produce electricity. In South Carolina, Duke Energy has two nuclear power plants, four coal power

³ Although Duke Energy introduced evidence regarding the fact that it charges a flat fee for outdoor lighting, that does not negate the fact that the vast majority of the electricity delivered by Duke Energy is sold based on quantity consumed. Moreover, the time period for which outdoor lighting operates is controlled by use of a photocell, and Duke Energy has information to make estimates regarding variables in the timing to determine a pricing for the outdoor lighting.

⁴ Mr. Dhiaa Jamil did testify that a portion of a customer's bill is a flat fee for a capacity charge, but he also testified that he did not know the rate or level at which that fee is imposed—other than that it is less than \$100—and, in fact, ultimately testified "that's really not my area." The Court concludes that this testimony does not assist Duke Energy in meeting its burden of proof.

plants, three hydroelectric power plants, and several oil or gas power plants.⁵ The electricity that is produced and consumed by its customers is created at Duke Energy generation facilities. A generator is a "mechanical device" that uses mechanical energy to produce electric energy or, as it is more commonly known, electricity. Generators have been used to produce electricity in substantially the same manner for over 100 years. Many, though not all, of Duke Energy's generation facilities use a turbine driven by steam power to turn the generator. Although the sources or inputs (e.g., coal, uranium, water) used at these different types of generation facilities may vary, all use a generator to produce electricity. The result, however, is the same: Duke Energy employs a mechanical device to produce and generate electricity using the same process employed since the early 20th century.

Duke Energy nonetheless offered evidence that the production of electricity does not create anything. Rather, Duke Energy avers it is doing nothing more than providing access to "the electromagnetic field." However, Duke Energy produces that electromagnetic field. Duke Energy's own witness testified that, "in layman's terms," electromagnetic field is electric current," and that any electromagnetic field results from the electric current created by the generator. No matter what moniker used to describe the product produced by Duke Energy, the electric current that generates that field, or even the field itself, is produced through a mechanical process run by Duke Energy.

Distribution and Sale of the Electricity

The process by which Duke Energy generates or produces electricity does not end at the generator. The generator is obviously connected to the transmission and distribution network. That network consists of transmission and distribution lines, which are conductors made of copper, towers and poles, and transformers. During the transmission and distribution process, the transformers process the electricity by "stepping up" and "stepping down" the voltage of the electricity. By "stepping up" the voltage, Duke Energy is able to transmit the electrical current at a low current. The "step up" process is done in order to efficiently deliver electricity by reducing line loss, which is the loss to Duke Energy of a quantity of electricity as heat during the transmission and distribution processes.

⁵ Duke Energy also produces electricity using natural gas, wind, and solar. Duke Energy also occasionally purchases electricity from other electric utilities. However, these methods of producing or acquiring electricity appear to be much less significant than the methods indicated above.

Ultimately, electricity must be delivered at the specified voltage so that it can be used by customers in their homes and businesses. Typically, electricity is not usable by a customer unless it is at 120 volts, although sometimes it is delivered at 220 volts. Whatever the required voltage, it is necessary to ensure that the electricity delivered to a customer is "stepped down" to the usable voltage, a process that is done close to where the electricity is eventually used by the customer.

Most customers of Duke Energy obtain the electricity after it passes through a meter. More specifically, by activating a switch, which creates a load and completes a circuit, the electricity passes through the customer's meter and operates the device. Duke Energy measures the amount of electricity consumed by each customer (usually in term of kilowatts) and then charges the consumer for the quantity used/consumed.⁶ Moreover, electricity is not a useable product unless it is delivered to customers at precise specifications. Prior to delivery of the electricity to the consumer through the meter, the electric utility owns the electricity, which is not delivered for sale until it is processed into a form usable by a consumer. This typically occurs closer to the customer's business or home.

Duke Energy compared the provision of electricity to the provision of telecommunication services—both cellular and landline. However, unlike Duke Energy, telecommunication companies do not generate electricity but, instead, only use electricity purchased from electric utilities. Furthermore, Duke Energy delivers to its customers a quantifiable product that is produced by Duke Energy. In contrast, telecommunications companies transmit communications or intelligence produced or created by one customer to another through a system operated by electricity purchased from utilities like Duke Energy. Additionally, cellular telephone providers use radio technology to transfer information between two locations. The frequencies and strengths of telecommunications waves are vastly different than the frequencies and strengths of electricity.

In sum, the generation, transmission, and distribution processes are interconnected. Duke Energy cannot produce or deliver electricity to consumers in the absence of any one of these parts, each of which provide an essential aspect of Duke Energy's process for producing,

⁶ Aside from the fact that electricity is measured by quantity, the nature of electricity, as a product, is further demonstrated by the fact that electric current is a flow of charges or charged particles, the rate of which is measured in amperes.

transmitting, and delivering electricity to customers. Moreover, Duke Energy presented no evidence that supports separating its electric transmission and distribution processes from its generation processes and, in fact, described the whole process as a "very elaborate system." Indeed, Mr. Jamil testified that each of the processes employed by Duke Energy is "used to produce electricity."⁷

Physical Nature of Electricity

Electricity is a physical product with physical characteristics. Regarding whether electricity may be sensed by humans, I do not find that the testimony presented by either party was probative as expert testimony. In other words, there was no evidence that the witnesses possessed "knowledge, skill, experience, training, or education" regarding the effect of electrical stimulation upon the human physiology justifying this Court to accept their opinion as expert testimony. Nevertheless, based upon the evidence, I find that it is possible to feel electricity, and thus electricity can be touched. Though Duke Energy presented valid instances in which a person may not feel electricity, that does not discount the instances when it can be felt.

Moreover, even if I were to find Duke Energy's evidence regarding this matter to be probative, I am unconvinced. Duke Energy's expert witness, Mr. Ioannis Papapolymerou, explained that a human cannot feel electricity but only the impact of the electricity. Though I find the proposed nuances between the feeling of an object itself and the feeling of the impact from the object to be the makings of an interesting theoretical debate, I find no considerable distinction between the two and therefore find that electricity can be felt by humans.

Electricity can also be stored. Concerning this issue, Duke Energy characterized an electric charge as the source of electricity and as the physical property that is stored. The electrical charge is nonetheless a component of what is produced by Duke Energy.

In sum, Duke Energy takes raw materials (e.g., coal, uranium, water), uses those materials to power mechanical devices to produce a form of electricity that is usable and consumed by the public. Although electricity is unique, it is a tangible product with identifiable physical characteristics that may be created, measured, felt, stored, and consumed, and an electric utility may exercise ownership rights over it.

⁷ Additionally, Duke Energy introduced an exhibit listing the "Functions" of Duke Energy as "Production," "Transmissions," and "Distribution."

Department's Policy History

The Department and the Commission have a longstanding interpretation that electric utilities should be characterized as manufacturers for purposes of corporate income tax apportionment. Though the Department's policy was never set forth in any public document, it was memorialized in the foreign corporation training manual used by the Department's auditors. Joseph Southard, a retired auditor for the Department with over 25 years of experience, who conducted audits of several electric utilities, including Duke Energy, explained that the Department's policy was that electric utilities were manufacturers for purposes of the apportionment statute.

The Department also applied this policy consistently, and Duke Energy offered nothing to show otherwise. No other electric utilities challenged that position before Duke Energy filed its amended returns. In fact, Duke Energy filed its returns using the multi-factor apportionment formula for at least 23 years before filing the amended returns and challenging the policy in 2002.

CONCLUSIONS OF LAW

In determining the income tax due from Duke Energy, the Department apportioned Duke Energy's South Carolina income using the multi-factor apportionment formula of Section 12-6-2250. The Department argues that Duke Energy's principal business in South Carolina is manufacturing and that Section 12-6-2250 should therefore apply. Duke Energy, however, contends that its principal business in South Carolina is the provision of service to customers and that Section 12-6-2290 should thus apply.

Burden of Proof

Because Duke Energy is challenging a determination by the Department that it must apportion its income under section 12-6-2250, it has the burden of proof. See SCALCR 29(B); Ford v. Atl. Coast Line R. Co., 169 S.C. 41, 168 S.E. 143, 167 (1932) ("The general rule is, in the absence of valid statutory enactment to the contrary, that the burden of proof rests upon him who has the affirmative of the issue and does not shift to the defendant even when aided, in the first instance, by a rebuttable presumption."); see also Anonymous v. State Bd. of Med. Exam'rs, 329 S.C. 371, 496 S.E.2d 17 (1998). This burden requires Duke Energy to prove that the Department's determination is wrong by a preponderance of the evidence. See, e.g., Janasik v. Fairway Oaks Villas Horizontal Prop. Regime, 307 S.C. 339, 346, 415 S.E.2d 384, 388 (1992)

("Findings of fact based upon a 'preponderance' of the evidence are those supported by the greatest 'weight, amount, credibility or truth' as reflected by the whole of the evidence before the court, or 'evidence which convinces as to its truth.'").

Apportionment of Income

The method of apportionment that a taxpayer must use depends upon the nature of the taxpayer's business in this State. Section 12-6-2250⁸ requires a taxpayer to apportion its multi-state income using the property, payroll, and sales factors if the taxpayer falls within the following definition:

A taxpayer whose principal business in this 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

S.C. Code Ann. § 12-6-2250.⁹ On the other hand, "[i]f the principal profits or income of a taxpayer are derived from sources other than those described in Section 12-6-2250," the taxpayer is required to use the single-factor gross-receipts apportionment formula. S.C. Code Ann. § 12-6-2290.¹⁰ Consequently, the issue that must be resolved for the Tax Periods at Issue is whether the Department erroneously determined that Duke Energy must apportion its income pursuant to Section 12-6-2250. After considering the evidence in the record and the pertinent legal authorities, I conclude that Duke Energy has failed to establish by the preponderance of the evidence that its principal business in South Carolina is not manufacturing or some other activity falling under Section 12-6-2250.

Agency Deference

The Department contends that in determining this issue the ALC must give its construction of Section 12-6-2250 deference. "An agency's long-standing interpretation of a statute is usually entitled to be given deference and should not be overruled by a reviewing court

⁸ Because the Tax Periods at Issue cover multiple years (1994-2001), a parenthetical date will not be used for the statutory citations.

⁹ Section 12-6-2250 during the Tax Periods at Issue required that the sales factor be double-weighted in calculation of the apportionment formula. This section was previously designated as section 12-7-1140, which was repealed in 1995. Prior to June 12, 1995, section 12-7-1140 provided a three-factor formula without the double-weighted sales factor.

¹⁰ Like section 12-6-2250, the predecessor of section 12-6-2290, S.C. Code § 12-7-1190, was repealed in 1995, but the language remained substantially the same. Section 12-6-2290 also excludes sources described in section 12-6-2310, but that statute references income earned by railroad companies, motor carriers, telephone service companies, pipeline companies, airline companies, and shipping lines, none of which are applicable in this case.

in the absence of cogent reasons. . . ." Media Gen. Commc'ns, Inc., and Media Gen. Broad. of S.C. Holdings, Inc. v. S.C. Dep't of Revenue, 388 S.C. 138, 149, 694 S.E.2d 525, 531 (2010) (citing Etiwan Fertilizer Co. v. S.C. Tax Comm'n, 217 S.C. 354, 360, 60 S.E.2d 682, 684 (1950)). In Etiwan, the Court further explained that: "[W]here the construction of the statute has been uniform for many years in administrative practice, and has been acquiesced in by the General Assembly for a long period of time, such construction is entitled to weight, and should not be overruled without cogent reasons." Etiwan, 217 S.C. at 359, 60 S.E.2d at 684. If the Department is entitled to deference, it is Duke Energy's burden to prove that the Department's policy is "arbitrary, discriminatory or unreasonable." Colonial Life & Acc. Ins. Co. v. S. Carolina Tax Comm'n, 248 S.C. 334, 339, 149 S.E.2d 777, 780 (1966) ("The Commission has the power and duty . . . to prescribe a method for arriving at a tax base which reasonably represents the proportion of the trade or business carried on within this State...and its determination thereabout will not be overthrown by the courts except upon a showing, absent here, that it is arbitrary, discriminatory or unreasonable") (internal quotation marks omitted); see also Vulcan, 342 S.C. at 496, 536 S.E.2d at 900; Etiwan, 217 S.C. at 359, 60 S.E.2d at 684. For the reasons set forth below, Duke Energy did not meet its burden in this regard.

The record shows that the Department and the Commission consistently have characterized electric utilities as manufacturers for purposes of corporate income tax apportionment.¹¹ Duke Energy filed its returns using the multi-factor apportionment formula for at least 23 years before filing the amended returns and challenging the policy in 2002, which reflects that Duke Energy was aware of the policy. And although a Duke Energy witness, Cooper Monroe,¹² testified that the original returns were filed in error, he also acknowledged that Duke Energy and accounting firms "in [his] experience" apply a review process before a tax return is filed. This long period of time in which Duke Energy filed returns using the multi-factor apportionment formula leads to the conclusion that the returns were filed in

¹¹ Duke Energy asserts that there is an inconsistency in the Department's audit manual in that service providers (those whose principal business is providing a service) have to apportion their income to South Carolina based on the single-factor gross-receipts apportionment method, while power companies must use the multi-factor apportionment formula. However, there is only an inconsistency if one adopts the premise that the generation, transmission, and distribution of electricity constitutes provision of service, or the premise that provision of service generates more profits or income than generation, transmission, and distribution of electricity, neither of which this Court adopts.

¹² Thomas Cooper Monroe, III is currently the Director of State and Local Tax for Duke Energy.

accordance with the policies and filing requirements promulgated by the Department and as understood by Duke Energy at the time the returns were originally filed.

Moreover, though the policy was not set forth in a publicly-issued advisory opinion, a decision of the Commission for property tax purposes supports the conclusion that the Department openly and consistently viewed electric utilities as manufacturers. In 1985, the Commission determined that "'X' Electric and Gas" was a manufacturer because the Supreme Court had held that its predecessor was a manufacturer in the Columbia Ry. decision. S.C. Tax Comm'n Decision P-D-532, 1985 WL 192777 (Apr. 11, 1985) (citing Columbia Ry., Gas & Elec. Co. v. Query, 134 S.C. 319, 152 S.E. 611, 612 (1926)). Although this ruling was rendered in the context of property taxes, it reflects a public position that the Department consistently applied the Columbia Ry., supra, and Duke Power, infra, decisions and consistently determined that electric utilities are manufacturers. The consistency of this policy is further evidenced by the fact that in P-D-532, the Department gave the electric utility the benefit of being a manufacturer by determining that its property-tax assessment ratio should be 6% as opposed to the 10.5% applicable to the personal property of non-manufacturing entities.¹³ More importantly, the South Carolina Supreme Court's decision in Columbia Ry., supra publicly reflects in the income-tax context the Department's position that those engaged sale of electricity are manufacturers. See also Duke Power Co. v. Bell, 156 S.C. 299, 152 S.E. 865 (1930) (recognizing the same position in the property-tax context). I find that though the notice to the General Assembly is traditionally given through a policy available to the public, the facts in this case meet the criteria envisioned in Etiwan. See also Whitner v. State, 328 S.C. 1, 6, 492 S.E.2d 777, 779 (1997) ("[T]here is a basic presumption that the legislature has knowledge of previous legislation as well as of judicial decisions construing that legislation when later statutes are enacted concerning related subjects.") (emphasis added). Nevertheless, whether or not the Department's position is given deference, I find that Duke Energy's principal business is manufacturing for the reasons given below.

¹³ Also, in 1970, the South Carolina Attorney General opined that the South Carolina Electric & Gas Company was a manufacturer and that any plant it used to produce electricity was a manufactory eligible for property tax exemptions. 1970 S.C. Op. Att'y Gen. 154, Op. No. 2909, 1970 WL 12192 (June 2, 1970). The basis for this ruling was the Columbia Ry. and Duke Power decisions.

Manufacturing

Duke Energy must apportion its multi-state income for the Periods at Issue pursuant to Section 12-6-2250 unless Duke Energy proves that its principal business within this State is not (1) "manufacturing"; or (2) "any form of collecting, buying, assembling, or processing goods and materials within this State"; or (3) "selling, distributing, or dealing in tangible personal property." Though Duke Energy suggests a contrary reading of this statute, the Legislature's use of the disjunction "or" following "manufacturing" in Section 12-6-2295(a)'s phrase "manufacturing or any form of collecting, buying, assembling, or processing goods and materials within this State" demonstrates that the term "manufacturing" is not dependent on, or modified by, the clause "any form of collecting, buying, assembling, or processing goods and materials within this State." Michau v. Georgetown County ex rel. S.C. Counties Workers Comp. Trust, 396 S.C. 589, 595, 723 S.E.2d 805, 808 (2012) ("[T]he 'use of the word 'or' in a statute 'is a disjunctive particle [sic] that marks an alternative.'" (citing K & A Acquisition Group, LLC v. Island Pointe, LLC, 383 S.C. 563, 580, 682 S.E.2d 252, 261 (2009))). This conclusion is supported by the statutory history, which reflects that the apportionment statute, when adopted, addressed only corporations "engaged in the business of manufacturing," 1927 S.C. Acts 1, No. 1, § 15(1),¹⁴ and that the latter clause of subsection (a) was added in 1946, 1946 S.C. Acts 1491, No. 553, § 3 (amending apportionment statute, then found in section 2451 of the 1942 Code, to apply to taxpayers whose "principal business ... in this State is manufacturing, or if it is any form of collecting, buying, selling, assembling or processing goods and materials within this State.") (emphasis added). Thus, inclusion of the phrase "or any form of collecting, buying, assembling, or processing goods and materials" after "manufacturing" in Section 12-6-2250(a) reflects that the Legislature intended to cover not just manufacturing but all activities that a business could perform in regards to a product prior to making that product available to its customers. See Charleston County Sch. Dist. v. State Budget and Control Bd., 313 S.C. 1, 5, 437 S.E.2d 6, 8 (1993) ("The cardinal rule of statutory construction is to ascertain and effectuate the intent of the legislature.").

Here, there is no dispute regarding several of the elements of Section 12-6-2250. It is undisputed that Duke Energy is a taxpayer required to file corporate income tax returns in this

¹⁴ This language remained the same in the apportionment statute enacted as Section 2451 in both the 1932 South Carolina Code of Laws and the 1942 South Carolina Code of Laws.

State. Similarly, it is undisputed that Duke Energy has multi-state income that must be apportioned. See S.C. Code Ann. § 12-6-2210(b). There is also no disagreement that Duke Energy is engaged in the business of generation, transmission, distribution, and sale of electricity in portions of both North Carolina and South Carolina. Mr. Dhiaa Jamil¹⁵ testified that providing electricity is Duke Energy's "primary business." To conduct its primary business, Duke Energy operates generation plants in both South Carolina and North Carolina.

Because "manufacturing" is not defined in the apportionment statutes, this Court must interpret it in accord with its usual and customary meaning. E.g., Travelscape, LLC v. S.C.

Dept. of Revenue, 391 S.C. 89, 99-100, 705 S.E.2d 28, 33-34 (2011). Merriam-Webster's

Dictionary presently defines "manufacture" as "the process of making wares by hand or by machinery especially when carried on systematically with division of labor." It further defines the term to include "productive industry using mechanical power and machinery" and "the act or process of producing something." See

<<http://www.merriam-webster.com/dictionary/manufacture>> (accessed October 18, 2012); see also Jennings v. Jennings, No. 27177 (Oct. 18, 2012) (Heam, J.) (referencing online Merriam-Webster's Dictionary for definition of a word).¹⁶ And in 1939, in holding that the generation of electricity is manufacturing, the Iowa Supreme Court referenced Webster's definition of manufacturing, which was "'to make by hand, by machinery, or by other agency; to work raw materials into forms for use; to produce mechanically.'" Winterfield, 285 N.W. at 224-25. Applying this definition, the court held that generating electricity is manufacturing. Id.

Our Supreme Court has also held on two different occasions that an electric utility that generates electricity is engaged in manufacturing. In Columbia Ry., the South Carolina Supreme Court held that a company engaged in the business of generating electricity was properly

¹⁵ Dhiaa M. Jamil, P.E., currently is the Executive Vice President of Nuclear Generation and the Chief Nuclear Officer for Duke Energy.

¹⁶ It is also worth noting that the current Merriam-Webster's definition of the term "ware," a term included in the definition of "manufacturing," includes manufactured goods. See <<http://www.merriam-webster.com/dictionary/ware>> (accessed October 18, 2012). Also, Merriam-Webster's current definition of "good" includes "something that has economic utility or satisfies an economic want" and "something manufactured or produced for sale." See <<http://www.merriam-webster.com/dictionary/good>> (accessed October 18, 2012). Thus, even if in Section 12-6-2250(a) "manufacturing" modified "goods," the electricity that Duke Energy generates, transmits, and distributes would be in accord with the common understanding of the term "manufactured good," and would therefore still satisfy Section 12-6-2250(a) under that alternative interpretation of the statute. Furthermore, Duke Energy has failed to prove by the preponderance of the evidence that the electricity it produces is not a good or that it is not manufactured.

considered a "manufacturer" for purposes of a statute that imposed a corporate income tax on "a corporation engaged in the business of manufacturing." 132 S.E. at 612 ("We do not think that there is any doubt that the appellant is engaged in the business of manufacturing gas and electricity"); see also State v. Broad River Power Co., 157 S.C. 1, 153 S.E. 537, 539 (1929) (noting that the Columbia Railway company built "a large plant for the manufacture of gas and electricity for sale to the public generally") (emphasis added).¹⁷ In a later case, reviewing a different statute, the Supreme Court held that Duke Power Co., a predecessor of Duke Energy, was entitled to claim a property tax exemption for manufactories—defined as a physical plant, or ~~a place or building, where manufacturing is carried on—because it was a manufacturer.~~ Duke Power, *supra*. The Court held that, based on Columbia Ry., Duke Power was engaged in manufacturing. *Id.*, 152 S.E. at 868 ("If a company engaged in the generation of electricity is a 'manufacturer' for the purposes of a Statute imposing a tax, the plan or structure wherein the process of generating such electricity is carried on is a manufactory for the purposes of a tax exempting statute."). Thus, although Columbia Ry. considered the 1926 Manufacturer's Tax Act, the Duke Power decision reflects that the Court's holding that Duke Power was engaged in manufacturing was not limited to that statute.¹⁸

The Supreme Court's determination that two different electric utilities were engaged in manufacturing for purposes of two different tax statutes certainly supports the conclusion that electric utilities are engaged in manufacturing for purposes of other tax statutes, including the apportionment statute. This is especially so given the Supreme Court's holding that "the legislative classification [of the apportionment statute] ... should be liberally construed in favor of the inclusion of business to which the formula is appropriate." Hertz Corp. v. S. C. Tax Comm'n, 246 S.C. 92, 96, 142 S.E.2d 445, 447 (1965) (holding that taxpayer involved in renting

¹⁷ Notably, the 1927 Century Dictionary defined manufacture as "the making of goods or wares by ... machinery, esp. on a large scale"

¹⁸ When the holding of Columbia Ry. is considered in light of the pertinent language from the Manufacturer's Tax Act at issue in that case, the application of that decision in this case becomes evident, especially in light of the absence of any distinction between Duke Energy's business in this State versus its business in North Carolina. Specifically, the Manufacturer's Tax Act provided that "every person, firm or corporation engaged in the business of manufacturing" was subject to the tax imposed on manufacturers. 1923 S.C. Acts 12, No. 21, §11-A. And although the tax at issue was a license tax on "the entire receipts," it was specifically imposed on "the business of manufacturing." Thus, the Columbia Ry. decision is based on a 1923 Act directed at manufacturers and uses the same language as the apportionment statute at issue in this case. Compare S.C. Code Ann. § 12-6-2250 (applying to "a taxpayer whose principal business in this State is ... manufacturing") with 1923 S.C. Acts 12, No. 21, §11-A (applying to a taxpayer "engaged in the business of manufacturing").

tangible personal property came within the predecessor to section 12-6-2250).¹⁹ The fact that the common definition of "manufacture" has remained constant from the time of the Columbia Railway and Duke Power decisions up to the present, and that definition is still applicable to Duke Energy's operations, further validates that Duke Energy is engaged in manufacturing electricity. In addition, Duke Energy generates, transmits, and distributes electricity in South Carolina using the same methods and principles employed during the era in which these cases were decided. Furthermore, Duke Energy's corporate charter for the Tax Periods at Issue retained the same language used in its original charter, which was considered pertinent by the ~~Supreme Court. Compare Duke Power, 152 S.E. at 867~~ (referencing charter granting authorization to Duke Power Company to "manufacture, generate, buy, sell, accumulate, store, transmit, furnish, and distribute electric current for light, heat, and power") with Restated Arts. Inc. Duke Power Co. (October 6, 1993) (authorizing company "[t]o manufacture, generate, buy, sell, accumulate, store, transmit, furnish and distribute electric current for light, heat and power") and Restated Arts. Inc. Duke Energy Corp. (June 18, 1997) (same). If the processes of generating, transmitting, and distributing electricity are the same today as those employed in 1926 and 1930, and if those processes constituted manufacturing for purposes of a tax statute during those years, then the generation of electricity constitutes manufacturing for purposes of a tax statute during the Tax Periods at Issue. Duke Energy therefore is engaged in the business of manufacturing in this State for purposes of Section 12-6-2250.

¹⁹ Although not binding here, courts in other states have held that generating or producing electricity is manufacturing, reflecting that a position such as that taken by the Department is reasonable. Some of these cases have cited Columbia Ry. and Duke Power as support for that holding. Curry v. Ala. Power Co., 8 So.2d 521, 525 (Ala. 1942) (citing Columbia Ry. and Duke Power decisions in holding that generating electricity is manufacturing); State ex rel. Winterfield v. Hardin County Rural Elec. Co-op., 285 N.W. 219, 226 (Iowa 1939) (citing Columbia Ry. and Duke Power and stating: "The great preponderance of authority as evidenced by the decisions of the courts supports the proposition that one engaged in the generation of electricity is engaged in a manufacturing or mechanical business"). Other states simply have held that generating electricity is manufacturing. E.g., Pub. Serv. Co. v. Dep't of Rev., 10CA1026, 2011 WL 4089971 (Colo. Ct. App. Sept. 15, 2011) (generating electricity is manufacturing); Davis v. Gulf Power Corp., 799 So. 2d 298, 301 (Fla. Dist. Ct. App. 2001) (generation of electricity is a manufacturing process and electricity is tangible personal property); Minn. Power & Light Co. v. Pers. Prop. Tax. Taxing Dist., City of Fraser, Sch. Dist. No. 695, 182 N.W.2d 685, 692 (Minn. 1970) (producing electricity is manufacturing); Bd. of Assessors of Holyoke v. State Tax Comm'n., 244 N.E.2d 287, 289 (Mass. 1969) (same); Morley v. Brown & Root, 239 S.W.2d 1012, 1015 (Ark. 1951); (same); City of Louisville ex rel. v. Howard, 208 S.W.2d 522, 526 (Ky. 1947) ("The generation of electricity is manufacturing."); Chicago, M., St. P. & P.R. Co. v. Custer County, 32 P.2d 8, 9 (Mont. 1934) (holding that "the electricity which exists in nature is not subject to use; the current which will cause the wheels of industry to turn, or will light a city, must be produced by the employment of labor and machinery and is, therefore, generally said to be manufactured"); see also Comm'r of Revenue v. Houghton Mifflin Co., 666 N.E.2d 491, 495 (Mass. 1996) (rejecting contention that process does not involve manufacturing merely because its inputs are not tangible).

Moreover, the evidence in this case establishes that Duke Energy is a manufacturer. As explained above, "manufacturing" is defined as "the act or process of producing something." Duke Energy's witnesses repeatedly characterized its business as "producing" electricity. Duke Energy is thus engaged in the "act or process of producing [electricity]." Electricity that is produced by Duke Energy and consumed by its customers is created at a generation facility.²⁰ The process that occurs at a generation facility reflects that it is manufacturing. Each of these facilities contains at least one generator. A generator is a "fairly large machine" and "mechanical device" that uses mechanical energy to produce electric energy or, as it is more ~~commonly known, electricity. The generator creates an electric current that is processed through~~ the transmission and distribution systems. Generators have been used to produce electricity in substantially the same manner for over 100 years. Many, though not all, of Duke Energy's generation facilities use a turbine driven by steam power to turn the generator.²¹ The result, however, is the same: Duke Energy employs a mechanical device to produce and generate electricity using the same process employed since the early 20th century. Thus, Duke Energy's generation facilities are, as recognized by our Supreme Court, locations at which manufacturing occurs. See Duke Power, 152 S.E. at 868.

Furthermore, though they disagree as to the ultimate characterization of electricity production, Duke Energy and the Department seem to agree that Duke Energy's generation, transmission, and distribution processes are interconnected. In other words, Duke Energy cannot produce or deliver electricity to consumers in the absence of any one of these parts, each of which provide an essential aspect of Duke Energy's process for producing, transmitting, and delivering electricity to customers. The generator is connected to the transmission system, which

²⁰ Mr. Jamil testified that Duke Energy could provide electricity even without its generation assets. That is, Duke Energy apparently contends that it could sell electricity without producing it and, thus, that it is not a manufacturer for that reason. But the fact that an entity could resell a product to customers without actually manufacturing that product does not mean that the entity that did produce the product is not a manufacturer. And a determination of whether any entity that simply resells electricity is a manufacturer is beyond the scope of this proceeding.

In any event, the record does not support any characterization of Duke Energy as a mere reseller of electricity for the Periods at Issue. The evidence reflects that Duke Energy generated virtually all of the electricity it sold during the Periods at Issue. [Duke Energy 1994-2001 Forms 10-K (showing "Electric Energy Generated" as being nearly equal to "Electric Energy Sold" each year) [Pet'r Hr'g Exs. 49-B-17 through 49-B-24].] Mr. Monroe testified that Duke Energy generates most of the electricity that it sells. Thus, the fact that other utilities might simply resell electricity without generating it, and that Duke Energy could do the same thing, is immaterial because the record reflects that Duke Energy does generate electricity; and it is therefore a manufacturer.

²¹ The design of a turbine used in these generation facilities has not significantly changed since the early 20th century.

is connected to the distribution system. As noted above, Duke Energy requires all three processes to provide electricity to its customers. Prior to distribution of the electricity to the consumer through the meter, the electric utility owns and continues to process the electricity, which is not in a form usable by a consumer prior to its distribution through the electric meter. Cf. Priest v. Brown, 302 S.C. 405, 411, 396 S.E.2d 638, 641 (Ct. App. 1990) (in affirming a trial court decision that strict liability was not applicable against electric utility for a person who was electrocuted and died after touching a downed distribution line, the court noted an affidavit that stating that "the electricity through these lines was of such a high voltage that it was not in a form immediately usable by a consumer" and held that the facts of this case alone suggest the electricity had not been placed into the stream of commerce . . .").

In addition, though electricity is a unique product with unique characteristics required by consumers, it is clearly produced by Duke Energy and distributed in keeping the required needs of the customers. Although there was testimony in the record regarding other forms of energy, such as kinetic and mechanical energy, those other energy forms are different than electricity or electric energy and do not meet the vast majority of consumer needs in homes and businesses. And this conclusion is not changed by the fact that electricity may exist in nature (e.g., a lightning strike is the effect of an electromagnetic field on air molecules), because that electricity is not usable by electric utilities or consumers in that form. See, e.g., Chicago, M., St. P. & P.R. Co. v. Custer County, 32 P.2d 8, 9 (Mont. 1934) (holding that "the electricity which exists in nature is not subject to use; the current which will cause the wheels of industry to turn, or will light a city, must be produced by the employment of labor and machinery and is, therefore, generally said to be manufactured . . .") (internal citations omitted).

The nature of electricity as a product produced by Duke Energy is further evidenced by the fact that Duke Energy does not have access to unlimited quantities of electricity because its ability to generate electricity is limited by the capacity of its generators. The fact that Duke Energy charges for electricity based on quantity, and cannot provide unlimited electricity, further supports the conclusion that generating electricity is manufacturing. Measuring electricity by quantity is the same as measuring any product by quantity, and the limitation on the quantity of electricity that can be produced is analogous to the limitation imposed on any manufacturer by the capacity of the machines employed in the manufacturing process.

In sum, the electricity consumed by Duke Energy's customers is the product of Duke Energy's generation of that electricity. Duke Energy employs an interconnected process of producing and delivering electricity that is substantially the same as that used by any entity that creates and produces a product using an assembly line and then charges the customer based on the amount of the product sold. A generator is analogous to any machine used by a manufacturer to produce a product for sale; the transmission and distribution systems are like the assembly line process used by a manufacturer to further refine and develop the product; and the customer is charged by the quantity of the product consumed.²² The fact that Duke Energy charges for electricity based on quantity, and cannot provide unlimited electricity, further supports the conclusion that generating electricity is manufacturing. Measuring electricity by quantity is the same as measuring any product by quantity, and the limitation on the quantity of electricity that can be produced is analogous to the limitation imposed on any manufacturer by the capacity of the machines employed in the manufacturing process.

Characterization of the Provision of Electricity as a Service

Duke Energy contends that its "principal business in South Carolina is the provision of electric service to its customers." (Emphasis added). At the outset, Duke Energy cannot "provide" electric service without the existence of electricity, and the electricity that Duke Energy provides cannot exist without first being produced, or manufactured. As to "electric service," the South Carolina Income Tax Act does not define the word "service." And the usage of the word "service" in the South Carolina Income Tax Act does not provide any guidance as to the term's meaning, as it is used in a variety of connotations.²³ Looking then to Merriam-

²² The Court recognizes that the transmission and distribution processes could be interpreted as being separate from manufacturing. Transmission of electricity, for instance, could fall under "processing" in Section 12-6-2250(a), because the electricity must be "stepped up" and "stepped down" in order to regulate the voltage so that line loss can be minimized. Also, for the electricity to be usable by the customers, it must be further manipulated to meet the specifications of the devices used by the customers. Likewise, distribution could be interpreted as "distributing . . . tangible personal property within this State," under Section 12-6-2250(b). This interpretation would require a determination of electricity's tangibility and whether electricity is "personal property." The Court will explain in more detail later in the decision why electricity is tangible personal property. At any rate, because the generation, transmission, and distribution of electricity are equally-necessary components of the business of providing electric power, Duke Energy's business activities seemingly could fall under Section 12-6-2250(a), or (a) and (b); but under either scenario, Duke Energy's principal business involves activities that are covered in Section 12-6-2250, which is the issue here.

²³ See, e.g., S.C. Code Ann. §§ 12-6-550 ("service" in the context of providing of water supply and sewage disposal); 12-6-1120 ("service" in the context of the National Guard and Armed Forces reserve components); 12-6-1720(1)(b) ("service" in the context of apportionment of nonresident individuals, trusts, estates, or beneficiaries); 12-6-2850 ("services" in the context of foreign trading receipts); and 12-6-3450 ("services" in the context of an

Webster's Dictionary, "service" is defined as "useful labor that does not produce a tangible commodity" or "a facility supplying some public demand." Merriam-Webster Online Dictionary, www.merriam-webster.com (last visited October 18, 2012). Because this Court, for reasons that will be discussed more fully below, finds electricity to be a tangible commodity, Duke Energy has failed to demonstrate that its "provision" of electricity to customers is a service under the first definition. As to the second definition, Duke Energy is doubtless a service because it is "a facility supplying some public demand." However, there is nothing in this definition of service that includes or excludes manufacturing. In this case, though, Duke Energy ~~supplies to its customers electricity that it has already manufactured, thus demonstrating that the~~ two activities are separate. Furthermore, a company need not be a manufacturer to be a provider of electric service. Indeed, Section 12-6-2250 itself draws the distinction between manufacturing, et. al., of goods and materials in (a) and selling, distributing, or dealing of tangible personal property in (b).

Duke Energy nevertheless contends that it is not manufacturing because it is not creating anything and is doing nothing more than "provid[ing] access to the electromagnetic field." However, Duke Energy fails to recognize that it produces/manufactures the product for which any service is provided. Electricity is a product that moves and is processed through the transmission and distribution systems and is delivered to the customer at the specifications required by that customer. Services typically are not measured by the quantity of the product consumed and are not delivered to or measured by mathematical calculations regarding the nature of the services.²⁴ In fact, even Duke Energy recognizes that it is producing something. Not even Duke Energy's own representations to the public refer to "providing access to the electromagnetic field." Moreover, Duke Energy's own witness testified that, "in layman's

employee's services for an employer in determining qualification for an income tax credit for persons terminated from employment as a result of the closing or realignment of a federal military installation).

²⁴ Duke Energy further supported its services argument through testimony that it currently is classified as a utility, not a manufacturer, for purposes of the North American Industry Classification System (NAICS), and that it classifies itself as a utility when filing its federal income tax returns. However, the specific NAICS and federal income tax return instructions referenced by the witness pertained to years after the Periods at Issue and, thus, do not assist in determining Duke Energy's character for the Periods at Issue. In any event, neither the NAICS nor the federal classification for data purposes answers the question of whether Duke Energy is a manufacturer for purposes of Section 12-6-2250. Similarly, Duke Energy's references to itself as a provider of services in various publications do not resolve the question of whether it falls within Section 12-6-2250.

terms," electromagnetic field is electric current," and that any electromagnetic field results from the electric current created by the generator.

Duke Energy also offered evidence that it charges a flat fee for outdoor lighting. That evidence does not negate the fact that the vast majority of the electricity delivered by Duke Energy is sold based on quantity consumed. Moreover, as Mr. Jamil testified, the time period for which outdoor lighting operates is controlled by use of a photocell, and Duke Energy is able to estimate the variables in the timing to determine a pricing for the outdoor lighting. Rather, as Mr. Monroe testified, Duke Energy sells electricity on a metered basis involving electricity ~~flowing through a meter and the company "read[ing] the meter periodically and send[ing] a bill~~ to the customer." Thus, substantially all, if not all, of the electricity provided by Duke Energy is priced at some level based on quantity.

Duke Energy finally attempts to compare the above-described processes to the provision of telecommunication services—both cellular and landline—but that comparison is unconvincing. Unlike Duke Energy, telecommunication companies do not generate or produce electricity, but instead only use electricity purchased from electric utilities. Moreover, the evidence in the record demonstrates the differences between a telecommunication service and Duke Energy's production and sale of electricity. First, Duke Energy delivers to its customers a quantifiable product that is produced by Duke Energy. In contrast, telecommunication companies transmit communication or intelligence from one customer to another through a system operated by electricity purchased from utilities like Duke Energy. In essence, the telecommunications company simply transports intelligence produced or created by one of its customers. The purpose of Duke Energy's business is thus to generate and provide electric energy while the purpose of a telecommunication company's business is to convey information. Because Duke Energy produces electricity for use by its customers at an appropriate specification, and telecommunications companies transport intelligence produced by its customers using electricity produced by an electric utility, I find that the purported comparison to a telecommunications company does not undermine the reasonableness of the Department's policy that Duke Energy is a manufacturer.

Conclusion

In sum, to conclude that Duke Energy provides a service rather than manufactures electricity would require a determination that the term "manufacturing" in Section 12-6-2250

means something different than “producing” (or “generating,” for that matter), a term generally used synonymously with “manufacturing.” Moreover, a person or entity providing services is not commonly understood to be “producing” services, and it is not commonly said that a company which generates and sells electricity is merely providing a service by “provid[ing] access to the electromagnetic field.” This is especially so given that the electric current that generates that field, or even the field itself, is generated through an asset-intensive process maintained and operated by Duke Energy. Finally, though it is conceivable that the processes of transmitting and distributing are not part of manufacturing, Duke Energy presented no evidence that would support separation of its electric transmission and distribution processes from its generation process and, in fact, described the whole process as a “very elaborate system.” In short, as Mr. Jamil testified, “you need all three.” In any event, even if the Court were to draw such a distinction, it would prove inconsequential to the outcome here because all three activities – generation, transmission, and distribution – fall under Section 12-6-2250.²⁵

Processing Goods and Materials within this State

Alternatively, the evidence reflects that Duke Energy comes within Section 12-6-2250 because its generation, transmission, and distribution of electricity constitutes “any form of...processing goods and materials within this state.” S.C. Code Ann. § 12-6-2250(a) (emphasis added). The use of “any form” in the statute reflects a legislative intent that the language be applied as broadly as possible and, concomitantly, a legislative preference for using the three-factor formula whenever possible. Hertz Corp., 246 S.C. at 96, 142 S.E.2d at 447 (identifying “any form” in predecessor to section 12-6-2250 as “broad language”). The evidence introduced by both parties shows that generating electricity is a form of processing raw materials

²⁵ Duke Energy also contends that electricity is not manufacturing because it is not tangible. Duke Energy’s conclusion is based upon two premises: 1) electricity is an intangible material and 2) the term “manufacturing” in Section 12-6-2250 is limited solely to tangible goods or materials. As to the first premise, this Court, for reasons discussed later in the text, finds that electricity Duke Energy produces is tangible. The Court, therefore, need not address the remaining premise. However, even if this Court found that electricity was intangible, this would not necessarily prevent electricity from being a manufactured product. Merriam-Webster’s definition of “manufacture” includes “the process of making wares by machinery” See <http://www.merriam-webster.com/dictionary/manufacture> (accessed October 19, 2012). Merriam-Webster’s definition of “wares” includes “intangible items” that are “marketable commodit[ies].” See <http://www.merriam-webster.com/dictionary/ware> (accessed October 19, 2012). Adopting this view of electricity, the Massachusetts Supreme Court, in Westinghouse Broad. Co., Inc. v. Comm’r of Revenue, noted that the proposition that an electric power company “may not be denied manufacturing status merely because its end product is intangible” . . . “conformed to [its] view that the production of electricity may entail manufacture” 382 Mass. 354, 358, 416 N.E.2d 191, 193 (1981).

such as coal, water, or nuclear fuel. These items are goods and materials.²⁶ These goods are processed and used to create energy to turn a generator either directly or indirectly, which constitutes "any form" of processing of those inputs in the generation process and, thus, falls within the statute.

Selling, Distributing, or Dealing in Tangible Personal Property

Duke Energy also comes within Section 12-6-2250 because its business constitutes "selling, distributing, or dealing in tangible personal property." Duke Energy, however, argues that it is a seller of services and therefore cannot be a seller, distributor, or dealer of tangible personal property. ~~The premise of this argument is that electric service is not tangible personal~~ property. Duke Energy also argues that the definition of "tangible personal property" should not be taken from S.C. Code Ann. § 12-36-60, which sets forth the definition of "tangible personal property" for sales and use tax purposes. Rather, Duke Energy urges the Court to adopt the definition of "tangible property" set forth in the Income Tax Act, specifically S.C. Code Ann. § 12-6-30(11).

I agree that because "tangible personal property" in Section 12-6-2250(b) is part of the Income Tax Act, the definition for "tangible property" under the Income Tax Act must be used. S.C. Code Ann. § 12-6-30(11) defines "tangible property" as "includ[ing] . . . corporeal personal property but does not include money, bank deposits, shares of stock, bonds, credits, evidence of debt, choses in action, or evidence of an interest in property." (Emphasis added). However, the term "corporeal" is not defined in the statute. "Where the legislature elects not to define a term in a statute, the courts will interpret the term in accord with its usual and customary meaning. In construing a statute, a court may consider legislation which deals with the same subject matter." Adoptive Parents v. Biological Parents, 315 S.C. 535, 543, 446 S.E.2d 404, 409 (1994).

Because Section 12-36-60(11) also addresses "tangible personal property" for tax purposes, this Court may therefore look to it for guidance and clarity as to the meaning of "corporeal" for tangibility purposes. See Floyd v. Nationwide Mut. Ins. Co., 367 S.C. 253, 626 S.E.2d 6 (2005) ("The true guide to statutory construction is not the phraseology of an isolated

²⁶ Merriam-Webster's definition of a "good" is "something that has economic utility or satisfies an economic want." See <<http://www.merriam-webster.com/dictionary/good>> (accessed October 19, 2012). It defines "material" as "the elements, constituents, or substances of which something is composed or can be made." See <<http://www.merriam-webster.com/dictionary/material>> (accessed October 19, 2012).

section or provision, but the language of the statute as a whole considered in light of its manifest purpose.”); TNS Mills, Inc. v. S.C. Dept. of Revenue, 331 S.C. 611, 620, 503 S.E.2d 471, 476 (1998) (“In construing statutory language, the statute must be read as a whole, and sections which are part of the same general statutory law must be construed together and each one given effect.”). The Court recognizes that Sections 12-6-30(11) and 12-36-60 differ with respect to their treatment of intangible personal property. Specifically, Section 12-36-60 includes as tangible personal property services and intangibles, whereas Section 12-6-30(11) excludes intangibles altogether; indeed, “intangible property” is separately defined under Section 12-6-30(12). ~~However, the specific exclusions from tangible personal property (which are not at issue here)~~ are nearly identical in both definitions,²⁷ and Section 12-36-60 provides a more specific definition of tangible personal property that also coincides with the general understanding of the term “corporeal” used Section 12-6-30(11) – “personal property which may be seen, weighed, measured, felt, touched, or which is in any other manner perceptible to the senses.”²⁸

Applying to the facts of this case the definition of tangible property found in Section 12-6-30(11) together with the general definition of tangible personal property given in the first sentence of Section 12-36-60, I conclude that electricity is tangible personal property. Electricity is a product delivered to customers at certain precise specifications. The evidence also established that electricity is a physical product with physical characteristics; that the electric charge associated with electricity is a physical property of matter; that it certainly is possible to feel electricity’s impact in the body; that electricity can be moved, manipulated, and stored, characteristics further suggesting the tangible nature of electricity; that the electric charge, which Duke Energy witnesses testified is the source of electricity, can be stored; and that electricity is a fungible product that is sold in quantifiable amounts. Further, in South Carolina, it is something that can be stolen and, thus, is subject to ownership rights. See S.C. Code Ann. § 16-13-380

²⁷ Section 12-6-30(11) excludes from tangible property the following: “money, bank deposits, shares of stock, bonds, credits, evidences of debt, choses in action, or evidences of an interest in property.” Similarly, Section 12-36-60 excludes from tangible personal property the following: “stocks, notes, bonds, mortgages, or other evidences of debt . . . [and] transmission of computer database information by a cooperative service when the database information has been assembled by and for the exclusive use of the members of the cooperative service.”

²⁸ The American Heritage College Dictionary 311 (3d ed. 1993) defines “corporeal” as “[o]f a material nature; tangible.” See also Black’s Law Dictionary 394, 1336, 1592 (9th ed. 2009) (defining “corporeal” as “tangible”; “tangible” as “corporeal”; and “corporeal personal property” as “tangible personal property”).

("Theft of electric current").²⁹ Also, because the electricity sold, distributed, or dealt by Duke Energy is used by its customers in amounts, duration, and purposes chosen by its customers, i.e., it is under the customers' control after it is distributed to them, the electricity becomes personal property of the customers.

On one hand, Duke Energy does not wish to apply the definition of "tangible personal property" under Section 12-36-60; but nonetheless, Duke Energy wishes to use Section 12-36-60 to establish its sales of electricity as a service. It argues that if Section 12-36-60 applied, "the Department's view on the characterization of electricity based on the sales and use tax definition was long ago rejected by this Court in Consolidated Hydro S.E., Inc. v. S.C. Dep't of Revenue & Taxation, No. 95-ALJ-17-0634, 1996 WL 909155 (S.C. Admin. L.J. Div. May 13, 1996) (Lee, A.L.J.)." In that case, the taxpayer owned and operated several hydro-electric power generation facilities in South Carolina and was engaged in the business of production and sale of electricity. Citing the definition of "tangible personal property" set forth in S.C. Code Ann. § 12-36-60, relating to sales and use taxes, the company argued that it did not provide or sell a "service" and was therefore not subject to additional license taxes. The court in that case disagreed, concluding that "while electricity is included in [12-36-60] discussing the application of sales tax on the sale of tangible personal property, the sale of electricity is specifically recognized and defined as a service."

First, that decision has no precedential value and is thus not binding on this Court. Secondly, that decision merely concluded that the taxpayer was providing a service and thus subject to a license fee under then-Section 12-19-110. However, Section 12-19-110 was imposed "[i]n addition to . . . all other license taxes and fees or taxes of whatever kind" Section 12-19-110 did not prevent the application to the taxpayer of any other tax laws, including those that implicated "tangible personal property." Thus, even if this Court were to adopt the position that the sale of electricity was merely a service, the sale of electricity would simply be a service that does not fall "within the meaning of the general definition" of "tangible personal property" set forth in the first sentence of Section 12-36-60, Consolidated Hydro *4. But that

²⁹ Interestingly, this statute references the theft of electricity by any "person who . . . has no contract, agreement, license, or permission with or from any person authorized to manufacture, sell, or use electricity for the purpose of light, heat, or power." S.C. Code Ann. § 16-13-380 (emphasis added); see also S.C. Code Ann. § 16-13-390 (prohibiting the wrongful use of electricity by a person who has a "contract, agreement, license or permission, oral or written, with or from any person authorized to manufacture, sell or use electricity for the purpose of light, heat or power.") (emphasis added).

service would still be considered tangible personal property, as set forth in the second sentence; and it would therefore be subject to tax laws imposed by other statutes upon tangible personal property, just as it was subject to license fees imposed by other statutes upon services. Thus, even under Duke Energy's theory, it would still be considered to be "selling, distributing, or dealing in tangible personal property within this State" for corporate income tax apportionment purposes under Section 12-6-2250.

Furthermore, as previously mentioned, Merriam-Webster's Dictionary defines "service" as "useful labor that does not produce a tangible commodity" or "a facility supplying some public demand." Merriam-Webster Online Dictionary, www.merriam-webster.com (last visited October 29, 2012). Because, for the reasons given above, I find that electricity is a tangible commodity manufactured by Duke Energy, Duke Energy has failed to demonstrate that its "provision" of electricity to customers is a service under the first definition. As to the second definition, Duke Energy is doubtless a service because it is "a facility supplying some public demand." However, there is nothing in this definition of service that is determinative of tangibility or intangibility. Indeed, the actual provision of a product may be intangible, while the product itself is tangible.³⁰ And, to reiterate, even if this Court were to look to the sales or use tax definition of "tangible personal property" under Section 12-36-60, sales of electricity, though considered services under that statute, are considered tangible personal property. See S.C. Code Ann. § 12-36-60 ("Tangible personal property" . . . also includes . . . sales of electricity . . ."). Thus, even looking to the sales or use tax definition, and considering the sale of electricity to be a service, the sale of electricity would still be tangible personal property for tax purposes.³¹

In sum, although it admittedly is unique, electricity is a tangible product with identifiable physical characteristics that may be created, measured, felt, stored, and consumed, and an electric utility may exercise ownership rights over it. And even if the Court were to consider the

³⁰ See, e.g., *Pub. Serv. Co. v. Dep't of Revenue*, __P.3d__, 2011 WL 4089971 (Colo. Ct. App. 2011) ("There is . . . Colorado authority that electricity is both a product and a service").

³¹ Duke Energy points out that several other states have treated the provision of electricity as something other than tangible personal property. These states would include: North Carolina, Oregon, California, and Massachusetts. However, this Court finds more persuasive the decisions of those states that hold that electricity is tangible personal property. See e.g., *Exelon Corp. v. Dep't of Revenue*, 234 Ill.2d 266, 917 N.E.2d 899 (2009); *Tucson Elec. Power Co. v. Ariz. Dep't of Revenue*, 170 Ariz. 145, 822 P.2d 498 (Ct. App. 1991). Moreover, Duke Energy acknowledges that other states, in contexts other than income tax, have ruled that the sale of electricity is the sale of tangible personal property. See, e.g., *Davis v. Gulf Power Corp.*, 799 So. 2d 298, 301 (Fla. Dist. Ct. App. 2001) (property tax); *Texas E. Transmission Corp. v. Benson*, 480 S.W.2d 905, 908 (Tenn. 1972) (sales tax); *S. Natural Gas Co. v. State*, 261 Ala. 222, 73 So. 2d 731 (1953) (use tax).

sale of electricity merely a service, it would still be considered tangible personal property for tax purposes. Therefore, Duke Energy also falls within Section 12-6-2250(b).

More-than-50-percent Test

Though Duke Energy, as the taxpayer, may engage in activities falling under Section 12-6-2250, Duke Energy may still apply the single-factor gross receipts apportionment method under Section 12-6-2290 if the principal amount of its profits or income is derived from activities other than those covered in Section 12-6-2250. However, Duke Energy, which was engaged in more than one line of business during the Tax Periods at Issue, has the burden of proving that its ~~principal business in this State was not from manufacturing, or any form of collecting, buying, assembling, or processing goods and materials within this State, or from selling, distributing, or~~ dealing in tangible personal property within this State. In making this "principal business" determination, South Carolina adopts a more-than-50-percent test. The Department's longstanding policy provides:

[W]hether a business is a service related industry can be made by comparing the gross receipts of the business derived from providing services to total gross receipts of the business. If over 50 percent of the gross receipts are from providing services, then the business would be service related. This method has been utilized by the [South Carolina Tax] [C]ommission in determining whether a multistate taxpayer is providing services and thus would utilize the gross receipts ratio to apportion its income.

Rev. Rul. No. RR-87-5 (S.C. Tax Comm'n Sept. 16, 1987). Thus, under the Department's policy, if more than 50 percent of a business's gross receipts are from providing services, then the business would be service-related and the taxpayer would be required to apportion its income to South Carolina using the single-factor gross-receipts apportionment method under S.C. Code Ann. § 12-6-2290. Otherwise, the business would have to apportion its income to South Carolina using the three-factor apportionment method under S.C. Code Ann. § 12-6-2250.

Here, Duke Energy presented testimony indicating that Duke Energy's principal business is the provision of electricity services because at all times during the Periods at Issue more than 50 percent Duke Energy's gross receipts were derived from the provision of electric services. However, in light of my findings that Duke Energy's generation, transmission, and distribution of electricity are activities falling within Section 12-6-2250, that electricity is tangible personal property, and that sales of electricity are sales of tangible personal property, I find Duke Energy's evidence insufficient to establish that more than 50 percent of Duke Energy's gross

receipts were derived from activities not covered in Section 12-6-2250. Indeed, Duke Energy introduced no evidence supporting any breakdown of its gross receipts from manufacturing, services, and/or any other activity.

Conclusion

After considering the evidence in the record and the pertinent legal authorities, I conclude that Duke Energy failed to establish by the preponderance of the evidence that its principal business in South Carolina is not manufacturing. This Court thus rejects Duke Energy's attempt to use the single-factor apportionment formula for tax years 1994-2001 instead of the multi-factor apportionment formula it used in its original corporate income tax returns.

ORDER

THEREFORE, IT IS HEREBY ORDERED that Duke Energy's claims for refunds with respect to its attempt to use the single-factor apportionment formula for the corporate income tax periods 1994-2001 are **DENIED** and the Department's Determination is **AFFIRMED**.

IT IS SO ORDERED.



Ralph K. Anderson, III
Chief Administrative Law Judge

November 2, 2012
Columbia, South Carolina

CERTIFICATE OF SERVICE

I, E. Harvin Belser Fair, hereby certify that I have this date served this Order upon all parties to this cause by depositing a copy hereof, in the United States mail, postage paid, in the Interagency Mail Service, or by electronic mail to the address provided by the party(ies) and/or their attorney(s).

E. Harvin Belser Fair

E. Harvin Belser Fair
Judicial Law Clerk

November 2, 2012
Columbia, South Carolina

NEXSEN|PRUET

January 2, 2013

Rick Reames III
Member
Admitted in SC

BY HAND DELIVERY

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

Re: Duke Energy Corporation v. South Carolina Department of Revenue
10-ALJ-17-0270-CC

Dear Ms. Kitchings:

Enclosed for filing is a Notice of Appeal in the above case. Also enclosed are the following:

Charleston
Charlotte
Columbia
Greensboro
Greenville
Hilton Head
Myrtle Beach
Raleigh

1. Proof of Service of the Notice of Appeal on the Respondent;
2. A copy of the Order (Exhibit A) which is to be challenged on appeal as well as the Reconsideration Order (Exhibit B); and
3. Our firm's check in the amount of \$100.00 for filing fee.

Please note that on October 9, 2012, the Appellant, Duke Energy previously filed a protective appeal in this matter. We anticipate moving to consolidate both appeals.

Please return one clocked copy to me via our courier. If you require anything further, please let me know.

Very truly yours,



Rick Reames III

RECEIVED

JAN 02 2013

SC Court of Appeals

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The Honorable Jenny Abbott Kitchings
January 2, 2013
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Enclosures

cc: The Honorable Ralph K. Anderson III
Harry Hancock
Milton Kimpson
John M. S. Hoefer
Tracey C. Green
John Roberts

THE STATE OF SOUTH CAROLINA
In The Court of Appeals

APPEAL FROM THE ADMINISTRATIVE LAW COURT

Ralph K. Anderson III, Administrative Law Judge

Case No. 10-ALJ-17-0270-CC

Duke Energy Corporation..... Appellant,

v.

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

NOTICE OF APPEAL

Duke Energy Corporation (hereinafter "Appellant") hereby appeals the following orders of the Honorable Ralph K. Anderson III of the Administrative Law Court ("ALC"): (1) Amended Final Order and Decision filed on December 4, 2012 ("Final Order"), a copy of which is attached hereto as Exhibit A; and (2) the ALC's Reconsideration Order filed on December 4, 2012, a copy of which is attached hereto as Exhibit B.

Thus, pursuant to ALC Rule 29(D)(4), this Notice of Appeal is timely filed within 30 days of the deemed denial of the Motion for Reconsideration.

RESPECTFULLY SUBMITTED,



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January 2, 2013

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Department of Revenue*

EXHIBIT A

**STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT**

Duke Energy Corporation,	)	
	)	Docket No. 10-ALJ-17-0270-CC
Petitioner,	)	
	)	
vs.	)	AMENDED FINAL ORDER
	)	AND DECISION
South Carolina Department of Revenue,	)	
	)	
Respondent.	)	
_____	)	

Appearances:

For the Petitioner: Burnet R. Maybank, III, Esq.; Eric S. Tresh, Esq.; Jeffrey A. Friedman, Esq.; and Maria M. Todorova, Esq.

For the Respondent: Tracey C. Green, Esq.; John W. Roberts, Esq.; Harry Hancock, Esq.; and J. Abraham Gutting, Esq.

STATEMENT OF THE CASE

This matter comes before the Administrative Law Court (ALC or Court) following Duke Energy Corporation's (Duke Energy) request for a contested case hearing under S.C. Code Ann. § 12-60-460 (Supp. 2006). Duke Energy is contesting the Determination of the South Carolina Department of Revenue (Department) denying Duke Energy's claim for a refund of South Carolina corporate income taxes for the tax years 1994 through 2001 (Tax Periods at Issue).¹ Duke Energy asserts that it is a service provider and thus is required to apportion its income to South Carolina on the basis of the single-factor gross-receipts apportionment formula. A hearing was held before this Court on September 5 and 6, 2012.

On November 2, 2012, this Court entered its Final Order and Decision denying Duke Energy's claims for refund of corporate income taxes for the Tax Periods at Issue and affirming the Department's Determination that Duke Energy cannot apportion its income based on the single-factor gross-receipts apportionment method. Duke Energy filed its Motion for Reconsideration of the Court's Final Order and Decision on November 13. On November 15,

¹ Duke Energy originally sought refunds for the tax years 1978 through 2001. On October 11, 2012, this Court ruled that Duke Energy's refund claims for the tax years 1978 through 1993 are untimely. Thus, Duke Energy's refund claims for 1978-1993 are not before the Court at this time.

FILED

December 4, 2012

SC ADMIN. LAW COURT

2012, the Department informed the Court that it was not going to file a response to Duke Energy's Motion for Reconsideration. After careful consideration of the arguments made by Duke Energy, the Court has amended its November 2, 2012 Final Order and Decision accordingly below.

LEGAL ISSUES RAISED

The following issue is raised in this proceeding: Whether Duke Energy, based on its activities within the State of South Carolina, falls under Section 12-6-2250 as a "manufactur[er]" or some other category listed in 12-6-2250, or whether Duke Energy is required to apportion its income to South Carolina based on the single-factor gross-receipts apportionment formula pursuant to Section 12-6-2290.²

STIPULATIONS OF FACT

At the hearing into this matter and pursuant to ALC Rule 25(C), the parties entered the following written stipulations of fact into the Record:

Preliminary Definitions

1. "Gross-receipts apportionment formula" refers to South Carolina's method of income apportionment prescribed under S.C. Code Ann. § 12-6-2290 and former S.C. Code Ann. § 12-7-1190.
2. "Multi-factor apportionment formula" refers to South Carolina's method of income apportionment prescribed under S.C. Code Ann. § 12-6-2250 and former S.C. Code Ann. § 12-7-1140.

² In my Amended Order Granting Summary Judgment in Part and Denying Summary Judgment in Part, I stated the issue presently before the Court as follows: "whether Duke Energy, based on its activities within the State, falls under Section 12-6-2250 as a "manufactur[er]," or whether Duke Energy is a seller of services, or otherwise falls under none of the above-categories, and is therefore required to apportion its income to South Carolina based on the single-factor gross-receipts apportionment formula" This statement of the issue contains the conclusory phrase "is a seller of services, or otherwise falls under none of the above categories." This phrase erroneously presupposes that a seller of services could not be included in Section 12-6-2250. However, as will be discussed in more detail later, sales of electricity, though considered a service for certain tax purposes, has also been considered "tangible personal property," for those same tax purposes. Therefore, electricity could be considered a service and still be tangible personal property under Section 12-6-2250. The error of excluding "seller of services" from Section 12-6-2250 in the statement of the issue, however, did not affect the need to have a hearing on the present issue because there is a genuine issue of material fact as to the nature of Duke Energy's status for purposes of Sections 12-6-2250, -2290 based on its business activities.

3. "Petitioner" means Duke Energy Corporation (formerly known as Duke Power Company) and any predecessor or successor and any other entity owned by Duke Energy Corporation.
4. "Respondent" means the South Carolina Department of Revenue.
5. "1978-2001 tax periods" means the Petitioner's tax years 1978 through 2001, all of which were reported on a calendar-year basis.

The Parties

6. Respondent is an administrative Cabinet-level agency of the State of South Carolina responsible for administering and enforcing the State's revenue laws.
7. Petitioner is, and was during the 1978-2001 tax periods, engaged in the generation, transmission, distribution, and sale of electricity in portions of North Carolina and South Carolina.
8. The Parties stipulated to Petitioner's restated corporate charters filed with the North Carolina Secretary of State on July 26, 1977, October 6, 1993, and June 18, 1997.
9. The Parties stipulated to Petitioner's Form 10-Ks for the 1978-2001 tax periods.
10. During the 1978-2001 tax periods, Petitioner was regulated by the South Carolina Public Service Commission (Commission) as an "electric utility" pursuant to Title 58-27-10(7).

Procedural History

11. Petitioner timely filed its South Carolina corporate income tax returns (including license tax returns) for the 1978-2001 tax periods.
12. On its originally-filed South Carolina corporate income tax returns for the tax periods 1978-2001, Petitioner filed using the multi-factor apportionment formula.
13. On December 12, 2002, Petitioner filed South Carolina amended corporate income tax returns for the 1978-2001 tax periods seeking a refund of corporate income taxes plus applicable interest ("1978-2001 Refund Claims").
14. The Parties stipulated to Petitioner's South Carolina amended corporate income tax returns filed on December 12, 2002 for the 1978-2001 tax periods.
15. The 1978-2001 Refund Claims reflected use of the gross-receipts apportionment formula to apportion Petitioner's income to South Carolina.
16. On February 12, 2003, Respondent denied Petitioner's 1978-2001 Refund Claims.

17. On March 13, 2003, Petitioner timely appealed from the denial of its 1978-2001 Refund Claims.
18. On February 4, 2010, Respondent issued a Determination denying Petitioner's refund claims for tax periods 1978-2001.
19. On March 3, 2010, Petitioner timely filed a Request for Contested Case Hearing with the Clerk's Office of the South Carolina Administrative Law Court in Columbia, South Carolina contesting the Determination.
20. Petitioner and Respondent timely filed their Prehearing Statements and Amended Prehearing Statements.

FINDINGS OF FACT

Having observed the witnesses and exhibits presented at the hearing and taking into consideration the burden of persuasion and the credibility of the witnesses, I make the following additional findings of fact by a preponderance of the evidence:

Duke Energy Business Operations

Duke Energy is engaged in the business of generation, transmission, distribution, and sale of electricity in portions of both North Carolina and South Carolina. Duke Energy owns and operates generation, transmission, and distribution assets in South Carolina and North Carolina. Clearly, providing electricity is Duke Energy's "primary business."

Duke Energy sells electricity on both a metered and flat-fee basis. Under the flat-fee plan, Duke Energy provides electricity for outdoor lighting at a fixed price.³ The metered service plan is based on usage, i.e., the electricity provided by Duke Energy is read by a meter and billed to the customer on the basis of usage during the billing period. Regardless of the service plan, a portion of each Duke Energy customer's service charge recovers Duke Energy's costs associated with maintaining the infrastructure that Duke Energy uses to provide electric service. This charge is known as a capacity charge and is billed to the customer as part of the monthly service charge, even if the customer does not use electricity in a given month. Nevertheless, however the profits from the flat-rate or capacity charges are perceived, those

³ Although Duke Energy introduced evidence regarding the fact that it charges a flat fee for outdoor lighting, that does not negate the fact that the vast majority of the electricity delivered by Duke Energy is sold based on quantity consumed. Moreover, the time period for which outdoor lighting operates is controlled by use of a photocell, and Duke Energy has information to make estimates regarding variables in the timing to determine a pricing for the outdoor lighting.

charges were not a significant portion of Duke Energy's profit from the sale of electricity during the Tax Periods at Issue.⁴

Production of Electricity

Duke Energy operates plants in both South Carolina and North Carolina to produce electricity. In South Carolina, Duke Energy has two nuclear power plants, four coal power plants, three hydroelectric power plants, and several oil or gas power plants.⁵ The electricity that is produced and consumed by its customers is created at Duke Energy generation facilities. A generator is a "mechanical device" that uses mechanical energy to produce electric energy or, as it is more commonly known, electricity. Generators have been used to produce electricity in substantially the same manner for over 100 years. Many, though not all, of Duke Energy's generation facilities use a turbine driven by steam power to turn the generator. Although the sources or inputs (e.g., coal, uranium, water) used at these different types of generation facilities may vary, all use a generator to produce electricity. The result, however, is the same: Duke Energy employs a mechanical device to produce and generate electricity using a process that has not changed significantly since the early 20th century.

Duke Energy nonetheless offered evidence that the production of electricity does not create anything. Rather, Duke Energy avers it is doing nothing more than providing access to "the electromagnetic field." However, Duke Energy produces that electromagnetic field. Duke Energy's own witness testified that, "in layman's terms," electromagnetic field is electric current," and that any electromagnetic field results from the electric current created by the generator. No matter what moniker used to describe the product produced by Duke Energy, the electric current that generates that field, or even the field itself, is produced through a mechanical process run by Duke Energy.

Distribution and Sale of the Electricity

The process by which Duke Energy generates or produces electricity does not end at the generator. The generator is obviously connected to the transmission and distribution network.

⁴ Mr. Dhiaa Jamil did testify that a portion of a customer's bill is a flat fee for a capacity charge, but he also testified that he did not know the rate or level at which that fee is imposed—other than that it is less than \$100—and, in fact, ultimately testified "that's really not my area." The Court concludes that this testimony does not assist Duke Energy in meeting its burden of proof.

⁵ Duke Energy also produces electricity using natural gas, wind, and solar. Duke Energy also occasionally purchases electricity from other electric utilities. However, these methods of producing or acquiring electricity appear to be less significant than the methods indicated above.

That network consists of transmission and distribution lines, which are conductors made of copper, towers and poles, and transformers. During the transmission and distribution process, the transformers process the electricity by "stepping up" and "stepping down" the voltage of the electricity. By "stepping up" the voltage, Duke Energy is able to transmit the electrical current at a low current. The "step up" process is done in order to efficiently deliver electricity by reducing line loss, which is the loss to Duke Energy of a quantity of electricity as heat during the transmission and distribution processes.

Ultimately, electricity must be delivered at the specified voltage so that it can be used by customers in their homes and businesses. Typically, electricity is not usable by a customer unless it is at 120 volts, although sometimes it is delivered at 220 volts. Whatever the required voltage, it is necessary to ensure that the electricity delivered to a customer is "stepped down" to the usable voltage, a process that is done close to where the electricity is eventually used by the customer.

Most customers of Duke Energy obtain the electricity after it passes through a meter. More specifically, by activating a switch, which creates a load and completes a circuit, the electricity passes through the customer's meter and operates the device. Duke Energy measures the amount of electricity consumed by each customer (usually in term of kilowatts) and then charges the consumer for the quantity used/consumed.⁶ Moreover, electricity is not a useable product unless it is delivered to customers at precise specifications. Prior to delivery of the electricity to the consumer through the meter, the electric utility owns the electricity, which is not delivered for sale until it is processed into a form usable by a consumer. This typically occurs closer to the customer's business or home.

Duke Energy compared the provision of electricity to the provision of telecommunication services—both cellular and landline. However, unlike Duke Energy, telecommunication companies do not generate electricity but, instead, only use electricity purchased from electric utilities. Furthermore, Duke Energy delivers to its customers a quantifiable product that is produced by Duke Energy. In contrast, telecommunications companies transmit communications or intelligence produced or created by one customer to another through a system operated by

⁶ Aside from the fact that electricity is measured by quantity, the nature of electricity, as a product, is further demonstrated by the fact that electric current is a flow of charges or charged particles, the rate of which is measured in amperes.

electricity purchased from utilities like Duke Energy. Additionally, cellular telephone providers use radio technology to transfer information between two locations. The frequencies and strengths of telecommunications waves are vastly different than the frequencies and strengths of electricity.

In sum, the generation, transmission, and distribution processes are interconnected. Duke Energy cannot produce or deliver electricity to consumers in the absence of any one of these parts, each of which provide an essential aspect of Duke Energy's process for producing, transmitting, and delivering electricity to customers. Moreover, Duke Energy presented no evidence that supports separating its electric transmission and distribution processes from its generation processes and, in fact, described the whole process as a "very elaborate system." Indeed, Mr. Jamil testified that each of the processes employed by Duke Energy is "used to produce electricity."⁷

Physical Nature of Electricity

Electricity is a physical product with physical characteristics. Regarding whether electricity may be sensed by humans, I do not find that the testimony presented by either party was probative as expert testimony. In other words, there was no evidence that the witnesses possessed "knowledge, skill, experience, training, or education" regarding the effect of electrical stimulation upon the human physiology justifying this Court to accept their opinion as expert testimony. Nevertheless, based upon the evidence, I find that it is possible to feel electricity, and thus electricity can be touched. Though Duke Energy presented valid instances in which a person may not feel electricity, that does not discount the instances when it can be felt.

Moreover, even if I were to find Duke Energy's evidence regarding this matter to be probative, I am unconvinced. Duke Energy's expert witness, Mr. Ioannis Papapolymerou, explained that a human cannot feel electricity but only the impact of the electricity. Though I find the proposed nuances between the feeling of an object itself and the feeling of the impact from the object to be the makings of an interesting theoretical debate, I find no considerable distinction between the two and therefore find that electricity can be felt by humans.

⁷ Additionally, Duke Energy introduced an exhibit listing the "Functions" of Duke Energy as "Production," "Transmissions," and "Distribution."

Electricity can also be stored. Concerning this issue, Duke Energy characterized an electric charge as the source of electricity and as the physical property that is stored. The electrical charge is nonetheless a component of what is produced by Duke Energy.

In sum, Duke Energy takes raw materials (e.g., coal, uranium, water), uses those materials to power mechanical devices to produce a form of electricity that is usable and consumed by the public. Although electricity is unique, it is a tangible product with identifiable physical characteristics that may be created, measured, felt, stored, and consumed, and an electric utility may exercise ownership rights over it.

Department's Policy History

The Department and the Commission have a longstanding interpretation that electric utilities should be characterized as manufacturers for purposes of corporate income tax apportionment. Though the Department's policy was never set forth in any public document, it was memorialized in the foreign corporation training manual used by the Department's auditors. Joseph Southard, a retired auditor for the Department with over 25 years of experience, who conducted audits of several electric utilities, including Duke Energy, explained that the Department's policy was that electric utilities were manufacturers for purposes of the apportionment statutes.

The Department also applied this policy consistently, and Duke Energy offered nothing to show otherwise. No other electric utilities challenged that position before Duke Energy filed its amended returns. In fact, Duke Energy filed its returns using the multi-factor apportionment formula for at least 23 years before filing the amended returns and challenging the policy in 2002.

CONCLUSIONS OF LAW

In determining the income tax due from Duke Energy, the Department apportioned Duke Energy's South Carolina income using the multi-factor apportionment formula of Section 12-6-2250. The Department argues that Duke Energy's principal business in South Carolina is manufacturing and that Section 12-6-2250 should therefore apply. Duke Energy, however, contends that its principal business in South Carolina is the provision of service to customers and that Section 12-6-2290 should thus apply.

Burden of Proof

Because Duke Energy is challenging a determination by the Department that it must apportion its income under section 12-6-2250, it has the burden of proof. See SCALCR 29(B); Ford v. Atl. Coast Line R. Co., 169 S.C. 41, 168 S.E. 143, 167 (1932) ("The general rule is, in the absence of valid statutory enactment to the contrary, that the burden of proof rests upon him who has the affirmative of the issue and does not shift to the defendant even when aided, in the first instance, by a rebuttable presumption."); see also Anonymous v. State Bd. of Med. Exam'rs., 329 S.C. 371, 496 S.E.2d 17 (1998). This burden requires Duke Energy to prove that the Department's determination is wrong by a preponderance of the evidence. See, e.g., Janasik v. Fairway Oaks Villas Horizontal Prop. Regime, 307 S.C. 339, 346, 415 S.E.2d 384, 388 (1992) ("Findings of fact based upon a 'preponderance' of the evidence are those supported by the greatest 'weight, amount, credibility or truth' as reflected by the whole of the evidence before the court, or 'evidence which convinces as to its truth.'").

Apportionment of Income

The method of apportionment that a taxpayer must use depends upon the nature of the taxpayer's business in this State. Section 12-6-2250⁸ requires a taxpayer to apportion its multi-state income using the property, payroll, and sales factors if the taxpayer falls within the following definition:

A taxpayer whose principal business in this 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

S.C. Code Ann. § 12-6-2250.⁹ On the other hand, "[i]f the principal profits or income of a taxpayer are derived from sources other than those described in Section 12-6-2250," the taxpayer is required to use the single-factor gross-receipts apportionment formula. S.C. Code Ann. § 12-6-2290.¹⁰ Consequently, the issue that must be resolved for the Tax Periods at Issue is

⁸ Because the Tax Periods at Issue cover multiple years (1994-2001), a parenthetical date will not be used for the statutory citations.

⁹ Section 12-6-2250 during the Tax Periods at Issue required that the sales factor be double-weighted in calculation of the apportionment formula. This section was previously designated as section 12-7-1140, which was repealed in 1995. Prior to June 12, 1995, section 12-7-1140 provided a three-factor formula without the double-weighted sales factor.

¹⁰ Like section 12-6-2250, the predecessor of section 12-6-2290, S.C. Code § 12-7-1190, was repealed in 1995, but the language remained substantially the same. Section 12-6-2290 also excludes sources described in section

whether the Department erroneously determined that Duke Energy must apportion its income pursuant to Section 12-6-2250. After considering the evidence in the record and the pertinent legal authorities, I conclude that Duke Energy has failed to establish by the preponderance of the evidence that its principal business in South Carolina is not manufacturing or some other activity falling under Section 12-6-2250.

Agency Deference

The Department contends that in determining this issue the ALC must give its construction of Section 12-6-2250 deference. "An agency's long-standing interpretation of a statute is usually entitled to be given deference and should not be overruled by a reviewing court in the absence of cogent reasons. . . ." Media Gen. Commc'ns, Inc., and Media Gen. Broad. of S.C. Holdings, Inc. v. S.C. Dep't of Revenue, 388 S.C. 138, 149, 694 S.E.2d 525, 531 (2010) (citing Etiwan Fertilizer Co. v. S.C. Tax Comm'n, 217 S.C. 354, 360, 60 S.E.2d 682, 684 (1950)). In Etiwan, the Court further explained that: "[W]here the construction of the statute has been uniform for many years in administrative practice, and has been acquiesced in by the General Assembly for a long period of time, such construction is entitled to weight, and should not be overruled without cogent reasons." Etiwan, 217 S.C. at 359, 60 S.E.2d at 684. If the Department is entitled to deference, it is Duke Energy's burden to prove that the Department's policy is "arbitrary, discriminatory or unreasonable." Colonial Life & Acc. Ins. Co. v. S. Carolina Tax Comm'n, 248 S.C. 334, 339, 149 S.E.2d 777, 780 (1966) ("The Commission has the power and duty . . . to prescribe a method for arriving at a tax base which reasonably represents the proportion of the trade or business carried on within this State...and its determination thereabout will not be overthrown by the courts except upon a showing, absent here, that it is arbitrary, discriminatory or unreasonable") (internal quotation marks omitted); see also Vulcan, 342 S.C. at 496, 536 S.E.2d at 900; Etiwan, 217 S.C. at 359, 60 S.E.2d at 684. For the reasons set forth below, Duke Energy did not meet its burden in this regard.

The record shows that the Department and the Commission consistently have characterized electric utilities as manufacturers for purposes of corporate income tax apportionment.¹¹ Duke Energy filed its returns using the multi-factor apportionment formula for

12-6-2310, but that statute references income earned by railroad companies, motor carriers, telephone service companies, pipeline companies, airline companies, and shipping lines, none of which are applicable in this case.

¹¹ Duke Energy asserts that there is an inconsistency in the Department's audit manual in that service providers (those whose principal business is providing a service) have to apportion their income to South Carolina based on

at least 23 years before filing the amended returns and challenging the policy in 2002, which reflects that Duke Energy was aware of the policy. And although a Duke Energy witness, Cooper Monroe,¹² testified that the original returns were filed in error, he also acknowledged that Duke Energy and accounting firms "in [his] experience" apply a review process before a tax return is filed. This long period of time in which Duke Energy filed returns using the multi-factor apportionment formula leads to the conclusion that the returns were filed in accordance with the policies and filing requirements promulgated by the Department as understood by Duke Energy at the time the returns were originally filed.

Moreover, though the policy was not set forth in a publicly-issued advisory opinion, a decision of the Commission for property tax purposes supports the conclusion that the Department openly and consistently viewed electric utilities as manufacturers. In 1985, the Commission determined that "'X' Electric and Gas" was a manufacturer because the Supreme Court had held that its predecessor was a manufacturer in the Columbia Ry. decision. S.C. Tax Comm'n Decision P-D-532, 1985 WL 192777 (Apr. 11, 1985) (citing Columbia Ry., Gas & Elec. Co. v. Query, 134 S.C. 319, 132 S.E. 611, 612 (1926)). Although this ruling was rendered in the context of property taxes, it reflects a public position that the Department consistently applied the Columbia Ry., supra, and Duke Power, infra, decisions and consistently determined that electric utilities are manufacturers. The consistency of this policy is further evidenced by the fact that in P-D-532, the Department gave the electric utility the benefit of being a manufacturer by determining that its property-tax assessment ratio should be 6% as opposed to the 10.5% applicable to the personal property of non-manufacturing entities.¹³ More importantly, the South Carolina Supreme Court's decision in Columbia Ry., supra publicly reflects, in the context of a license tax imposed upon manufacturers' gross receipts, the Department's position that those engaged in the sale of electricity are manufacturers. See also

the single-factor gross-receipts apportionment method, while power companies must use the multi-factor apportionment formula. However, there is only an inconsistency if one adopts the premise that the generation, transmission, and distribution of electricity constitutes provision of service, or the premise that provision of service generates more profits or income than generation, transmission, and distribution of electricity, neither of which this Court adopts.

¹² Thomas Cooper Monroe, III is currently the Director of State and Local Tax for Duke Energy.

¹³ Also, in 1970, the South Carolina Attorney General opined that the South Carolina Electric & Gas Company was a manufacturer and that any plant it used to produce electricity was a manufactory eligible for property tax exemptions. 1970 S.C. Op. Att'y Gen. 154, Op. No. 2909, 1970 WL 12192 (June 2, 1970). The basis for this ruling was the Columbia Ry. and Duke Power decisions.

Duke Power Co. v. Bell, 156 S.C. 299, 152 S.E. 865 (1930) (recognizing the same position in the property-tax context). I find that though the notice to the General Assembly is traditionally given through a policy available to the public, the facts in this case meet the criteria envisioned in Etiwan. See also Whitner v. State, 328 S.C. 1, 6, 492 S.E.2d 777, 779 (1997) (“[T]here is a basic presumption that the legislature has knowledge of previous legislation as well as of judicial decisions construing that legislation when later statutes are enacted concerning related subjects.”) (emphasis added). Nevertheless, whether or not the Department’s position is given deference, I find that Duke Energy’s principal business is manufacturing for the reasons given below.

Manufacturing

Duke Energy must apportion its multi-state income for the Periods at Issue pursuant to Section 12-6-2250 unless Duke Energy proves that its principal business within this State is not (1) “manufacturing”; or (2) “any form of collecting, buying, assembling, or processing goods and materials within this State”; or (3) “selling, distributing, or dealing in tangible personal property.” Though Duke Energy suggests a contrary reading of this statute, the Legislature’s use of the disjunction “or” following “manufacturing” in Section 12-6-2295(a)’s phrase “manufacturing or any form of collecting, buying, assembling, or processing goods and materials within this State” demonstrates that the term “manufacturing” is not dependent on, or modified by, the clause “any form of collecting, buying, assembling, or processing goods and materials within this State.” Michau v. Georgetown County ex rel. S.C. Counties Workers Comp. Trust, 396 S.C. 589, 595, 723 S.E.2d 805, 808 (2012) (“[T]he ‘use of the word ‘or’ in a statute ‘is a disjunctive particle [sic] that marks an alternative.’”) (citing K & A Acquisition Group, LLC v. Island Pointe, LLC, 383 S.C. 563, 580, 682 S.E.2d 252, 261 (2009)). This conclusion is supported by the statutory history, which reflects that the apportionment statute, when adopted, addressed only corporations “engaged in the business of manufacturing,” 1927 S.C. Acts 1, No. 1, § 15(1),¹⁴ and that the latter clause of subsection (a) was added in 1946, 1946 S.C. Acts 1491, No. 553, § 3 (amending apportionment statute, then found in section 2451 of the 1942 Code, to apply to taxpayers whose “principal business ... in this State is manufacturing, or if it is any form of collecting, buying, selling, assembling or processing goods and materials within this

¹⁴ This language remained the same in the apportionment statute enacted as Section 2451 in both the 1932 South Carolina Code of Laws and the 1942 South Carolina Code of Laws.

State.”) (emphasis added). Thus, inclusion of the phrase “or any form of collecting, buying, assembling, or processing goods and materials” after “manufacturing” in Section 12-6-2250(a) reflects that the Legislature intended to cover not just manufacturing but all activities that a business could perform in regards to goods or materials prior to making those goods or materials available to its customers. See Charleston County Sch. Dist. v. State Budget and Control Bd., 313 S.C. 1, 5, 437 S.E.2d 6, 8 (1993) (“The cardinal rule of statutory construction is to ascertain and effectuate the intent of the legislature.”).

Here, there is no dispute regarding several of the elements of Section 12-6-2250. It is undisputed that Duke Energy is a taxpayer required to file corporate income tax returns in this State. Similarly, it is undisputed that Duke Energy has multi-state income that must be apportioned. See S.C. Code Ann. § 12-6-2210(b). There is also no disagreement that Duke Energy is engaged in the business of generation, transmission, distribution, and sale of electricity in portions of both North Carolina and South Carolina. Mr. Dhiaa Jamil¹⁵ testified that providing electricity is Duke Energy’s “primary business.” To conduct its primary business, Duke Energy operates generation plants in both South Carolina and North Carolina.

Because “manufacturing” is not defined in the apportionment statutes, this Court must interpret it in accord with its usual and customary meaning. E.g., Travelscape, LLC v. S.C. Dept. of Revenue, 391 S.C. 89, 99-100, 705 S.E.2d 28, 33-34 (2011). Merriam-Webster’s Dictionary presently defines “manufacture” as “the process of making wares by hand or by machinery especially when carried on systematically with division of labor.” It further defines the term to include “productive industry using mechanical power and machinery” and “the act or process of producing something.” See <<http://www.merriam-webster.com/dictionary/manufacture>> (accessed October 18, 2012); see also Jennings v. Jennings, No. 27177 (Oct. 18, 2012) (Hearn, J.) (referencing online Merriam-Webster’s Dictionary for definition of a word).¹⁶ And in 1939, in holding that the generation of

¹⁵ Dhiaa M. Jamil, P.E., currently is the Executive Vice President of Nuclear Generation and the Chief Nuclear Officer for Duke Energy.

¹⁶ It is also worth noting that the current Merriam-Webster’s definition of the term “ware,” a term included in the definition of “manufacturing,” includes manufactured goods. See <<http://www.merriam-webster.com/dictionary/ware>> (accessed October 18, 2012). Also, Merriam-Webster’s current definition of “good” includes “something that has economic utility or satisfies an economic want” and “something manufactured or produced for sale.” See <<http://www.merriam-webster.com/dictionary/good>> (accessed October 18, 2012). Thus, even if in Section 12-6-2250(a) “manufacturing” modified “goods,” the electricity that Duke Energy generates, transmits, and distributes would be in accord with the common understanding of the term

electricity is manufacturing, the Iowa Supreme Court referenced Webster's definition of manufacturing, which was "to make by hand, by machinery, or by other agency; to work raw materials into forms for use; to produce mechanically." Winterfield, 285 N.W. at 224-25. Applying this definition, the court held that generating electricity is manufacturing. Id.

Our Supreme Court has also held on two different occasions that an electric utility that generates electricity is engaged in manufacturing. In Columbia Ry., the South Carolina Supreme Court held that a company engaged in the business of generating electricity was properly considered a "manufacturer" for purposes of a statute that imposed a corporate license tax on the gross receipts of "a corporation engaged in the business of manufacturing." 132 S.E. at 612 ("We do not think that there is any doubt that the appellant is engaged in the business of manufacturing gas and electricity"); see also State v. Broad River Power Co., 157 S.C. 1, 153 S.E. 537, 539 (1929) (noting that the Columbia Railway company built "a large plant for the manufacture of gas and electricity for sale to the public generally") (emphasis added).¹⁷ In a later case, reviewing a different statute, the Supreme Court held that Duke Power Co., a predecessor of Duke Energy, was entitled to claim a property tax exemption for manufactories—defined as a physical plant, or a place or building, where manufacturing is carried on—because it was a manufacturer. Duke Power, *supra*. The Court held that, based on Columbia Ry., Duke Power was engaged in manufacturing. Id., 152 S.E. at 868 ("If a company engaged in the generation of electricity is a 'manufacturer' for the purposes of a Statute imposing a tax, the plan or structure wherein the process of generating such electricity is carried on is a manufactory for the purposes of a tax exempting statute."). Thus, although Columbia Ry. considered the 1926 Manufacturer's Tax Act, the Duke Power decision reflects that the Court's holding that Duke Power was engaged in manufacturing was not limited to that statute.¹⁸

"manufactured good," and would therefore still satisfy Section 12-6-2250(a) under that alternative interpretation of the statute. Furthermore, Duke Energy has failed to prove by the preponderance of the evidence that the electricity it produces is not a good or that it is not manufactured.

¹⁷ Notably, the 1927 Century Dictionary defined manufacture as "the making of goods or wares by ... machinery, esp. on a large scale"

¹⁸ When the holding of Columbia Ry. is considered in light of the pertinent language from the Manufacturer's Tax Act at issue in that case, the application of that decision in this case becomes evident, especially in light of the absence of any distinction between Duke Energy's business in this State versus its business in North Carolina. Specifically, the Manufacturer's Tax Act provided that "every person, firm or corporation engaged in the business of manufacturing" was subject to the tax imposed on manufacturers. 1923 S.C. Acts 12, No. 21, §11-A. And although the tax at issue was a license tax on "the entire receipts," it was specifically imposed on "the business of manufacturing." Thus, the Columbia Ry. decision is based on a 1923 Act directed at manufacturers and uses the

The Supreme Court's determination that two different electric utilities were engaged in manufacturing for purposes of two different tax statutes certainly supports the conclusion that electric utilities are engaged in manufacturing for purposes of other tax statutes, including the apportionment statute. This is especially so given the Supreme Court's holding that "the legislative classification [of the apportionment statute] ... should be liberally construed in favor of the inclusion of business to which the formula is appropriate." Hertz Corp. v. S. C. Tax Comm'n, 246 S.C. 92, 96, 142 S.E.2d 445, 447 (1965) (holding that taxpayer involved in renting tangible personal property came within the predecessor to section 12-6-2250).¹⁹ The fact that the common definition of "manufacture" has remained constant from the time of the Columbia Railway and Duke Power decisions up to the present, and that definition is still applicable to Duke Energy's operations, further validates that Duke Energy is engaged in manufacturing electricity. In addition, Duke Energy generates, transmits, and distributes electricity in South Carolina using the same methods and principles employed during the era in which these cases were decided. Furthermore, Duke Energy's corporate charter for the Tax Periods at Issue retained the same language used in its original charter, which was considered pertinent by the Supreme Court. Compare Duke Power, 152 S.E. at 867 (referencing charter granting authorization to Duke Power Company to "manufacture, generate, buy, sell, accumulate, store,

same language as the apportionment statute at issue in this case. Compare S.C. Code Ann. § 12-6-2250 (applying to "a taxpayer whose principal business in this State is ... manufacturing") with 1923 S.C. Acts 12, No. 21, § 11-A (applying to a taxpayer "engaged in the business of manufacturing").

¹⁹ Although not binding here, courts in other states have held that generating or producing electricity is manufacturing, reflecting that a position such as that taken by the Department is reasonable. Some of these cases have cited Columbia Ry. and Duke Power as support for that holding. Curry v. Ala. Power Co., 8 So.2d 521, 525 (Ala. 1942) (citing Columbia Ry. and Duke Power decisions in holding that generating electricity is manufacturing); State ex rel. Winterfield v. Hardin County Rural Elec. Co-op., 285 N.W. 219, 226 (Iowa 1939) (citing Columbia Ry. and Duke Power and stating: "The great preponderance of authority as evidenced by the decisions of the courts supports the proposition that one engaged in the generation of electricity is engaged in a manufacturing or mechanical business"). Other states simply have held that generating electricity is manufacturing. E.g., Pub. Serv. Co. v. Dep't of Rev., 10CA1026, 2011 WL 4089971 (Colo. Ct. App. Sept. 15, 2011) (generating electricity is manufacturing); Davis v. Gulf Power Corp., 799 So. 2d 298, 301 (Fla. Dist. Ct. App. 2001) (generation of electricity is a manufacturing process and electricity is tangible personal property); Minn. Power & Light Co. v. Pers. Prop. Tax. Taxing Dist. City of Fraser, Sch. Dist. No. 695, 182 N.W.2d 685, 692 (Minn. 1970) (producing electricity is manufacturing); Bd. of Assessors of Holyoke v. State Tax Comm'n, 244 N.E.2d 287, 289 (Mass. 1969) (same); Marley v. Brown & Root, 239 S.W.2d 1012, 1015 (Ark. 1951); (same); City of Louisville ex rel. v. Howard, 208 S.W.2d 522, 526 (Ky. 1947) ("The generation of electricity is manufacturing."); Chicago, M., St. P. & P.R. Co. v. Custer County, 32 P.2d 8, 9 (Mont. 1934) (holding that "the electricity which exists in nature is not subject to use; the current which will cause the wheels of industry to turn, or will light a city, must be produced by the employment of labor and machinery and is, therefore, generally said to be manufactured"); see also Comm'r of Revenue v. Houghton Mifflin Co., 666 N.E.2d 491, 495 (Mass. 1996) (rejecting contention that process does not involve manufacturing merely because its inputs are not tangible).

transmit, furnish, and distribute electric current for light, heat, and power”) with Restated Arts. Inc. Duke Power Co. (October 6, 1993) (authorizing company “[t]o manufacture, generate, buy, sell, accumulate, store, transmit, furnish and distribute electric current for light, heat and power”) and Restated Arts. Inc. Duke Energy Corp. (June 18, 1997) (same). If the processes of generating, transmitting, and distributing electricity are, for the most part, the same today as those employed in 1926 and 1930, and if those processes constituted manufacturing for purposes of a tax statute during those years, then the generation of electricity constitutes manufacturing for purposes of a tax statute during the Tax Periods at Issue.²⁰ Duke Energy therefore is engaged in the business of manufacturing in this State for purposes of Section 12-6-2250.

Moreover, the evidence in this case establishes that Duke Energy is a manufacturer. As explained above, “manufacturing” is defined in Merriam-Webster’s online dictionary as “the process of making wares by hand or by machinery especially when carried on systematically with division of labor.” It further defines the term to include “productive industry using mechanical power and machinery” A “ware” is defined as “an ‘article of commerce.’” The American Heritage College Dictionary 1521 (3d ed. 1993). Duke Energy’s witnesses repeatedly characterized its business as “producing” electricity.²¹ Electricity that is produced by Duke Energy and consumed by its customers is created at a generation facility.²² The process that

²⁰ Mr. Papapolymerou testified that although for the most part the process of generating electricity has not changed in the last one hundred years ago, Duke Energy has added renewable energies, developed solar panels, and developed more efficient wind generators. However, there is no evidence that these developments were implemented during the Tax Periods at Issue (1994-2001); and even had they been implemented during those periods, electricity was still being generated for the most part by the same processes that the Supreme Court has considered to be manufacturing. Mr. Jamil also testified that the basic generation process is the same today as it was in the early 20th century.

²¹ “Manufacturing,” as discussed previously, also includes “the act or process of producing something.” However, this definition, though accurate and applicable, describes manufacturing in its most general sense. The Court will use the other two definitions, as they are more specific.

²² Mr. Jamil testified that Duke Energy could provide electricity even without its generation assets. That is, Duke Energy apparently contends that it could sell electricity without producing it and, thus, that it is not a manufacturer for that reason. But the fact that an entity could resell a product to customers without actually manufacturing that product does not mean that the entity that did produce the product is not a manufacturer. And a determination of whether any entity that simply resells electricity is a manufacturer is beyond the scope of this proceeding.

In any event, the record does not support any characterization of Duke Energy as a mere reseller of electricity for the Tax Periods at Issue. The evidence reflects that Duke Energy generated virtually all of the electricity it sold during the Tax Periods at Issue. [Duke Energy 1994-2001 Forms 10-K (showing “Electric Energy Generated” as being nearly equal to “Electric Energy Sold” each year) [Pet’r Hr’g Exs. 49-B-17 through 49-B-24].] Mr. Monroe testified that Duke Energy generates most of the electricity that it sells. Thus, the fact that other utilities might simply resell electricity without generating it, and that Duke Energy could do the same thing, is immaterial because the record reflects that Duke Energy does generate electricity; and it is therefore a manufacturer.

occurs at a generation facility reflects that it is manufacturing. Each of these facilities contains at least one generator. A generator is a "fairly large machine" and "mechanical device" that uses mechanical energy to produce electric energy or, as it is more commonly known, electricity. The generator creates an electric current that is processed through the transmission and distribution systems. Generators have been used to produce electricity in substantially the same manner for over 100 years. Many, though not all, of Duke Energy's generation facilities use a turbine driven by steam power to turn the generator.²³ The result, however, is the same: Duke Energy employs a mechanical device to produce and generate electricity using the same process employed since the early 20th century. Thus, Duke Energy's generation facilities are, as recognized by our Supreme Court, locations at which manufacturing occurs. See Duke Power, 152 S.E. at 868.

Furthermore, though they disagree as to the ultimate characterization of electricity production, Duke Energy and the Department seem to agree that Duke Energy's generation, transmission, and distribution processes are interconnected. In other words, Duke Energy cannot generate electricity to deliver to consumers in the absence of any one of these parts.²⁴ The generator is connected to the transmission system, which is connected to the distribution system. As noted above, Duke Energy requires all three processes to provide electricity to its customers. Prior to distribution of the electricity to the consumer through the meter, the electric utility owns and continues to process the electricity, which is not in a form usable by a consumer prior to its distribution through the electric meter. Cf. Priest v. Brown, 302 S.C. 405, 411, 396 S.E.2d 638, 641 (Ct. App. 1990) (in affirming a trial court decision that strict liability was not applicable against electric utility for a person who was electrocuted and died after touching a downed distribution line, the court noted an affidavit that stating that "the electricity through these lines was of such a high voltage that it was not in a form immediately usable by a consumer" and held that the facts of this case alone suggest the electricity had not been placed into the stream of commerce . . .").

In addition, though electricity is a unique product with unique characteristics required by consumers, it is clearly produced by Duke Energy and distributed in keeping the required needs

²³ The design of a turbine used in these generation facilities has not significantly changed since the early 20th century.

²⁴ Duke Energy sometimes provides to its customers electricity that it has purchased from other utilities. But most of the electricity that Duke Energy provides to its customers is generated by Duke Energy.

of the customers. Although there was testimony in the record regarding other forms of energy, such as kinetic and mechanical energy, those other energy forms are different than electricity or electric energy and do not meet the vast majority of consumer needs in homes and businesses. And this conclusion is not changed by the fact that electricity may exist in nature (e.g., a lightning strike is the effect of an electromagnetic field on air molecules), because that electricity is not usable by electric utilities or consumers in that form. See, e.g., Chicago, M., St. P. & P.R. Co. v. Custer County, 32 P.2d 8, 9 (Mont. 1934) (holding that "the electricity which exists in nature is not subject to use; the current which will cause the wheels of industry to turn, or will light a city, must be produced by the employment of labor and machinery and is, therefore, generally said to be manufactured . . .") (internal citations omitted).

The nature of electricity as a product produced by Duke Energy is further evidenced by the fact that Duke Energy does not have access to unlimited quantities of electricity because its ability to generate electricity is limited by the capacity of its generators. The fact that Duke Energy charges for electricity based on quantity, and cannot provide unlimited electricity, further supports the conclusion that generating electricity is manufacturing. Measuring electricity by quantity is the same as measuring any product by quantity, and the limitation on the quantity of electricity that can be produced is analogous to the limitation imposed on any manufacturer by the capacity of the machines employed in the manufacturing process.²⁵

In sum, the electricity consumed by Duke Energy's customers is the product of Duke Energy's generation of that electricity. Duke Energy employs an interconnected process of producing and delivering electricity that is substantially the same as that used by any entity that creates and produces a product using an assembly line and then charges the customer based on the amount of the product sold. A generator is analogous to any machine used by a manufacturer to produce a product for sale; the transmission and distribution systems are like the assembly line process used by a manufacturer to further refine and develop the product; and the customer is

²⁵ Interestingly, S.C. Code Ann. § 16-13-380 references the theft of electricity by any "person who ... has no contract, agreement, license, or permission with or from any person authorized to manufacture, sell, or use electricity for the purpose of light, heat, or power." S.C. Code Ann. § 16-13-380 (emphasis added); see also S.C. Code Ann. § 16-13-390 (prohibiting the wrongful use of electricity by a person who has a "contract, agreement, license or permission, oral or written, with or from any person authorized to manufacture, sell or use electricity for the purpose of light, heat or power.") (emphasis added). Therefore, it is clear that the General Assembly understands that electricity can be manufactured.

charged by the quantity of the product consumed.²⁶ The fact that Duke Energy charges for electricity based on quantity, and cannot provide unlimited electricity, further supports the conclusion that generating electricity is manufacturing. Measuring electricity by quantity is the same as measuring any product by quantity, and the limitation on the quantity of electricity that can be produced is analogous to the limitation imposed on any manufacturer by the capacity of the machines employed in the manufacturing process.

Characterization of the Provision of Electricity as a Service

Duke Energy contends that its "principal business in South Carolina is the provision of electric service to its customers." (Emphasis added). At the outset, Duke Energy cannot "provide" electric service without the existence of electricity, and the electricity that Duke Energy provides cannot exist without first being produced, or manufactured. As to "electric service," the South Carolina Income Tax Act does not define the word "service." And the usage of the word "service" in the South Carolina Income Tax Act does not provide any guidance as to the term's meaning, as it is used in a variety of connotations.²⁷ Looking then to Merriam-Webster's Dictionary, "service" is defined as "useful labor that does not produce a tangible commodity" or "a facility supplying some public demand." Merriam-Webster Online Dictionary, www.merriam-webster.com (last visited October 18, 2012). Because this Court, for reasons that will be discussed more fully below, finds electricity to be a tangible commodity, Duke Energy has failed to demonstrate that its "provision" of electricity to customers is a service under the first definition. As to the second definition, Duke Energy is doubtless a service

²⁶ The Court recognizes that the transmission and distribution processes could be interpreted as being separate from manufacturing. Transmission of electricity, for instance, could fall under "processing" in Section 12-6-2250(a), because the electricity must be "stepped up" and "stepped down" in order to regulate the voltage so that line loss can be minimized. Also, for the electricity to be usable by the customers, it must be further manipulated to meet the specifications of the devices used by the customers. Likewise, distribution could be interpreted as "distributing . . . tangible personal property within this State," under Section 12-6-2250(b). This interpretation would require a determination of electricity's tangibility and whether electricity is "personal property." The Court will explain in more detail later in the decision why electricity is tangible personal property. At any rate, because the generation, transmission, and distribution of electricity are equally-necessary components of the business of providing electric power, Duke Energy's business activities seemingly could fall under Section 12-6-2250(a), or (a) and (b); but under either scenario, Duke Energy's principal business involves activities that are covered in Section 12-6-2250, which is the issue here.

²⁷ See, e.g., S.C. Code Ann. §§ 12-6-550 ("service" in the context of providing of water supply and sewage disposal); 12-6-1120 ("service" in the context of the National Guard and Armed Forces reserve components); 12-6-1720(1)(b) ("service" in the context of apportionment of nonresident individuals, trusts, estates, or beneficiaries); 12-6-2850 ("services" in the context of foreign trading receipts); and 12-6-3450 ("services" in the context of an employee's services for an employer in determining qualification for an income tax credit for persons terminated from employment as a result of the closing or realignment of a federal military installation).

because it is "a facility supplying some public demand." However, there is nothing in this definition of service that includes or excludes manufacturing. In this case, though, Duke Energy supplies to its customers electricity that it has already manufactured, thus demonstrating that the two activities are separate.

Duke Energy nevertheless contends that it is not manufacturing because it is not creating anything and is doing nothing more than "provid[ing] access to the electromagnetic field." However, Duke Energy fails to recognize that it produces/manufactures the product for which any service is provided. Electricity is a product that moves and is processed through the transmission and distribution systems and is delivered to the customer at the specifications required by that customer. Services are typically measured by the quantity of time provided, not by the quantity of the product consumed.²⁸ In fact, even Duke Energy recognizes that it is producing something. Not even Duke Energy's own representations to the public refer to "providing access to the electromagnetic field." Moreover, Duke Energy's own witness testified that, "in layman's terms," electromagnetic field is electric current," and that any electromagnetic field results from the oscillation of electrons caused by the electric charge created by the generator which moves in the form of a current.

Duke Energy also offered evidence that it charges a flat fee for outdoor lighting. That evidence does not negate the fact that the majority of the electricity delivered by Duke Energy is sold based on quantity consumed. Moreover, as Mr. Jamil testified, the time period for which outdoor lighting operates is controlled by use of a photocell, and Duke Energy is able to estimate the variables in the timing to determine a pricing for the outdoor lighting. Rather, as Mr. Monroe testified, Duke Energy sells electricity on a metered basis involving electricity flowing through a meter and the company "read[ing] the meter periodically and send[ing] a bill to the customer." Thus, the majority of the electricity provided by Duke Energy is priced at some level based on quantity.

²⁸ Duke Energy further supported its services argument through testimony that it currently is classified as a utility, not a manufacturer, for purposes of the North American Industry Classification System (NAICS), and that it classifies itself as a utility when filing its federal income tax returns. However, the specific NAICS and federal income tax return instructions referenced by the witness pertained to years after the Tax Periods at Issue and, thus, do not assist in determining Duke Energy's character for the Tax Periods at Issue. In any event, neither the NAICS nor the federal classification for data purposes answers the question of whether Duke Energy is a manufacturer for purposes of Section 12-6-2250. Similarly, Duke Energy's references to itself as a provider of services in various publications do not resolve the question of whether it falls within Section 12-6-2250.

Duke Energy finally attempts to compare the above-described processes to the provision of telecommunication services—both cellular and landline—but that comparison is unconvincing. Unlike Duke Energy, telecommunication companies do not generate or produce electricity, but instead only use electricity purchased from electric utilities. Moreover, the evidence in the record demonstrates the differences between a telecommunication service and Duke Energy's production and sale of electricity. First, Duke Energy delivers to its customers a quantifiable product that is produced by Duke Energy. In contrast, telecommunication companies transmit communication or intelligence from one customer to another through a system operated by electricity purchased from utilities like Duke Energy. In essence, the telecommunications company simply transports intelligence produced or created by one of its customers. The purpose of Duke Energy's business is thus to generate and provide electric energy while the purpose of a telecommunication company's business is to convey information. Because Duke Energy produces electricity for use by its customers at an appropriate specification, and telecommunications companies transport intelligence produced by its customers using electricity produced by an electric utility, I find that the purported comparison to a telecommunications company does not undermine the reasonableness of the Department's policy that Duke Energy is a manufacturer.

Conclusion

In sum, to conclude that Duke Energy provides a service rather than manufactures electricity would require a determination that the term "manufacturing" in Section 12-6-2250 means something different than "producing" (or "generating," for that matter), a term generally used synonymously with "manufacturing." Moreover, a person or entity providing services is not commonly understood to be "producing" services, and it is not commonly said that a company which generates and sells electricity is merely providing a service by "provid[ing] access to the electromagnetic field." This is especially so given that the electric current that generates that field, or even the field itself, is generated through an asset-intensive process maintained and operated by Duke Energy. Finally, though it is conceivable that the processes of transmitting and distributing are not part of manufacturing, Duke Energy presented no evidence that would support separation of its electric transmission and distribution processes from its generation process and, in fact, described the whole process as a "very elaborate system." In short, as Mr. Jamil testified, "you need all three." In any event, even if the Court were to draw

such a distinction, it would prove inconsequential to the outcome here because all three activities – generation, transmission, and distribution – fall under Section 12-6-2250.²⁹

Processing Goods and Materials within this State

Alternatively, the evidence reflects that Duke Energy comes within Section 12-6-2250 because its generation, transmission, and distribution of electricity constitutes “any form of...processing goods and materials within this state.” S.C. Code Ann. § 12-6-2250(a) (emphasis added). The use of “any form” in the statute reflects a legislative intent that the language be applied as broadly as possible and, concomitantly, a legislative preference for using the three-factor formula whenever possible. Hertz Corp., 246 S.C. at 96, 142 S.E.2d at 447 (identifying “any form” in predecessor to section 12-6-2250 as “broad language”). The evidence introduced by both parties shows that generating electricity is a form of processing raw materials such as coal, water, or nuclear fuel. These items are goods and materials.³⁰ These goods are processed and used to create energy to turn a generator either directly or indirectly, which constitutes “any form” of processing of those inputs in the generation process and, thus, falls within the statute.

Selling, Distributing, or Dealing in Tangible Personal Property

Duke Energy also comes within Section 12-6-2250 because its business constitutes “selling, distributing, or dealing in tangible personal property.” Duke Energy, however, argues that it is a seller of services and therefore cannot be a seller, distributor, or dealer of tangible personal property. The premise of this argument is that electric service is not tangible personal

²⁹ Duke Energy also contends that electricity is not manufacturing because it is not tangible. Duke Energy's conclusion is based upon two premises: 1) electricity is an intangible material and 2) the term “manufacturing” in Section 12-6-2250 is limited solely to tangible goods or materials. As to the first premise, this Court, for reasons discussed later in the text, finds that the electricity Duke Energy produces is tangible. The Court, therefore, need not address the remaining premise. However, even if this Court found that electricity was intangible, this would not necessarily prevent electricity from being a manufactured product. Merriam-Webster's definition of “manufacture” includes “the process of making wares by machinery” See <<http://www.merriam-webster.com/dictionary/manufacture>> (accessed October 19, 2012). Merriam-Webster's definition of “wares” includes “intangible items” that are “marketable commodit[ies].” See <<http://www.merriam-webster.com/dictionary/ware>> (accessed October 19, 2012). Adopting this view of electricity, the Massachusetts Supreme Court, in Westinghouse Broad. Co., Inc. v. Comm'r of Revenue, noted that the proposition that an electric power company “may not be denied manufacturing status merely because its end product is intangible” . . . “conformed to [its] view that the production of electricity may entail manufacture” 382 Mass. 354, 358, 416 N.E.2d 191, 193 (1981).

³⁰ Merriam-Webster's definition of a “good” is “something that has economic utility or satisfies an economic want.” See <<http://www.merriam-webster.com/dictionary/good>> (accessed October 19, 2012). It defines “material” as “the elements, constituents, or substances of which something is composed or can be made.” See <<http://www.merriam-webster.com/dictionary/material>> (accessed October 19, 2012).

property. Duke Energy also argues that the definition of "tangible personal property" should not be taken from S.C. Code Ann. § 12-36-60, which sets forth the definition of "tangible personal property" for sales and use tax purposes. Rather, Duke Energy urges the Court to adopt the definition of "tangible property" set forth in the Income Tax Act, specifically S.C. Code Ann. § 12-6-30(11).

I agree that because "tangible personal property" in Section 12-6-2250(b) is part of the Income Tax Act, the definition for "tangible property" under the Income Tax Act must be used. S.C. Code Ann. § 12-6-30(11) defines "tangible property" as "includ[ing] . . . corporeal personal property but does not include money, bank deposits, shares of stock, bonds, credits, evidence of debt, chose in action, or evidence of an interest in property." (Emphasis added). The primary purpose in interpreting statutes is to ascertain the intent of the Legislature. Hodges v. Rainey, 341 S.C. 79, 85, 533 S.E.2d 578, 581 (2000). "[This Court] cannot construe a statute without regard to its plain and ordinary meaning, and this Court may not resort to subtle or forced construction in an attempt to limit or expand a statute's scope." Cain v. Nationwide Prop. And Cas. Ins. Co., 378 S.C. 25, 29, 661 S.E.2d 349, 352 (2008) (internal citation omitted). "Where the statute's language is plain and unambiguous, and conveys a clear and definite meaning, the rules of statutory interpretation are not needed and the court has no right to impose another meaning." Id. at 30, 661 S.E.2d at 352 (internal citation omitted).

In this case, it is clear that tangible personal property includes "corporeal personal property." "Corporeal" is not a legal term of art in this case, and it is generally understood to mean "[o]f a material nature; tangible."³¹ In further support of this plain understanding of the definition of "tangible property," Section 12-36-60, which addresses "tangible personal property" for sales and use tax purposes, defines this term as "personal property which may be seen, weighed, measured, felt, touched, or which is in any other manner perceptible to the senses." This definition coincides with the general understanding of the term "corporeal" included in the definition of "tangible property" under Section 12-6-30(11).³²

³¹ The American Heritage College Dictionary 311 (3d ed. 1993). See also Black's Law Dictionary 394, 1336, 1592 (9th ed. 2009) (defining "corporeal" as "tangible"; "tangible" as "corporeal"; and "corporeal personal property" as "tangible personal property").

³² The Court recognizes that Sections 12-6-30(11) and 12-36-60 differ with respect to their treatment of intangible personal property. Specifically, Section 12-36-60 includes as tangible personal property services and intangibles, whereas Section 12-6-30(11) excludes intangibles altogether; indeed, "intangible property" is separately defined under Section 12-6-30(12). However, the specific exclusions from tangible personal property (which are not at issue

Applying to the facts of this case the definition of tangible property found in Section 12-6-30(11), according to its plain and ordinary meaning which is supported by the general definition of tangible personal property given in the first sentence of Section 12-36-60, I conclude that electricity is tangible personal property. Electricity is a product delivered to customers at certain precise specifications. The evidence also established that electricity is a physical product with physical characteristics; that the electric charge associated with electricity is a physical property of matter; that it certainly is possible to feel electricity's impact in the body; that electricity can be moved, manipulated, and stored, characteristics further suggesting the tangible nature of electricity; that the electric charge, which Duke Energy witnesses testified is the source of electricity, can be stored; and that electricity is a fungible product that is sold in quantifiable amounts. Also, because the electricity sold, distributed, or dealt by Duke Energy is used by its customers in amounts, duration, and purposes chosen by its customers, i.e., it is under the customers' control after it is distributed to them, the electricity becomes personal property of the customers.

On one hand, Duke Energy does not wish to apply the definition of "tangible personal property" under Section 12-36-60; but nonetheless, Duke Energy wishes to use Section 12-36-60 to establish its sales of electricity as a service. It argues that if Section 12-36-60 applied, "the Department's view on the characterization of electricity based on the sales and use tax definition was long ago rejected by this Court in [Consolidated Hydro S.E., Inc. v. S.C. Dep't of Revenue & Taxation, No. 95-ALJ-17-0634, 1996 WL 909155 (S.C. Admin. L.J. Div. May 13, 1996) (Lee, A.L.J.)]." In that case, the taxpayer owned and operated several hydro-electric power generation facilities in South Carolina and was engaged in the business of production and sale of electricity. Citing the definition of "tangible personal property" set forth in S.C. Code Ann. § 12-36-60, relating to sales and use taxes, the company argued that it did not provide or sell a "service" and was therefore not subject to additional license taxes. The court in that case disagreed, concluding that "while electricity is included in [12-36-60] discussing the application of sales tax

here) are nearly identical in both definitions. Section 12-6-30(11) excludes from tangible property the following: "money, bank deposits, shares of stock, bonds, credits, evidences of debt, choses in action, or evidences of an interest in property." Similarly, Section 12-36-60 excludes from tangible personal property the following: "stocks, notes, bonds, mortgages, or other evidences of debt . . . [, and] transmission of computer database information by a cooperative service when the database information has been assembled by and for the exclusive use of the members of the cooperative service." Also, as discussed above, Section 12-36-60 provides a specific definition of "tangible personal property" that coincides with the general understanding of "corporeal personal property" included in the definition of "tangible property" under Section 12-6-30(11).

on the sale of tangible personal property, the sale of electricity is specifically recognized and defined as a service.”

First, that decision has no precedential value and is thus not binding on this Court.

Secondly, that decision merely concluded that the taxpayer was providing a service and was thus subject to a license fee under then-Section 12-19-110. However, Section 12-19-110 was imposed “[i]n addition to . . . all other license taxes and fees or taxes of whatever kind” Section 12-19-110 did not prevent the application to the taxpayer of any other tax laws, including those that implicated “tangible personal property.” Thus, even if this Court were to adopt the position that the sale of electricity was merely a service under the Sales and Use Tax Act, the sale of electricity would simply be a service that does not fall “within the meaning of the general definition” of “tangible personal property” set forth in the first sentence of Section 12-36-60, Consolidated Hydro *4. But the inquiry does not end there in this case. The sale of electricity, though a service, would still be considered tangible personal property, as set forth in the second sentence. As such, it would be subject to tax laws imposed by other statutes upon tangible personal property, just as it was subject to license fees imposed by other statutes upon services. Thus, even under Duke Energy’s theory, it would still be considered to be “selling, distributing, or dealing in tangible personal property within this State” for corporate income tax apportionment purposes under Section 12-6-2250.

Furthermore, as previously mentioned, Merriam-Webster’s Dictionary defines “service” as “useful labor that does not produce a tangible commodity” or “a facility supplying some public demand.” Merriam-Webster Online Dictionary, www.merriam-webster.com (last visited October 29, 2012). Because, for the reasons given above, I find that electricity is a tangible commodity manufactured by Duke Energy, Duke Energy has failed to demonstrate that its “provision” of electricity to customers is a service under the first definition. As to the second definition, Duke Energy is doubtless a service because it is “a facility supplying some public demand.” However, there is nothing in this definition of service that is determinative of tangibility or intangibility. Indeed, the actual provision of a product may be intangible, while the product itself is tangible.³³ This is evident with the sales or use tax definition of “tangible personal property” under Section 12-36-60, in which sales of electricity, though considered

³³ See, e.g., *Pub. Serv. Co. v. Dep’t of Revenue*, —P.3d—, 2011 WL 4089971 (Colo. Ct. App. 2011) (“There is . . . Colorado authority that electricity is both a product and a service”).

services under that statute, are considered tangible personal property. See S.C. Code Ann. § 12-36-60 (“Tangible personal property” . . . also includes . . . sales of electricity . . .”). Thus, even looking to the sales or use tax definition, and considering the sale of electricity to be a service, the sale of electricity would still be tangible personal property for tax purposes.³⁴

In sum, although it admittedly is unique, electricity is a tangible product with identifiable physical characteristics that may be created, measured, felt, stored, and consumed, and an electric utility may exercise ownership rights over it. And even if the Court were to consider the sale of electricity merely a service, it would still be considered tangible personal property for tax purposes. Therefore, Duke Energy also falls within Section 12-6-2250(b).

More-than-50-percent Test

Though Duke Energy, as the taxpayer, may engage in activities falling under Section 12-6-2250, Duke Energy may still apply the single-factor gross receipts apportionment method under Section 12-6-2290 if the principal amount of its profits or income is derived from activities other than those covered in Section 12-6-2250. However, Duke Energy, which was engaged in more than one line of business during the Tax Periods at Issue, has the burden of proving that its principal business in this State was not from manufacturing, or any form of collecting, buying, assembling, or processing goods and materials within this State, or from selling, distributing, or dealing in tangible personal property within this State. In making this “principal business” determination, South Carolina adopts a more-than-50-percent test. The Department’s longstanding policy provides:

[W]hether a business is a service related industry can be made by comparing the gross receipts of the business derived from providing services to total gross receipts of the business. If over 50 percent of the gross receipts are from providing services, then the business would be service related. This method has been utilized by the [South Carolina Tax] [C]ommission in determining whether a multistate taxpayer is providing services and thus would utilize the gross receipts ratio to apportion its income.

³⁴ Duke Energy points out that several other states have treated the provision of electricity as something other than tangible personal property. These states would include: North Carolina, Oregon, California, and Massachusetts. However, this Court finds more persuasive the decisions of those states that hold that electricity is tangible personal property. See e.g., Exelon Corp. v. Dept’t of Revenue, 234 Ill.2d 266, 917 N.E.2d 899 (2009); Tucson Elec. Power Co. v. Ariz. Dep’t of Revenue, 170 Ariz. 145, 822 P.2d 498 (Ct. App. 1991). Moreover, Duke Energy acknowledges that other states, in contexts other than income tax, have ruled that the sale of electricity is the sale of tangible personal property. See, e.g., Davis v. Gulf Power Corp., 799 So. 2d 298, 301 (Fla. Dist. Ct. App. 2001) (property tax); Texas E. Transmission Corp. v. Benson, 480 S.W.2d 905, 908 (Tenn. 1972) (sales tax); S. Natural Gas Co. v. State, 261 Ala. 222, 73 So. 2d 731 (1953) (use tax).

Rev. Rul. No. RR-87-5 (S.C. Tax Comm'n Sept. 16, 1987). Thus, under the Department's policy, if more than 50 percent of a business's gross receipts are from providing services, then the business would be service-related and the taxpayer would be required to apportion its income to South Carolina using the single-factor gross-receipts apportionment method under S.C. Code Ann. § 12-6-2290. Otherwise, the business would have to apportion its income to South Carolina using the three-factor apportionment method under S.C. Code Ann. § 12-6-2250.

Here, Duke Energy presented testimony indicating that Duke Energy's principal business is the provision of electricity services because at all times during the Periods at Issue more than 50 percent Duke Energy's gross receipts were derived from the provision of electric services. However, in light of my findings that Duke Energy's generation, transmission, and distribution of electricity are activities falling within Section 12-6-2250, that electricity is tangible personal property, and that sales of electricity are sales of tangible personal property, I find Duke Energy's evidence insufficient to establish that more than 50 percent of Duke Energy's gross receipts were derived from activities not covered in Section 12-6-2250. Indeed, Duke Energy introduced no evidence supporting any breakdown of its gross receipts from manufacturing, services, and/or any other activity.

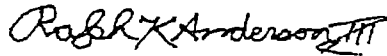
Conclusion

After considering the evidence in the record and the pertinent legal authorities, I conclude that Duke Energy failed to establish by the preponderance of the evidence that its principal business in South Carolina is not manufacturing. This Court thus rejects Duke Energy's attempt to use the single-factor apportionment formula for tax years 1994-2001 instead of the multi-factor apportionment formula it used in its original corporate income tax returns.

ORDER

THEREFORE, IT IS HEREBY ORDERED that Duke Energy's claims for refunds with respect to its attempt to use the single-factor apportionment formula for the corporate income tax periods 1994-2001 are **DENIED** and the Department's Determination is **AFFIRMED**.

IT IS SO ORDERED.



Ralph K. Anderson, III
Chief Administrative Law Judge

December 4, 2012
Columbia, South Carolina

CERTIFICATE OF SERVICE

I, E. Harvin Belser Fair, hereby certify that I have this date served this Order upon all parties to this cause by depositing a copy hereof, in the United States mail, postage paid, in the Interagency Mail Service, or by electronic mail to the address provided by the party(ies) and/or their attorney(s).

E. Harvin Belser Fair

E. Harvin Belser Fair
Judicial Law Clerk

December 4, 2012
Columbia, South Carolina

EXHIBIT B

**STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT**

Duke Energy Corporation,	)	
	)	
Petitioner,	)	Docket No. 10-ALJ-17-0270-CC
	)	
vs.	)	RECONSIDERATION ORDER
	)	
South Carolina Department of Revenue,	)	
	)	
Respondent.	)	
_____	)	

Appearances:

For the Petitioner: Burnet R. Maybank, III, Esq.; Eric S. Tresh, Esq.; Jeffrey A. Friedman, Esq.; and Maria M. Todorova, Esq.

For the Respondent: Tracey C. Green, Esq.; John W. Roberts, Esq.; Harry Hancock, Esq.; and J. Abraham Gutting, Esq.

This matter came before the Administrative Law Court (ALC or Court) following Duke Energy Corporation's (Duke Energy) request for a contested case hearing under S.C. Code Ann. § 12-60-460 (Supp. 2006). Duke Energy is contesting the Determination of the South Carolina Department of Revenue (Department) denying Duke Energy's claim for a refund of South Carolina corporate income taxes for the tax years 1994 through 2001 (Tax Periods at Issue).¹ A hearing was held before this Court on September 5 and 6, 2012. On November 2, 2012, this Court entered its Final Order and Decision (Final Decision) denying Duke Energy's claims for refund of corporate income taxes for the Tax Periods at Issue and affirming the Department's Determination that Duke Energy cannot apportion its income based on the single-factor gross-receipts apportionment method. Afterwards, Duke Energy filed a Motion for Reconsideration of the Court's Final Decision on November 13.

Some of Duke Energy's arguments warrant clarification or amendment of the original Final Decision. Accordingly, I am issuing an Amended Final Decision in this case addressing

¹ Duke Energy originally sought refunds for the tax years 1978 through 2001. On October 11, 2012, this Court ruled that Duke Energy's refund claims for the tax years 1978 through 1993 are untimely. Thus, Duke Energy's refund claims for 1978-1993 were not before the Court.

FILED

December 4, 2012

SC ADMIN. LAW COURT

those issues of whether Duke Energy can apportion its income based on the single-factor gross-receipts apportionment method. The remaining arguments will be addressed below.

DISCUSSION

Duke Energy's Motion for Reconsideration presented fifty instances in which they contend that this Court erred in the issuance of its Final Decision. Those arguments are addressed below in the numerical sequence in which they were presented.

1. Duke Energy contends that Court erred in finding that Duke Energy "furthers its primary business by owning and operating transmission and distribution assets in South Carolina and North Carolina." The Final Decision has been amended to address this issue.

2-4. Duke Energy contends that the Court improperly disregarded factual evidence that Duke Energy was subject to the regulation of its "rates and services" by the South Carolina Public Services Commission and the Federal Energy Regulatory Commission and its operations were characterized as a "franchise electric service business." The Court clearly acknowledged in the Stipulations of Fact (stipulation 10, p. 3) that Petitioner was regulated by the South Carolina Public Service Commission (Commission) as an "electric utility" pursuant to S.C. Code Ann. § 58-27-10 (7). Though Section 58-27-10(7) does not refer to an "electric utility" as providing a "service, Section 58-27-10 (8) does set forth that:

The term "rate" means and includes every compensation, charge, toll, rental, and classification, or any of them, demanded, observed, charged, or collected by any electrical utility for any electric current or service offered by it to the public and any rules, regulations, practices, or contracts affecting any such compensation, charge, toll, rental, or classification.

The Court further recognizes that Duke Energy "services" are subject to the regulation of the Federal Energy Regulatory Commission. Nevertheless, as explained in the Court's Decision, this "service" is that of "a facility supplying some public demand." See e.g., Black River Elec. Co-op., Inc. v. Pub. Serv. Comm'n, 39 P.U.R.3d 232, 120 S.E.2d 6 (S.C. 1961) ("The purpose underlying Section 24-63 was to prevent competition between utilities rendering service of the same kind so as to eliminate waste incident to a duplication of facilities."). Therefore, citation to the regulation of those bodies did not support Duke Energy's contentions. It thus was not probative as to the nature of Duke Energy's primary activities and thus its classification for corporation income tax purposes under either Section 12-6-2250 or -2290.

5. Duke Energy contends that the Court erred in finding that the profits from the flat-rate and capacity charges were not a significant portion of Duke Energy's profit from the sale of electricity. As the finder of fact, the Court simply does not find that the evidence established that these charges were a significant portion of Duke Energy's business. In fact, I find the evidence established otherwise. For instance, Mr. Robinson testified that a majority of an electric utility's, and thus Duke Energy's, product is not provided on a flat-fee basis. Tr. p. 393, lines 5-18. And Duke Energy's expert witness, Mr. Jamil, testified that though not always, Duke Energy typically provides electric service on a metered basis. Id. at 106, lines 22-23. He testified that he could not testify as to whether a flat fee for lighting generated a significant amount of Duke Energy's revenues. Id. at 175, lines 10-21.

As to the capacity charge, Mr. Jamil did testify that the capacity charge was a significant part of a customer's bill. However, he also testified that the amount of the charge depends on the customer's usage. Id. at 178, lines 18-19. He also testified that the amount of the charge would depend on the customer class. Id. at 179, lines 20-25 to p. 180, line 1. When asked about the capacity charge for a residence per month, Mr. Jamil testified that he did not have that information. Id. at 180, lines 8-12. Duke Energy has the burden of proving its case by a preponderance, or greater weight of the evidence, and merely stating that a capacity charge is a significant portion of a customer's bill (he did not testify that this charge was a significant portion of Duke Energy's receipts), is insufficient, especially in light of the fact that the witness admitted that the charge in relation to the bill was variable.

6. Duke Energy contends that the Court erred in finding that the process of generating electricity is the same process employed since the early 20th century. Duke Energy failed to set forth facts in the record to support this claim. See e.g., Campbell v. Carr, 361 S.C. 258, 603 S.E.2d 625 (Ct. App. 2004). Moreover, Duke Energy failed to explain the implication of the purported error upon the decision in this case. Furthermore, there is no evidence that the introduction of renewable energies, the use of solar panels, and the development of more efficient wind generators occurred during the Periods at Issue (1994-2001). Nevertheless, the following facts are cited as supporting the amended finding regarding this issue:

Q: Now, a lot of your generation facilities use a turbine; is that correct?

A: (Nods head affirmatively.)

Q: Not all of them.

A: Many of them do.
 Q: Many of them.
 A: Yeah.
 Q: And the design of a turbine used in one of these plants hasn't really changed since the early 20th century, has it?
 A: Not significantly.
 Q: And the generation process that we're discussing here today that Duke Energy makes available, that's not really changed much since the early 20th century, has it?
 A: I mean, we've made it significantly more efficient, but
 Q: Used technology --
 A: Yeah.
 Q: -- and things like that?
 A: Different material --
 Q: Is that correct?
 A: Yeah.
 Q: But the basic process is the same.
 A: Basic process is the same

Tr. p. 169 line 25 to p. 170, line 24.

Q: And the process of generating electricity hasn't changed in the last hundred years.
 A: For most of the part, no. However, we have added renewable energies. So in consideration of the environment, we have developed solar panels. We have also developed more efficient wind generators. Again, mainly to mitigate any environmental effects that we may have from traditional techniques.

Tr. p. 289 lines 11-19.

7-8. Duke Energy contends that the Court erred in finding that Duke Energy's generation and purchase of electricity using natural gas, wind and solar, "appear to be much less significant" than other methods. Duke Energy failed to explain the implication of the purported error upon the decision in this case. Furthermore, as the finder of fact, the Court is entitled to attribute as much or as little weight to evidence as it wishes. See MRI at Belfair, LLC v. S.C. Dep't of Health and Envtl. Control, 392 S.C. 314, 324, 709 S.E.2d 626, 631 (2011) ("[A]s the fact-finder, the ALC was free to make factual findings based on its view of the credibility and weight of the evidence"). Here, as the finder of fact, the Court simply does not find that the

evidence established that Duke Energy's generation of electricity based upon natural gas, wind, and solar was significant during the Tax Periods at Issue. See e.g., Tr. p. 117, line 10 to p. 118, line 1. Duke Energy also argues that the Court erred in finding that Duke Energy's purchase of electricity from other electric utilities "appear[s] to be much less significant." Duke Energy instead asserts that it presented evidence that purchasing electricity from other utilities is an integral and necessary part of its primary business. However, Duke Energy's own witness, Mr. Monroe, testified as follows:

Q: But Duke Energy generates most of its own electricity that it sells, doesn't it?

A: Yes.

Tr. p. 88, lines 9 -11.

9. Duke Energy contends that the Court improperly ignored that the Department had conceded, in its Determination denying Duke Energy's refund claims and in its Pre-Hearing Statement, that Duke Energy provides a service. The Administrative Law Court hears this case as the de novo finder of fact. Young v. S.C. Dept. of Health and Envtl. Control, 383 S.C. 452, 680 S.E.2d 784 (Ct. App. 2009); Risher v. S.C. Dept. of Health and Envtl. Control, 393 S.C. 198, 207, 712 S.E.2d 428, 433 (2011), reh'g denied (July 21, 2011) ("The ALC, as the ultimate finder of fact in this action, was free to visit the Lot and draw its own conclusions therefrom."). The Court therefore makes its determination based upon its reasonable view of the facts. Furthermore, the Court is free to reach its own conclusions of law. As such, the Court in this case found, as set forth in its Final Decision, that Duke Energy's primary business is manufacturing and not providing a "service."

10. Duke Energy contends that the Court failed to consider the legislative history of Sections 12-6-2250 (and its predecessor Section 12-7-1120) and 12-6-2290 (and its predecessor Section 12-7-1190), as well as guidance issued by the Department on the same topic that the multi-factor apportionment formula is designed for taxpayers dealing in tangible personal property (such as manufacturers) whereas the single-factor gross-receipts formula is designed for taxpayers who do not deal in tangible personal property, such as service businesses. The Court simply disagrees with that assertion. The Court certainly made clear, as finder of fact and in its conclusions of law, that electricity is tangible personal property. Furthermore, there is evidence in the record that electricity is tangible. See e.g., Tr. p. 335, lines 19-21; p. 363, lines 3-7; p. 376, lines 12-23.

11. Duke Energy contends that the Court erred in disregarding the testimony of Duke Energy's expert witness, Dr. Papapolymerou, regarding whether one can feel electricity. First, Duke Energy carries the burden of proving that a person can not feel electricity, and as the finder of fact, the Court can choose to accept in part or in whole the testimony of expert witnesses. MRI at Belfair, LLC, 392 S.C. at 324, 709 S.E. at 631 ("[A]s the fact-finder, the ALC was free to make factual findings based on its view of the credibility and weight of the evidence"). Second, there is evidence in the record that electricity can be touched and sensed. See e.g., Tr. p. 332, lines 19 - 25; p. 376, lines 12 - 23. Here, the Court did not find any of the witnesses credible as to the physiology of the human body with respect to the nervous system, but did determine that electricity can be sensed, touched, and therefore felt.

12-13. Duke Energy contends that the Court erred in finding that Duke Energy produces electrical charge. Duke Energy also contends that the Court failed to consider the parties' expert witnesses' testimony that Duke Energy does not create the electrons residing in the power lines, and that the provision of electricity is not the transfer of electrons to the customers. As the finder of fact, the Court can choose to accept in part or in whole the testimony of expert witnesses. See MRI at Belfair, LLC, 392 S.C. at 324, 709 S.E. at 631 ("[A]s the fact-finder, the ALC was free to make factual findings based on its view of the credibility and weight of the evidence"). Moreover, the Court found that an electrical charge is a component of what is produced by Duke Energy. Dr. Papapolymerou testified that Duke Energy generates the electromagnetic field that causes the electrons to oscillate and thus the charges to flow, providing energy. See e.g., Tr. p. 285, lines 13 - 23; p. 288, line 13 to p. 289, line 3. Thus, electrical charge is a component of the energy generated by Duke Energy because the charges are manipulated by the magnetic field that is created and controlled by Duke Energy, which creates the energy that Duke Energy provides.

14. Duke Energy contends that the Court erred in making a factual finding that electricity can be created, felt, stored, or consumed and is a tangible product with identifiable physical characteristics. Duke Energy carries the burden of proving that a person can not feel electricity, and as the finder of fact, the Court is entitled to attribute as much or as little weight to evidence as it wishes. See MRI at Belfair, LLC, 392 S.C. at 324, 709 S.E. at 631 ("[A]s the fact-finder, the ALC was free to make factual findings based on its view of the credibility and weight of the evidence"). Here, the answers above, and the Amended Final Decision on pp. 23-24, address the issues of whether electricity can be created, felt, or is tangible. Moreover,

"consumed," as utilized in the Final Decision and Amended Final Decision, refers to the utilization of electricity as a customer. See Merriam-Webster Online Dictionary, www.merriam-webster.com (defining "consumed" as "to utilize as a customer") (last visited November 20, 2012). The evidence also established that the source of electricity, an electrical charge, can be stored. See e.g., Tr. p. 121 line 24 to p. 122, line 10; p. 259 lines 19-25; p. 277, line 17 to p. 278, line 4; p. 299 lines 4-5.

15. Duke Energy contends that the Court erred in disregarding Duke Energy's expert witness's testimony regarding the nature of electricity. Duke Energy carries the burden of proof and as the finder of fact, the Court is entitled to attribute as much or as little weight to evidence as it wishes. See MRI at Belfair, LLC, 392 S.C. at 324, 709 S.E. at 631 ("[A]s the fact-finder, the ALC was free to make factual findings based on its view of the credibility and weight of the evidence"). Moreover, this overly-broad issue fails to sufficiently specify an error.

16. Duke Energy contends that the Court erred in disregarding the Department's expert witness's testimony that Duke Energy provides a service. Duke Energy carries the burden of proof and as the finder of fact, the Court is entitled to attribute as much or as little weight to evidence as it wishes. MRI at Belfair, LLC, 392 S.C. at 324, 709 S.E. at 631 ("[A]s the fact-finder, the ALC was free to make factual findings based on its view of the credibility and weight of the evidence"). In reaching my factual determinations, I gave this evidence little, if any, weight and therefore chose not to reference it, being unpersuasive. Nevertheless, I now specifically find this evidence was not persuasive.²

17. Duke Energy contends that the Court erred in holding that "No other electrical utilities challenged that position [that electric utilities were manufacturers]" Duke Energy carries the burden of proof and as the finder of fact, the Court is entitled to attribute as much or as little weight to evidence as it wishes. See MRI at Belfair, LLC, 392 S.C. at 324, 709 S.E. at 631 ("[A]s the fact-finder, the ALC was free to make factual findings based on its view of the credibility and weight of the evidence"). Here, the evidence reflected that Mr. Southard was not aware of any challenges to the Department's position, other than that posed by Duke Energy. See Tr. p. 203, lines 1-2. And Duke Energy presented no evidence to the contrary. Moreover,

² I further note that it is the Court's responsibility to make "findings of fact." However, I am not aware of any responsibility to make "non-findings of fact."

since Duke Energy did not challenge the legal implications of this determination, the Court will not address that issue.

18. Duke Energy contends that the Court erroneously concluded that the Department has a longstanding policy of treating electric utilities as manufacturers for purposes of corporate income tax apportionment. I find the law cited in the Court's Final Decision supports the conclusion reached by the Court. The Court did not give deference to the Department based on its audit manual. Rather, the Court relied on a 1985 S.C. Tax Commission determination and on earlier S.C. Supreme Court decisions in Columbia Ry. and Duke Power Co. v. Bell in concluding that the public, including the General Assembly, was given notice of the Department's policy of treating electric utilities as manufacturers for purposes of corporate income tax apportionment.

19-20. Duke Energy contends that the Court gave improper deference to the Department's alleged long-standing policy of treating electric utilities as manufacturers for South Carolina income tax purposes. As set forth above, the law cited in the Court's Final Decision supports the conclusion reached by the Court. Here, there were prior known interpretations regarding the Department's policy of treating electric utilities as manufacturers for South Carolina corporate income tax purposes, and those interpretations were not contrary to any statute or regulation. The Court's rejection of Duke Energy's position is not a failure to consider that position. Moreover, Duke Energy cited no law in its Motion for Reconsideration to support its reasoning regarding these issues. See e.g., Campbell v. Carr, 361 S.C. 258, 603 S.E.2d 625 (S.C. App. 2004).

21. Duke Energy contends that the Court erroneously concluded that because Duke Energy filed its tax returns using the multi-factor apportionment formula over the course of 23 years, "the returns were filed in accordance with the policies and filing requirements promulgated by the Department." The Court found that Duke's filing according to the multi-factor apportionment formula over the course of 23 years "leads to the conclusion that "the returns were filed in accordance with the policies and filing requirements promulgated by the Department and as understood by Duke Energy at the time the returns were originally filed." (Emphasis added). The Final Decision has been amended to remove "and" from before "as understood" because it is unnecessary. Furthermore, Duke Energy failed to explain the implication of the purported error upon the decision in this case. Moreover, as the finder of fact, the Court is entitled to attribute as much or as little weight to evidence as it wishes. See MRI at

Belfair, LLC, 392 S.C. at 324, 709 S.E. at 631 (“[A]s the fact-finder, the ALC was free to make factual findings based on its view of the credibility and weight of the evidence”). Here, there was sufficient evidence from which the Court as the finder of fact could reasonably conclude that the Department had a longstanding policy of which Duke Energy should have been aware.

22. Duke Energy contends that the Court erroneously concluded that Columbia Ry. Gas & Elec. Co. v. Query, 134 S.C. 319, 132 S.E. 611 (1926), was decided in the income tax context. The Court’s Final Decision has been amended to address this issue.

23. Duke Energy contends that the Court erred in holding that the Department, in S.C. Tax Comm’n Decision P-D-532, 1985 WL 192777 (Apr. 11, 1985), ruled that the property tax assessment ratio for electric utilities should be 6% (as opposed to 10.5% applicable to the personal property of non-manufacturing entities).” However, as the Tax Commission pointed out in S.C. Tax Comm’n Decision P-D-532, 1985 WL 192777 (Apr. 11, 1985), South Carolina, in Columbia Ry., “has recognized that certain utilities may also be manufacturers,” and that utilities that generate electricity or any other power that they supply to their customers are such utilities and therefore manufacturers. The Commission also cited 17 A.L.R.3d, Taxes, “Manufacturing,” § 44, 102. The Tax Commission thus concluded that “X” Electric and Gas was a manufacturer and that the tax assessment ratio that applied to it was only 6% - the rate that a manufacturer paid on real property owned by or leased to the manufacturer and used primarily as an office building that is not located on the premises of or contiguous to the plant site of the manufacturer, which was the situation in that case. As the Tax Commission also properly pointed out, the reference to “utilities” in 12-43-220(a)(1) is limited to utilities that merely supply light, water, power, heat, transportation or means of communication, but do not generate the power that they supply to their customers. Those that generate the power they supply, such as Duke Energy, are considered manufacturers, not mere utilities.

24. Duke Energy contends that the Court erred in concluding that the terms “goods and materials” contained in Section 12-6-2250(a) “reflect[] that the Legislature intended to cover not just manufacturing but all activities that a business could perform in regards to a *product* prior to making that *product* available to its customers.” (Emphasis in original). The Final Decision has been amended to address this contention.

Duke Energy also asserts that both parties’ experts agree that electricity is not a material. The Court never found that electricity is a material. Rather, the Court noted that raw materials,

such as coal, water, or nuclear fuel, are processed to generate or produce the electricity. Under the facts of this case, the Court considers "generation," "manufacturing," and "production," from which the term "product" is derived, to be synonymous. Duke Energy then argues that Duke Energy presented ample evidence showing that electricity is not tangible personal property or a good. First, as reflected in the Final Decision, tangible personal property is a separate consideration, under subsection (b), from the "goods and materials" discussed in subsection (a). Nevertheless, the evidence established that electricity is tangible. See, e.g., Tr. p. 335, lines 19-21; p. 363, lines 3-7; p. 376, lines 12-23; p. 378, lines 13-15. Finally, Duke Energy maintains that the Department has not presented any evidence to show that electricity is a good or material. On the contrary, there is more than sufficient evidence that the electricity that Duke Energy generated during the Tax Periods at Issue satisfied an economic want, which causes that electricity to fall under the definition of "good."³

25. Duke Energy contends that the Court improperly applied the Webster's definitions of "manufacturing" and erroneously concluded that Duke Energy "makes" or "produces" "something." Duke Energy has cited no law explaining what was improper about applying Webster's definitions of "manufacturing." "Manufacturing" is not defined in the applicable statutes, and it is not a legal term of art. Therefore, it is perfectly proper to refer to a dictionary to understand the common usage of a statutorily-undefined term, as our Supreme Court has often done. Again, this Court finds "make," "produce," and "manufacture" to be synonymous. As finder of fact recognizing the burden of proof, this Court finds that there was more than sufficient evidence to support its finding that Duke Energy generates, or manufactures, electricity. In fact, Duke Energy's own witness, Mr. Jamil, testified that Duke Energy generates electricity, and also affirmed that Duke Energy uses various generation processes to produce electricity. See, e.g., Tr. p. 101, line 13 to p. 102, line 48. Therefore, Duke Energy's own witness testified not only that electric energy is generated or produced by Duke Energy, but also, based on his responses, clearly viewed generation and production as synonymous, and naturally so.

26. Duke Energy contends that the Court erred in finding that "the evidence in this case establishes that Duke Energy is a manufacturer" based on the Court's definition of

³ The sum of money involved in this case, being just income taxes alone, reflects that Duke Energy's electricity satisfied a vast quantity of economic want.

"manufacturing" as "the act or process of producing something" when Duke Energy presented evidence that it does not produce anything because electricity cannot be created or destroyed. The Court adopts the conclusions stated in response (25) above and further notes that Duke Energy carries the burden of proof, and as the finder of fact, the Court is entitled to attribute as much or as little weight to evidence as it wishes. See MRI at Belfair, LLC, 392 S.C. at 324, 709 S.E. at 631 ("[A]s the fact-finder, the ALC was free to make factual findings based on its view of the credibility and weight of the evidence").

27. Duke Energy contends that the Court improperly considered cases from other states decided in tax contexts *other than income tax* holding that the generation of electricity is manufacturing, while, at the same time, the Court failed to consider *more recent* decisions from other jurisdictions decided in the *corporate income tax context* which hold that the provision of electricity is a service and not manufacturing. First, this Court finds that the cases cited properly supports the legal conclusions reached by the Court. Interestingly, one of the cases cited by the Court is dated September 15, 2011, which appears to this Court to be "recent." In addition, Duke Energy has not explained why the ages of cases discredit the legal holding of those courts. It is simply a reflection that in those states, as in South Carolina, the law on this issue was settled long ago. Moreover, the Court found cases cited in Footnote 19 to be more akin to South Carolina law and therefore more convincing.

28. Duke Energy contends that the Court erred in making a factual finding that Duke Energy "cannot produce or deliver electricity to consumers in the absence of any one of these parts [- generation, transmission, and distribution,]." At the outset, Duke Energy carries the burden of proof, and as the finder of fact, the Court is entitled to attribute as much or as little weight to evidence as it wishes. See MRI at Belfair, LLC, 392 S.C. at 324, 709 S.E. at 631 ("[A]s the fact-finder, the ALC was free to make factual findings based on its view of the credibility and weight of the evidence"). Nevertheless, in light of Duke Energy assertion, the disputed language has been modified in the Amended Final Decision.

As to the remaining language, there was evidence that Duke Energy sometimes purchases electricity from other electric utilities. See e.g., Tr. p. 117, line 10 to 119, line 8; Tr. p. 181, lines 8-11. However, the evidence did not establish that Duke Energy's purchasing of electricity from other electric utilities is a significant or necessary part of its business, or is "routinely" done. Mr. Jamil testified that it was "possible" to provide all of its electric service to

South Carolina without generating the electricity. Id. at 118, line 25 to 19, line 5. But he also admitted that he understands this would not be the most cost efficient. Id. at 119, line 6-8. More importantly, what Duke Energy could possibly do and what it actually did during the Taxable Periods at Issue are two different things. Duke Energy may sometimes purchase electricity from other electric utilities, but most of the electricity that Duke Energy provides to its customers is generated by Duke Energy. In addition, the evidence also clearly established that Duke Energy needs three components – generation, transmission and distribution – to provide electricity to its customers. See e.g., Id. at 104, lines 11-24.

29. Duke Energy contends that the Court erroneously reasoned that because electricity can be measured, generating electricity is manufacturing, when in fact, Duke Energy presented evidence that it also provides electricity on a fixed-fee basis. As to Duke Energy's provision of electricity on a fixed-fee basis, this was addressed in Footnote 3 and on p. 20 of the Final Decision, and need not be repeated here. As to measurability, this Court quite agrees that measurability alone is not an indication of manufacturing, which is why the Court noted measurability as "further evidence[]" and "further support[]" that generating electricity is manufacturing. All of the other reasons why generation is manufacturing were discussed prior to the paragraph on measurability. Together, all of these reasons led the Court to the conclusion that the generation of electricity was manufacturing.

30. Duke Energy contends that the Court erroneously concluded that Duke Energy cannot "provide" electric service "without the existence of electricity, and the electricity that Duke Energy provides cannot exist without first being produced, or manufactured." Quizzically, Duke Energy questions whether Duke Energy can provide electricity without its existence (it argues that electricity cannot be created or destroyed). The error of that objection is so obvious the Court need not comment further. Furthermore, as reflected in the record, electricity must be sold at a regulated voltage to be usable by the public. Duke Energy's expert testified that "[w]e drop the voltage down to a level that is usable to the customer – typically 120 volts; sometimes 220 volts. . . ." Tr. p. 115, lines 21-24. Since there was no evidence that electricity naturally exist at 120 volts, this Court found that "the electricity that Duke Energy provides cannot exist without first being produced, or manufactured." Additionally, see responses (25) and (26) above for additional explanation.

31. Duke Energy contends that the Court failed to consider testimony by Duke Energy's witness that the Standard Industry Classification System, which was in effect during the Periods at Issue, classified electric utilities and manufacturers in two separate categories, having two different codes, and that as an electric utility, Duke Energy was required to use the code applicable to the electric utilities classification. Footnote 24 in the Final Decision (Footnote 28 in the Amended Final Decision) adequately addresses this issue.

32. Duke Energy contends that the Court made an erroneous finding that "services typically are not measured by the quantity of the product consumed and are not delivered to or measured by mathematical calculations regarding the nature of the services." The Final Decision has been amended to address this issue.

33. Duke Energy contends that the Court made an erroneous finding when it concluded that "any electromagnetic field results from the electric current created by the generator." The Final Decision has been amended to clarify the Court's findings. However, Duke Energy's expert witness (Mr. Jamil), explained that in layman's terms the "electromagnetic field" is "current" or an "electric field." Tr. p. 153, lines 1-3; 17-23. Nevertheless, it is a "charge." *Id.* Mr. Jamil also explained that an electromagnetic field does not exist unless there is a current. Tr. p. 154, lines 21-25. He further testified as follows:

Q: And you have generation facilities in South Carolina and North Carolina.

A: Yes, we do.

Q: And the generator turns by -- it's the -- I assume it's a fairly large machine; is that correct?

A: Oh, yes.

Q: A mechanical device?

A: Yes.

Q: And then it creates a varying magnetic field?

A: Yes, it does.

Q: And then that generates the electricity?

A: That -- yes, that generates --

Tr. p. 157, lines 14-16; p. 159, lines 7-16. Therefore, ultimately, the electromagnetic field that is created by Duke Energy's generators results in the production of electricity that is sold by Duke Energy.

34. Duke Energy contends that the Court made an erroneous finding and failed to consider evidence presented by Duke Energy when it concluded that "substantially all, if not all, of the electricity provided by Duke Energy is priced at some level based on quantity." I agree. Therefore, the Final Decision has been amended to reflect the change. "Substantially all, if not all," will be replaced by "the majority."

35. Duke Energy contends that the Court improperly discounted the similarities between the electricity provided by a telecommunications company and the electricity provided by Duke Energy. Again, Duke Energy carries the burden of proof, and as the finder of fact, the Court is entitled to attribute as much or as little weight to evidence as it wishes. See MRI at Belfair, LLC, 392 S.C. at 324, 709 S.E. at 631 ("[A]s the fact-finder, the ALC was free to make factual findings based on its view of the credibility and weight of the evidence"). Here, telecommunications companies use electricity, but they are providers or conveyors of communications or intelligence produced or created by one customer to another. This finding is more thoroughly addressed on pp. 20-21 of the Amended Final Decision.

36. Duke Energy contends that the Court failed to consider the definition of "manufacturing" in other contexts of the South Carolina Income Tax, as brought to the Court's attention in Duke Energy's Pre-Trial Brief. To the contrary, the Court considered Duke Energy's definition as set forth on p. 16 of its pretrial brief in the other contexts of the South Carolina Income Tax Act. The first context cited by Duke Energy was the Renewable Tax Incentive Program under S.C. Code Ann. § 12-6-3588(B)(2). However, the Court rejected the definition of "manufacturing" under that statute because it became effective January 1, 2011, well after the Tax Periods at Issue in this case. As to the other provision cited by Duke Energy in its pretrial brief, Section 12-6-2260(M)(5), (6), the Court could not consider what it could not find. There was no subsection (M)(5) or (6) for Section 12-6-2260 during the Tax Periods at Issue. "Manufacture" is mentioned in (D)(5), the last provision of this statute, but this relates to unmanufactured tobacco stored in warehouses in this State for subsequent shipment to a manufacturer in another state. It provides no guidance as to the meaning of "manufacture" and is unrelated to the case at hand.

As to the definition of tangible personal property, in the Final Decision the Court agreed with Duke Energy that the "tangible property" definition under 12-6-30(11) should be used and did apply that definition. That definition included the term "corporeal," which is not a legal term

of art in this case, and which is generally understood to mean "of a material nature; tangible." The Final Decision has nonetheless been amended to clarify that the Court only looked to the other statutory definition of "tangible property" to further support the plain meaning of the definition under 12-6-30(11). Section 12-36-60's definition was perfectly consistent with the plain ordinary meaning of "tangible" as something corporeal (material/physical).

37. Duke Energy contends that the Court improperly ignored the definition of "manufacturing" contained in the Income Tax Act, Jobs Tax Credit provisions. Duke Energy avers that the Court should have applied Section 12-6-3360(M)(8), which defines a "manufacturing facility" as "an establishment where *tangible* personal property is produced or assembled." However, during the Periods at Issue, the term "manufacturing facility" was defined in Section 12-6-3360(M)(5), not (8). Nevertheless, the Court agrees with the definition of "manufacturing" contained therein; and because the Court finds that the electricity generated by Duke Energy is tangible personal property, this definition is consistent with the Court's definitions of "manufacturing" and thus there is no ambiguity as to the definition of the term "manufacturing."

38. Duke Energy contends that the Court erred in holding that "manufacturing" is defined as "the act of processing or producing something." In light of this allegation, the Final Decision has been amended to include the more specific definitions for "manufacturing." Additionally, as to Duke Energy's arguments concerning the nature of the product produced by law firms, that is not at issue in this case. The Court notes, however, that law firms, like telecommunications, are in the business of conveying information, intelligence, and communications, and therefore do not appear to be manufacturers.

39. Duke Energy contends that the Court erred in holding that Duke Energy is a manufacturer because it charges its customers based on quantity and cannot produce unlimited quantities. To the contrary, all tangible items must be quantifiable, but not all quantifiable items are tangible.⁴ Hours, though quantifiable, are not tangible.⁵ And again, as mentioned in

⁴ Duke Energy argument is an example of the fallacy of denying the antecedent. See, Ruggero J. Aldisert, Logic for Lawyers: A Guide to Clear Legal Thinking 160 (National Institute for Trial Advocacy 3d ed. 1997); see also Irving M. Copi, Introduction to Logic 295 (5th ed. 1978).

⁵ It is nonetheless notable that the computation of hours is not based upon a physical quantification, but a formulaic quantification. As explained above, electrical current is measured based upon the movement or charge of an electrons, which have mass. Tr. 285, line 21 to p. 283, line 2; p. 330, line 1 to 331, line 2.

response (29) above, the finding that Duke Energy is a manufacturer was not based solely on the fact that it charges customers based on quantity and cannot produce unlimited quantities.⁶ Because tangible items must be quantifiable, showing that an item is quantifiable, though not itself conclusive, is a further indication that an item is tangible. At any rate, Duke Energy carries the burden of proving that electricity is not tangible, which it has failed to meet.

40. Duke Energy contends that the Court's construction of "manufacturer" was erroneous because "the statute's language is plain, unambiguous, and conveys a clear, definite meaning" and even if any ambiguities exist, "the taxpayer should receive the benefit in case of doubt." The soundness of the Court's decision regarding this issue is set forth in the Amended Final Decision and in responses (36) and (37) of this Order.

41. Duke Energy contends that the Court erred in finding that the generation of electricity is a form of processing raw materials used to create energy when Duke Energy presented uncontroverted evidence that electricity (or energy) cannot be created. That contention was controverted by Duke Energy's own witness. Mr. Jamil testified that Duke Energy's generators, which are turned by energy released by Duke Energy's processing of raw materials such as water, coal, or nuclear fuel, create an electric charge that travels in the form of a current and that oscillates electrons to produce an electromagnetic field, and that electromagnetic field generates electricity. Indeed, he testified that all of the generation processes that Duke Energy uses produce electricity. See response (33) above; Tr. p. 101, line 23 to p. 102, lines 1-24; p. 154, lines 11-18; p. 159, lines 7-16.

42. Duke Energy contends that the Court erred in considering Section 12-36-60 to interpret the term "corporeal" used in the definition of "tangible property" codified in Section 12-6-30(11). Though Section 12-36-60 does not mention the term "corporeal," at least in name, it does provide a specific definition of "tangible personal property" – "personal property which may be seen, weighed, measured, felt, touched, or which is in any manner perceptible to the sense" – which coincides with the general understanding of the term "corporeal," which is included as "tangible property under Section 12-6-30(11). The Final Decision has been amended to clarify this point.

⁶ This conclusion is reflected by the Court's finding in the Final Decision that Duke Energy is engaging in manufacturing uses the terms "further evidenced" and "further supports." See Page. 18 of Amended Final Decision.

43. Duke Energy contends that the Court erred in relying on the sales tax definition of "tangible personal property" in Section 12-36-60 in determining whether electricity is tangible or a service for income tax purposes. The Court's response (36) of this Order addresses this assertion. Furthermore, this Court found no conflict in the definitions of tangible property. Rather, it considered both provisions and found that both set forth the plain, ordinary meaning of "tangible." In addition, the term "corporeal" used in the first definition is well understood to be synonymous with "tangible." The Court's reason for citing the alternate definition of "tangible" was to further reflect this fact.

44. Duke Energy contends that the Court erred in concluding that electricity is tangible personal property based on the first sentence of the sales tax definition of "tangible personal property" in Section 12-36-60. To the contrary, a plain reading of the statute reflects that it clearly includes "intangibles or services" under the definition of "tangible personal property," as Duke Energy admits in its allegation (45).

45. Duke Energy contends that the Court misinterpreted the sales tax definition of "tangible personal property" in Section 12-36-60, because there the South Carolina Legislature specifically chose to define "services and intangibles, including ... sales of electricity" as tangible personal property, something the Legislature did not do in the income tax context. This issue is addressed in Footnote 32 of the Amended Final Decision. It is also notable that Duke Energy cited Consolidated Hydro, in which the court applied sales tax statutes, including Section 12-36-60, in a license fee context.

46. Duke Energy contends that the Court misinterpreted the nonbinding holding in Consolidated Hydro S.E., Inc. v. S.C. Dep't of Revenue & Taxation, No. 95-ALJ-17-0634, 1996 WL 909155 (S.C. Admin. L.J. Div. May 13, 1996). More specifically, Duke Energy submits that the court in Consolidated Hydro did not apply the sales tax definition of that term in the license tax context because the Legislature had not defined "services and intangibles, including ... sales of electricity" as "tangible personal property" for license tax purposes. I simply disagree. A license fee was at issue, yet the court in Consolidated Hydro applied sales tax statutes, devoting two paragraphs to consideration of its implications in that case.

47. Duke Energy contends that the Court erred in relying on Section 16-13-380, regarding the theft of electrical services. I agree that the Court erred, but only as to how the Court used that section. The Final Decision has been amended accordingly.

48. Duke Energy contends the Court erred in holding that electricity is a tangible product because it can be measured, felt, stored and consumed, when in fact intangibles such as sunlight, wind, and gravity are all subject to the same. Duke Energy carries the burden of proving that electricity is not tangible, which it has failed to meet. As to the implications of measuring a product, Duke Energy's argument is premised upon the contention that if intangible products can be measured, then the measurement of a product is irrelevant to the determination of whether a product is in fact tangible. It is true that just because something can be measured, felt, etc. does not necessarily mean that it is tangible. However, because that which is tangible must be measurable, demonstrating measurability, though not conclusive of tangibility, supports a showing of tangibility.⁷

As to whether, electricity may be felt, stored or consumed, those issues are addressed above.

49. Duke Energy contends that the Court erroneously concluded that Duke Energy's evidence was insufficient to establish that more than 50 percent of its gross receipts were derived from activities not covered in Section 12-6-2250. Stated more correctly, the Court concluded that Duke Energy failed to meet its burden of proving that more than 50 percent of its gross receipts were derived from activities not covered in Section 12-6-2250. Duke Energy carries the burden of proof and as the finder of fact, the Court is entitled to attribute as much or as little weight to evidence as it wishes. See MRI at Belfair, LLC, 392 S.C. at 324, 709 S.E. at 631 ("[A]s the fact-finder, the ALC was free to make factual findings based on its view of the credibility and weight of the evidence"). Here, Duke Energy introduced no evidence supporting any breakdown of its gross receipts from manufacturing, services, and/or any other activity. In fact, there was evidence to the contrary. Mr. Robinson testified as follows:

Q: Do you have any experience with respect to working in an electric utility that provided electricity on a flat-fee basis?

A: I know that all electric utilities provide a minority of their product on a flat-fee basis, but the majority is charged for.

Tr. p. 393, lines 13-18.

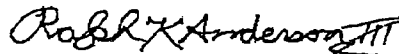
⁷ Once again, Duke Energy tramples upon the fallacy of denying the antecedent. See, Ruggero J. Aldisert, Logic for Lawyers: A Guide to Clear Legal Thinking 160 (National Institute for Trial Advocacy 3d ed. 1997); see also Irving M. Copi, Introduction to Logic 295 (5th ed. 1978).

50. Duke Energy contends that the Court failed to consider Duke Energy's argument that Duke Energy's 1977 Restated Charter is of little use in deciding whether Duke Energy is engaged in manufacturing. This allegation is perplexing. The Court did not cite the Restated Charter in its factual finding or legal conclusion. The only reference to the Charter is in the Stipulations of Fact. Since the Court failed to address even the existence of the Charter in its Final Decision – thus giving it no weight – it is difficult to understand how the Court erred in giving "little" weight.

IT IS THEREFORE ORDERED that that the Petitioners' Motion for Reconsideration is denied, in part, and granted, in part, in keeping with this Order.

IT IS FURTHER ORDERED that all additional factual findings in this Order are incorporated into the Amended Final Order and Decision as findings of fact.

AND IT IS SO ORDERED.



Ralph King Anderson, III
Chief Administrative Law Judge

December 4, 2012
Columbia, South Carolina

CERTIFICATE OF SERVICE

I, E. Harvin Belser Fair, hereby certify that I have this date served this Order upon all parties to this cause by depositing a copy hereof, in the United States mail, postage paid, in the Interagency Mail Service, or by electronic mail to the address provided by the party(ies) and/or their attorney(s).

E. Harvin Belser Fair

E. Harvin Belser Fair
Judicial Law Clerk

December 4, 2012
Columbia, South Carolina

NEXSEN|PRUET

January 3, 2013

Burnet R. Maybank, III
Member
Admitted in SC

BY HAND DELIVERY

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

RECEIVED

JAN 03 2013

Re: Duke Energy Corporation v. South Carolina Department of Revenue
10-ALJ-17-0270-CC

SC Court of Appeals

Dear Ms. Kitchings:

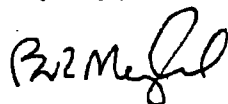
Enclosed for filing is an Amended Notice of Appeal in the above case. Also enclosed are the following:

Charleston
Charlotte
Columbia
Greensboro
Greenville
Hilton Head
Myrtle Beach
Raleigh

1. Proof of Service of the Amended Notice of Appeal on the Respondent; and
2. A copy of the Orders (referenced as Exhibits A through G) which are to be challenged on appeal.

Please return one clocked copy to me via our courier. If you require anything further, please let me know.

Very truly yours,



Burnet R. Maybank, III

BRM/caa
Enclosures

cc: The Honorable Ralph K. Anderson III

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The Honorable Jenny Abbott Kitchings
January 3, 2013
Page 2

Jana E. Shealy, Clerk, ALC
Harry Hancock
Milton Kimpson
John M. S. Hoefler
Tracey C. Green
John Roberts

THE STATE OF SOUTH CAROLINA
In The Court of Appeals

APPEAL FROM THE ADMINISTRATIVE LAW COURT

Ralph K. Anderson III, Administrative Law Judge

Case No. 10-ALJ-17-0270-CC

RECEIVED

JAN 03 2013

SC Court of Appeals

Duke Energy Corporation..... Appellant,
v.
South Carolina Department of Revenue..... Respondent.

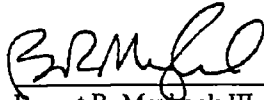
AMENDED NOTICE OF APPEAL

Duke Energy Corporation (hereinafter "Appellant") hereby amends its Notice of Appeal previously filed on January 2, 2013 and appeals from the following seven orders of the Honorable Ralph K. Anderson III of the Administrative Law Court ("ALC"): (1) Order Granting Summary Judgment in Part and Denying Summary Judgment in Part filed on August 9, 2012, a copy of which is attached hereto as exhibit A; (2) The ALC's deemed denial of Appellant's Motion for Reconsideration which was filed on August 20, 2012, a copy of which is attached as Exhibit B; (3) Amended Order Granting Summary Judgment in Part and Denying Summary Judgment in Part filed on October 11, 2012, a copy of which is attached as Exhibit C; (4) Order Denying Motion for Reconsideration in Part and Granting Reconsideration in Part filed on October 11, 2012, a copy of which is attached as Exhibit D; (5) Final Order and Decision filed on November 2, 2012, a copy of which is attached hereto as Exhibit E; (6) Amended Final Order and Decision filed on

December 4, 2012, a copy of which is attached hereto as Exhibit F; and (7) the ALC's Reconsideration Order filed on December 4, 2012, a copy of which is attached hereto as Exhibit G.

Thus, pursuant to ALC Rules 29(D)(4) and 31 and South Carolina Appellate Court Rule 203(b)(6), this Amended Notice of Appeal is timely filed within 30 days of the receipt of the ALC's final decision in this matter.

RESPECTFULLY SUBMITTED,



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January 3, 2013

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*Attorneys for Respondent South Carolina
Department of Revenue*

EXHIBIT A

**STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT**

Duke Energy Corporation,	)	
	)	
Petitioner,	)	Docket No. 10-ALJ-17-0270-CC
	)	
	)	
vs.	)	ORDER GRANTING SUMMARY
	)	JUDGMENT IN PART AND DENYING
	)	SUMMARY JUDGMENT IN PART
South Carolina Department of Revenue,	)	
	)	
Respondent.	)	
	)	

Appearances:

For the Petitioners: Burnet R. Maybank, III, Esq.; Eric S. Tresh, Esq.; Jeffrey A. Friedman, Esq.; and Maria M. Todorova, Esq.

For the Respondent: Tracey C. Green, Esq.; John W. Roberts, Esq.; Harry Hancock, Esq.; and J. Abraham Gutting, Esq.

This matter is before the Administrative Law Court (ALC or Court) upon a Motion for Summary Judgment filed by Respondent Department of Revenue (Department) and a Cross-motion for Partial Summary Judgment filed by Petitioner Duke Energy Corporation (Duke Energy). The underlying case arises from the Department's denial of amended corporate income tax returns filed by Duke Energy in 2002 for income tax years 1978-2001.¹ In its Motion for Summary Judgment, the Department contends that prior to the effective date of the Revenue Procedures Act (RPA), August 1, 1995, it lacked authority to extend the limitation period during which a taxpayer could file a refund claim and therefore, as a matter of law, the Forms FS-43 executed by Duke Energy and the Department prior to that time were ineffective in extending the refund-claim filing periods, rendering Duke Energy's filing of amended corporate income tax returns for tax years ending 1978-1993 untimely.² The Department also contends that Duke Energy, as a matter of law, is a "manufacturer" under the applicable apportionment statute and must therefore use a multi-factor apportionment formula, consisting of property, sales, and

¹ These are the tax periods at issue in this case.

² Both parties stipulate that Duke Energy's amended return for tax year 1994 was timely filed.

FILED

August 9, 2012

SC ADMIN. LAW COURT

payroll factors, not a single-factor gross-receipts formula.³ The Department further contends that as a matter of law, Duke Energy cannot, in its calculation of corporate income tax owed to South Carolina, include in the apportionment formula the return of principal from its sales of securities and other investment transactions. Finally, Duke Energy, in its Cross-Motion for Summary Judgment, argues that it was required to include in the apportionment formula the return of principal from its sales of securities and other investment transactions.

A hearing regarding these motions was held before this Court on June 26, 2012, in Columbia, South Carolina. For the reasons set forth below, I conclude that the Department's Motion for Summary Judgment as to the timeliness of Duke Energy's amended refund claims for tax years ending 1978-1993 must be granted; that the Department's Motion for Summary Judgment as to whether Duke Energy is considered a "manufacturer" under the applicable apportionment statute must be denied; and that the Department's Motion for Summary Judgment as to Duke Energy's inclusion of the return of principal in its apportionment formula must be granted and Duke Energy's Cross-Motion for Partial Summary Judgment on this issue must be denied.

FACTUAL BACKGROUND

The Department began auditing Duke Energy's corporate income taxes for income tax year ending 1978. That audit was extended a number of times, over a period of years due to the pending results of an audit of Duke Energy by the Internal Revenue Service (IRS), and also due to the health issues experienced by the Department's auditor and changes in the Department's personnel. These extensions were approved by Forms FS-43, each entitled "Field Services Division – Consent to Extend the Time to Assess Tax." The first Form FS-43, executed in August 1988, pertained to the income tax years ending December 31, 1983 and 1984. Significantly, the income tax years ending December 31, 1978 through December 31, 1982 were incorporated into the executed Forms FS-43 in May 1996. Additional Forms FS-43 periodically

³ Between the tax years ending 1978-1993, taxpayers whose principal business in South Carolina was "(a) manufacturing or a 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," were required to apportion their income based on a multi-factor apportionment formula, consisting of property, sales, and payroll factors. S.C. Code Ann. § 12-6-2250 (applicable to tax years after 1995); S.C. Code Ann. § 12-7-1120 (applicable to tax years prior to 1996). In this case, no party argued that Duke Energy engaged in collecting, buying, assembling, or processing of goods and materials within South Carolina, or that Duke Energy engaged in selling, distributing, or dealing in tangible personal property within South Carolina. Therefore, the Court will only focus its discussion on whether Duke Energy was a manufacturer for purposes of Section 12-6-2250.

were executed and additional income tax years added until the execution of the final Form FS-43 in June 2002.

In December 2002, Duke Energy filed amended corporate tax returns for the income tax years 1978-2001 seeking a total refund of \$126,240,645 plus interest.⁴ Duke Energy sought to change the apportionment formula – the mechanism for determining how much income is associated with Duke Energy’s South Carolina’s business activities – to the single-factor gross-receipts apportionment formula instead of the three-factor formula that it had previously used. It also sought to include the gross receipts, including the return of principal, from its sales of securities and other capital investments in the denominator of the gross-receipts formula for tax years 1978-1999.⁵ However, on February 4, 2010, the Department denied Duke Energy’s refund claims, after which Duke Energy filed a request for a contested case hearing with this Court on March 3, 2010.

STANDARD OF REVIEW

Rule 68 of the Administrative Law Court Rules provides that “[t]he South Carolina Rules of Civil Procedure . . . may, in the discretion of the presiding administrative law judge, be applied in proceedings before the Court to resolve questions not addressed by these rules.” ALC Rule 68. Rule 56(c) of the South Carolina Rules of Civil Procedure states that summary judgment is properly granted when the “pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that any party is entitled to a judgment as a matter of law.” Rule 56(c), SCRCF.

“The purpose of summary judgment is to expedite disposition of cases which do not require the services of a fact finder.” George v. Fabri, 345 S.C. 440, 452, 548 S.E.2d 868, 874 (2001). “In determining whether summary judgment is proper, the court must construe all ambiguities, conclusions, and inferences arising from the evidence against the moving party. Byers v. Westinghouse Elec. Corp., 310 S.C. 5, 7, 425 S.E.2d 23, 24 (1992). Because it is a

⁴ This is the amount set forth by the Department. However, Duke Energy stated in its Memorandum in Opposition to the Department’s Motion for Summary Judgment and in Support of Duke Energy’s Cross-Motion for Partial Summary Judgment that the Department’s refund calculations in its Memorandum were incorrect, and that damages would need to be resolved should the Court find in the Department’s favor on any issue.

⁵ For 2000 and 2001, Duke Energy’s original tax returns included receipts from sales of securities in the sales factor in the denominator of the three-factor formula.

drastic remedy, summary judgment should be cautiously invoked to ensure that a litigant is not improperly deprived of a trial on disputed factual issues. Helena Chem. Co. v. Allianz Underwriters Ins. Co., 357 S.C. 631, 644, 594 S.E.2d 455, 462 (2004). However, "when plain, palpable, and indisputable facts exist on which reasonable minds cannot differ, summary judgment should be granted." Bayle v. S.C. Dep't of Transp., 344 S.C. 115, 120, 542 S.E.2d 736, 738 (Ct. App. 2001).

S.C. Code Ann. § 1-23-600(A) (Supp. 2010) grants jurisdiction to the ALC to hear contested cases under the Administrative Procedures Act. Additionally, Section 12-60-460 grants the ALC the authority to conduct contested case hearings in matters concerning tax assessment and refunds.

DISCUSSION

I. Timeliness of Duke Energy's Amended Income Tax Return Filings

The Department asserts that Duke Energy did not timely file its request for tax refunds for tax years ending 1978-1993, and therefore this case should be summarily dismissed. Undisputedly, in every instance Duke Energy's amended tax returns for tax years ending 1978-1993 do not meet the statutory deadline to file its amended tax returns. Duke Energy nevertheless argues that its amended tax returns for the disputed tax years were timely filed because the Forms FS-43 extended the statutory deadlines for filing claims for tax refunds and waived any refund limitation periods. In this case, there is no dispute that both parties executed a number of Forms FS-43 periodically between the years 1988 and 2002. The parties also stipulated in their respective memoranda regarding the motions for summary judgment and in the hearing held before this Court on June 26, 2012 that the Form FS-43 executed on December 19, 1997 for the tax year ending 1994 effectively extended the period for filing a refund claim.⁶

Duke Energy argues that the execution of the Forms FS-43 covering the income tax years ending 1978-1993 extended the deadlines for filing claims for tax refunds and waived any refund limitation periods. Duke Energy also argues that because the Department could order a refund if

⁶ Pursuant to S.C. Code Ann. § 12-47-440 (****), which applied to the tax years ending 1990-1994, the period for filing a refund claim was three years. Moreover, S.C. Code Ann. § 12-6-4970(B), which was also applicable during these years, allowed a three-year time period for filing a refund claim for the tax year ending 1994 which would have begun on March 15, 1995. Therefore, because the filing of the Form FS-43 for the year 1994 was executed on December 19, 1997- after the enactment of the RPA and, and thus before March 15, 1998 - the period for filing a refund claim was still open. Consequently, the extension of the deadline was effective.

it discovered that a taxpayer had overpaid a tax, a penalty, or interest, even after a refund limitation period, this allows Duke Energy to file a claim for a refund after the limitation period. The analysis of Duke Energy's arguments is addressed in three parts: A) Did S.C. Code Ann. § 12-54-80 grant authority to the Department to extend the time to file an amended tax return; B) did S.C. Code Ann. § 12-54-30 authorize Duke Energy to file an amended tax return requesting a refund beyond the statutorily-prescribed timeframe; and C) did the language in the Form FS-43 executed by the Department extend the time for Duke Energy to file an amended tax return?

A. Statutory Authority to Extend the Time to File an Amended Tax Return

Duke Energy contends that Section 12-54-80 authorizes a taxpayer to request a refund once an extension is granted pursuant to that provision. Section 12-54-80, which applied to the tax periods prior to August 1, 1995 (the enactment date of the Revenue Procedures Act (RPA)), provided:

If, before the expiration of the time prescribed in this section for the mailing of a notice of assessment, the taxpayer has consented in writing to the mailing of the notice after the time, **notice of assessment may be mailed at any time prior to the expiration of the period agreed upon.** The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

S.C. Code Ann. § 12-54-80 (1978) (repealed in 1995) (emphasis added).

In general, when interpreting a statute, the sole function of the Court is to determine and give effect to the intent of the legislature. Hodges v. Rainey, 341 S.C. 79, 85, 533 S.E.2d 578, 581 (2000). The starting point in doing so should always be the text of the statute itself. Id. (holding that "[w]hat a legislature says in the text of a statute is considered the best evidence of the legislative intent or will"); Wigfall v. Tideland Utils., Inc., 354 S.C. 100, 110, 580 S.E.2d 100, 105 (2003). In interpreting the text, the plain meaning rule requires that "words must be given their plain and ordinary meaning without resort to subtle or forced construction to limit or expand that statute's operation." State v. Leopard, 349 S.C. 467, 471, 563 S.E.2d 342, 344 (Ct. App. 2002). Finally, "[w]here the statute's language is plain and unambiguous, and conveys a clear and definite meaning, the rules of statutory interpretation are not needed and the court has no right to impose another meaning." Hodges, 341 S.C. at 85, 533 S.E.2d at 581.

Moreover, in considering this issue, this Court is further bound by the rules of statutory construction relating to tax law. For instance "[a] refund of taxes is solely a matter of governmental grace, . . . and any person seeking such relief must bring himself clearly within the

terms of the statute authorizing the same. . . ." Asmer v. Livingston, 225 S.C. 341, 344, 82 S.E.2d 465, 466 (1954) (internal citations omitted); Guar. Bank & Trust Co. v. S. Carolina Tax Comm'n, 254 S.C. 82, 173 S.E.2d 367 (1970) ("A refund of taxes is solely a matter of governmental or legislative grace and any person seeking such relief must bring himself clearly within the terms of the statute authorizing the same."). The Court's analysis in Guaranty Bank also offers guidance in this case. In Guaranty Bank, the taxpayer claimed it was entitled to recover income tax paid on gain from an involuntary conversion of property. However, the law at the time prescribed a specific timeframe in which the proceeds from the converted property must be reinvested. In construing whether the taxpayer's claim was timely the Court held that the "statutory language creating exemption from taxation will not be strained or liberally construed in favor of the taxpayer claiming an exemption, and he must, in order to be entitled to such exemption, clearly bring himself within the exemption on which he relies." 254 S.C. at 89, 173 S.E.2d at 370.⁷ Furthermore, in making that determination, the Court recognized its previous holding that "a taxpayer who seeks to take advantage of a tax deduction must meet the conditions of the statute creating such." Id.

Here, the plain language of Section 12-54-80 does not establish any authority to extend a taxpayer's right to seek a refund but rather allowed the Department, with the taxpayer's consent, to extend the time for it to mail its assessment of the tax owed by the taxpayer. Clearly, when speaking of mailing an assessment, the statute is speaking to an action by the Department. Thus, the plain language of the form extends the timeframe for the Department to mail an assessment to the taxpayer.

Moreover, Section 12-54-80 does not use the word "refund" anywhere within that provision. As explained below, the legislature set forth specific provisions expressing the timeframe to seek a refund for tax years ending 1978-1993. In Spectre, LLC v. S.C. Dep't of Health & Envtl. Control, 386 S.C. 357, 372, 688 S.E.2d 844, 852 (2010), the South Carolina Supreme Court held that: "Where there is one statute addressing an issue in general terms and another statute dealing with the identical issue in a more specific and definite manner, the more specific statute will be considered an exception to, or a qualifier of, the general statute and given

⁷ The court in Guaranty Bank, likewise held that "in order for a taxpayer to avail himself of a deduction in the calculation of a tax, he must bring himself squarely within the terms of the statute expressly authorizing it." 254 S.C. at 89-90, 173 S.E.2d at 370.

such effect.” Here, it is incredulous that the legislature intended to grant an exception to the timeframe to seek a refund without even mentioning the term.

The Court nevertheless recognizes that the application of Section 12-54-80 could result in a refund of taxes paid by the taxpayer, but clearly such a refund would occur within the context of fulfilling the purpose of the statute. The purpose of Section 12-54-80 is to provide an option for the Department to extend the time during which the “notice of assessment may be mailed.” If, after the extension of time to make its determination, the Department decided that a taxpayer owed additional taxes, it would notify the taxpayer of that assessment and seek payment based upon that assessment. Conversely, if the Department’s assessment of the taxes owed was less than the taxes proffered by the taxpayer, the taxpayer would be refunded the difference.⁸ However, there is simply no language in Section 12-54-80 that provides that if the Department requests to extend its time to mail a notice of assessment—or determination of the taxes owed—this request, in turn, creates a right for a taxpayer to amend its previous filing and seek a refund upon its revised request.

This Court cannot simply by implication extend the time to file a refund request. Duke Energy must establish a statutory right to make that claim. To the contrary, Duke Energy failed to meet the required timeframes to request a refund for tax years 1978 to 1993. The timeframes for making those refund requests fell into two distinct regulatory periods: 1) 1978 to 1989; and 2) 1990 to 1993.

1. Income Tax Years Ending 1978-1989

The South Carolina Supreme Court set forth in Bass v. State that Section 12-47-440 only applied to property taxes and that “the exclusive remedy for contesting an alleged erroneous assessment of *income taxes* [is] by payment under protest of the tax claimed as illegal and a suit at law for recovery of the sum so paid, in accordance with Sections 65-2661 and 65-2662 of the Code. [predecessors of §§ 12-47-210 and 12-47-220].” 307 S.C. 113, 117, 414 S.E.2d 110, 112 (1992), (internal quotation marks omitted) (emphasis in the original), cert. granted, judgment vacated on other grounds by Bass v. South Carolina, 509 U.S. 916 and abrogated by Harper v. Virginia Dep’t of Taxation, 509 U.S. 86 (1993); see also Perpetual Bldg. & Loan Ass’n of Columbia v. S.C. Tax Comm’n, 255 S.C. 523, 527, 180 S.E.2d 195, 197 (1971). Thus, the

⁸ As addressed more fully below, S.C. Code Ann. § 12-54-30 (****) granted the Department the authority to issue a refund under those circumstances.

timeliness of Duke Energy's refund claims for the years 1978-1989 is governed by S.C. Code Ann. §§ 12-47-210 and 12-47-220 (****).⁹

Sections 12-47-210 and 12-47-220 required a taxpayer who sought to receive a refund of amounts paid to the state to expressly pay the taxes under protest and then institute an action in circuit court within 30 days after payment of the taxes. See S.C. Nat. Bank v. S.C. Tax Comm'n, 297 S.C. 279, 282, 376 S.E.2d 512, 514 (1989). Failure to pay the taxes under protest was fatal to a refund claim. See, e.g., City of Columbia v. Glens Falls Ins. Co., 245 S.C. 119, 139 S.E.2d 529 (1964). Here, there is no evidence that any of the payments for these years were made under protest. And even if the payments were made under protest, no action was filed in circuit court within 30 days after the payment was made. Rather, the refund claims were filed in the ALC well after the 30-day period expired.¹⁰ Therefore, none of the refund claims filed for Duke Energy's 1978-1989 tax years were timely. I thus conclude that the refund claims for the tax years 1978-1989 also are barred from consideration by this Court.

2. Income Tax Years Ending 1990-1994

As explained above, in 1992 the South Carolina Supreme Court in Bass held that Section 12-47-440 only applied to property taxes and that the exclusive remedy for obtaining a refund of income taxes was Sections 12-47-210 and 12-47-220 (****). Id. However, the General Assembly thereafter amended Section 12-47-440 to expressly apply to income tax refund claims, but only for tax years beginning in 1990 and later. See Act No. 464, 1994 S.C. Acts, Section 3(B).

⁹ (****) is used in this order in lieu of statutory years because this case involves numerous tax years, and therefore the years of the applicable statutes are equally numerous and varying, and the law applicable during many years was unchanged. The statutory law can be divided into two yearly ranges: 1978-1995 and 1996-2001, as the law regarding this issue did not change during the first range, and then did not change during the second range after the RPA changes in 1995.

¹⁰ There is also an additional reason for concluding the purported extensions of the corporate income tax years 1978-1982 are untimely. These years appeared for the first time on the face of the executed Form FS-43 effective May 30, 1996. Obviously, under either the modern era provisions or the pre-1995 provisions, these extensions were executed well after the refund periods had closed. See S.C. Code Ann. § 12-54-85 (three years from date return filed or two years after date of payment); S.C. Code Ann. §§ 12-47-210, -220 (pay under protest and file claim for refund within 30 days). The only available avenue for reviewing the taxable income of the years 1978-1982 therefore would have been the statutory provisions regarding an assessment based on a determination issued by the IRS. See S.C. Code Ann. § 12-54-85(D)(1); cf. S.C. Code Ann. § 12-54-80 (prior law). However, Duke Energy did not establish that the IRS issued a final determination within 180 days of May 30, 1996. Moreover, any extension attributable to an IRS determination in that circumstance would have been limited to the tax issues raised by the IRS. Because the allocation and apportionment issues raised by the taxpayers could not have been at issue in an IRS determination, the purported extensions of the 1978-1982 tax years are untimely for purposes of the issues before this Court.

Section 12-47-440 provides for a three-year period of limitation in which to file a refund claim. Therefore, for the 1990-1994 tax years, Duke Energy was required to file its claims for refund within three years after its corporate income tax return was originally due. It is undisputed that Duke Energy filed its corporate income tax returns based on a calendar year. Thus, the returns and payment originally were due without regard to any extension on March 15th of the following year. S.C. Code Ann. §§ 12-6-4970(B) (effective for tax years beginning after 1995); 12-7-1640 (effective for tax years prior to 1996). The refund periods applicable to Duke Energy under Section 12-47-440 for the income tax years 1990-1994 were therefore as follows:

Income Tax Years	Return Originally Due	Close of Refund Period
1990	March 15, 1991	March 15, 1994
1991	March 15, 1992	March 15, 1995
1992	March 15, 1993	March 15, 1996
1993	March 15, 1994	March 15, 1997
1994	March 15, 1995	March 15, 1998

B Section 12-54-30

In its Post-Trial Brief, Duke Energy nevertheless argues that during the tax years at issue S.C. Code Ann. § 12-54-30 (****) provided a different "mechanism" by which it could file an amended tax return requesting a refund. Section 12-54-30 provided in relevant part that: "If the commission discovers on examination of a return or otherwise that the tax, penalty, or interest paid by any person is in excess of the amount legally due, the commission may order a refund or give credit for the overpayment." The plain language of Section 12-54-30 permitted the Department to refund amounts discovered on examination of a return. See Anders v. S.C. Parole & Cmty. Corr. Bd., 279 S.C. 206, 305 S.E.2d 229 (1983) ("[T]he Court's primary function in interpreting a statute is to ascertain the intention of the legislature, and when the terms of the statute are clear and unambiguous, the Court must apply them according to the literal meaning."). Section 12-54-30 does not reference whatsoever the timeframe for a taxpayer to file a request for a refund. To the contrary, as set forth above, there were specific statutes that articulated the timeframe in which a taxpayer could file for a refund for tax years 1978 to 1993. As aforementioned, the statute which deals with an issue in a more specific and definite manner prevails over a statute which addresses the issue in general terms, Spectre, 688 S.E.2d 844. Furthermore, "[w]hen construing statutory language, the statute must be read as a whole, and sections which are part of the same general statutory law must be construed together and each

one given effect.” Duval v. S.C. Budget and Control Bd., 377 S.C. 36, 42, 659 S.E.2d 125, 127 (2008).

Thus, Section 12-54-30 allowed the Department to grant relief to a taxpayer if it discovered an overpayment on examination of a return or otherwise, even if a claim for refund would be untimely. It did not, however, change the fact that the taxpayer had to strictly comply with the provisions of the refund statutes if it wanted to file a claim for refund that would be subject to judicial review. See Hodges v. Rainey, 341 S.C. 79, 533 S.E.2d 578 (2000) (“The canon of construction ‘*expressio unius est exclusio alterius*’ or ‘*inclusio unius est exclusio alterius*’ holds that ‘to express or include one thing implies the exclusion of another, or of the alternative.’”). The logic of this interpretation of Section 12-54-30 was reflected in Argent Lumber Co. v. Query, 178 S.C. 1, 182 S.E. 93 (1935), overruled on other grounds by McCall by Andrews v. Batson, 285 S.C. 243, 329 S.E.2d 741 (1985). The Court in Argent Lumber held that under a statute similar to the one in the present case, the taxpayer had no right to judicial review of the Tax Commission’s refusal to grant the taxpayer a refund notwithstanding the Commission’s discovery of overpaid taxes and the Commission’s authority to grant refunds at the time of the tax periods at issue. The reason for this, aside from a lack of statutory authority at the time to compel the Commission to issue a refund of overpaid taxes, was that the taxpayer had failed to comply with the refund statute but instead waited more than ten years after the overpayment and almost four years after the amount of the claim was ascertained to bring suit. Id. at 94-95.

C. Form FS-43

In light of the statutory timeframes for filing an amended return requesting a refund, Duke Energy’s case centers upon the implications of the Department’s Form FS-43. Duke Energy contends that the Forms FS-43 executed in this case allowed it additional time to file a claim for a refund, an extension that would run for more than twenty years in some cases. At the outset, I do not find that the Forms FS-43 authorized a party to seek a refund after the statutory time for filing such a request.

The language contained in the Form FS-43 prior to August 1, 1995 was as follows:

This agreement extends the time for mailing the notice of assessment or refund of the above tax pursuant to the provisions of Section 12-54-80 of the 1976 South Carolina Code of Laws, as amended.

(Emphasis added).

Clearly, when referencing the mailing of the notice of an assessment or refund, Form FS-43 is speaking to an action by the Department. Thus, the plain language of the form extends the timeframe for the Department to mail the notice of a refund or assessment to the taxpayer in keeping with Section 12-54-80. That purpose is reflected by the title of the Form FS-43: "Consent to Extend the Time to Assess Tax." The purpose also logically flows from the operation of the tax laws. Because a notice of assessment is issued and mailed by the Department, it necessarily follows that Form FS-43 applies only to extend the time in which the Department may issue and mail a notice of assessment or refund that it determines is due. Thus, the refund language in Form FS 43 refers **not** to allowing a taxpayer additional time in which to file a claim for a refund—which, as explained above, the statutory provisions did not permit—but to affording the Department additional time to review the taxpayer's records and issue a notice of assessment or refund, as it determines appropriate based on a review of the taxpayer's records.

Furthermore, Form FS-43 does not **infer** that a taxpayer has a right to amend its previous tax filing and seek a refund upon alternative grounds. Duke Energy's proposition is not supported by a specific statutory grant of the authority to extend the timeframe to file an amended request for a refund. Rather, Duke Energy reasons that the use of the term "refund" in the Form FS-43 language infers the grant of an extension to file its request for a refund. However, Form FS-43 reflects its limited purpose by referencing the time an assessment or refund is allowed "pursuant to the provisions of Section 12-54-80." As explained above, Section 12-54-80 does not authorize a taxpayer to file a request for a refund outside of the statutes that specifically set forth that timeframe.

Duke Energy nonetheless contends that since the Department agrees that Form FS-43 had that effect for 1995 and later, it must have had that effect before 1995. Duke Energy avers that since the "refund" language is absent in S.C. Code Ann. § 12-54-85(C)(5) (****) – the section with which the RPA supplanted Section 12-54-80 as of August 1, 1995 – that indeed Section 12-54-80 must have also have granted it the right to file an amended tax return seeking a refund.¹¹

¹¹ Duke Energy also pointed out that the Forms FS-43 executed by the Department and Duke Energy from 1996 to 1999, well after the redesignation of Section 12-54-80 as Section 12-54-85, continued to make reference to Section 12-54-80, a statute that no longer existed. And the Forms FS-43 executed by the Department and Duke Energy from 2000 through 2002 incorrectly cited to subsection (C)(5) of S.C. Code Ann. § 12-54-85 instead of subsection (C)(4). Those arguments carry no legal value, but are probative as to the apparent shoddy fashion in which the Forms FS-43 were executed.

Taxes may be determined after the thirty-six month limitation if:

Duke Energy's argument, however, ignores the substantial and wholesale changes that were enacted as part of the RPA. As with Section 12-54-80, the provisions addressing the authority and timeframes within which to seek a refund were addressed in separate statutory provisions. The RPA added S.C. Code Ann. § 12-60-470 (****), which states that "[a] taxpayer may seek a refund of any state tax by filing a written claim for refund with the [D]epartment. . ." and that a "claim for refund is timely filed if filed within the period specified in Section 12-54-85" The RPA also added S.C. Code Ann. § 12-60-40 (****), which allows the Department to grant extensions of any tax-related time limitations. "It will be presumed that the Legislature in adopting an amendment to a statute intended to make some change in the existing law." Vernon v. Harleyville Mut. Cas. Co., 244 S.C. 152, 155, 135 S.E.2d 841, 844 (1964). It is therefore clear that the General Assembly intended to grant the Department, through the RPA, the authority to extend the period for filing of refund claims, an extension of power which the General Assembly had theretofore limited to the deadline for mailing notices of assessment.

In its Memorandum of Law in opposition to the Department's Motion for Summary Judgment, Duke Energy further argues that because Form FS-43 does not reference Section 12-54-30, that statute does not apply to the Department's determination in this matter. Putting aside

the application of Section 12-54-30 in this case, the fallacy of Duke Energy's assertion is referred to as "the fallacy of denying the antecedent" and is illustrated in a hypothetical syllogism as:

If A, then B.

Not A.

Therefore, not B.

Ruggero J. Aldisert, Logic for Lawyers: A Guide to Clear Legal Thinking 160 (National Institute for Trial Advocacy 3d ed. 1997); see also Irving M. Copi, Introduction to Logic 295 (5th ed. 1978).

Stated in terms of syllogism, Duke Energy's arguments proceed as follows:

If Form FS-43 had referenced Section 12-54-30, then that section would be applicable to determining the timeframe for a refund pursuant to Form FS-43.

Form FS-43 did not reference Section 12-54-30.

Therefore, Section 12-54-30 is not applicable to determining the timeframe for a refund pursuant to Form FS-43.

Other courts have also found this reasoning to be faulty. For instance, in Crouse-Hinds Co. v. InterNorth, Inc., 634 F.2d 690, 703 (2d Cir. 1980), the court held that:

The proposition that "A implies B" is not the equivalent of "non-A implies non-B," and neither proposition follows logically from the other. The process of inferring one from the other is known as "the fallacy of denying the antecedent."

634 F.2d at 703 (cited in Logic for Lawyers).

Moreover, logic dictates a conclusion contrary to Duke Energy's assertion. The failure to reference a provision that governs when the Department may issue a refund upon its own initiative does not suggest it is inapplicable. Nevertheless, the failure to reference any statute (including Section 12-54-30) that addresses the authority of the Department to issue refunds profoundly suggests that Form FS-43 was not addressing a taxpayer's authority to amend its tax returns and seek a refund, or the Department's authority to extend the timeframe within which a refund claim could be filed. If Form FS-43 was granting the authority to extend the time to make refund claims, it would not only reference the statute upon which that authority was granted, but would presumably do so with clarity rather than making the reference: "mailing of notice of assessment or refund." To the contrary, Form FS-43 was based upon Section 12-54-80, which governs the time period in which the Department could assess taxes — a provision that says nothing about refunds or extensions of time to file refund claims.

Waiver of a Statute of Limitations

Duke Energy also contends that the Department “waived” the “statute of limitations” for filing a refund. Duke Energy bases its contention upon the language of Form FS-43; upon the alleged grant by Department employees of an extension of the time during which to file a request for a refund; and upon Duke Energy’s belief that the Department’s Revenue Procedures reflected that right. Duke Energy contends that “[f]or years, the Department advised taxpayers that it had in place a policy to execute waiver agreements extending the statute of limitations for both assessments and refunds.”¹²

However, the phrase “statute of limitations” invokes specific case law that is not applicable to this matter. Obviously, this case does not involve a “cause of action” in which the Court must first determine when the statute of limitations begins to run. In other words, it does not involve parties who possess the discretion to control when a cause of action may properly accrue. Rather, this case involves a determination of when the State of South Carolina grants a right to seek a refund pursuant to the existing tax laws. In Dep’t of Conservation v. Co-De Coal Co., 388 S.W.2d 614 (Ky. 1965), the court aptly explained the distinction between a statute of limitations and a statutory timeframe for filing a request for refund from a state. The court noted: “whereas a statute of limitations neither creates nor extinguishes any rights, but merely places a limitation upon the remedy (which can be waived or tolled), a limitation such as the one in question is a condition essential to the existence of the right.” Co-De Coal, 388 S.W.2d at 617 (internal citations omitted). The court added: “The bringing of the action within the limited time is a condition to the exercise of the right, and, if the condition is not complied with, there is neither right nor remedy.” Id. (internal citation and quotation marks omitted).

Indeed, this concept is supported by South Carolina case law. In Labruce v. City of N. Charleston, 268 S.C. 465, 234 S.E.2d 866 (1977), the appellants instituted an action to recover business license taxes paid under protest. The Court recognized that at that time, Section 65-2661 et seq., Code of Laws, 1962, provided the exclusive remedy for the recovery of contested taxes and held that “[s]trict compliance with the conditions precedent is prescribed when one

¹² In its post-hearing brief, Duke Energy alleges that the Department had respected the “waiver” agreements it had with Duke Energy for tax years 1978-1994 by agreeing, in 2002, to offset refunds of its South Carolina corporate income tax for tax years 1978-1994 against the corporate income, license, and sales taxes for those same years, resulting in a net refund owed to Duke Energy. However, this allegation was based on an affidavit referred to as the “Monroe Affidavit,” designated as “Exhibit A,” that was not submitted prior to, or during, the hearing. Therefore, this Court will not consider this information in rendering its decision.

invokes the statutory remedy.” 234 S.E.2d at 867. See also 4 S.C. Jur. Action § 13 (“One who invokes a statutory remedy must bring himself within the statute and comply with the conditions prescribed therein. Moreover, the Court of Appeals recently reiterated this principle, noting that a nonclaim statute (the sort at issue in the present case)¹³ differs from a statute of limitations in that a nonclaim statute creates no enforceable right of action “[u]nless the claim is filed within the prescribed time set out in the statute,” whereas a statute of limitations “creates a defense to an action brought after the expiration of the time allowed by law for the bringing of such an action.” Phillips ex rel. Barnett v. Quick, Op. No. 5003, 2012 WL 2913296 (S.C. Ct. App. filed July 18, 2012) (citing Estate of Decker v. Farm Credit Servs. Of Mid-Am. ACA, 684 N.E.2d 1137, 1138-39 (Ind. 1997).

As a general rule, when a statute creates a new right and at the same time prescribes a remedy for enforcing the right, the prescribed statutory course must be followed by anyone claiming the right.”); 72 Am. Jur. 2d State and Local Taxation § 996 (“Strict compliance with conditions precedent is required to invoke the statutory remedy for recovery of contested taxes.”). When a statute both creates a cause of action and includes a time limit for its commencement, compliance with the time limit is a condition precedent to the maintenance of the action. 54 C.J.S. Limitations of Actions § 31 (updated October 2010). “Such a statutory time limit conditions the existence of the right of action, thereby creating a substantive, rather than procedural, limitation on the right. Bringing suit within the prescribed time is a condition of liability itself, not of the remedy alone.” Id.

Thus, the statutes that grant a South Carolina taxpayer a right to seek a refund are not statutes of limitations but rather conditions precedent to obtain a right to a refund. Accordingly, the courts have not adopted the doctrine of waiver involving tax claims. To the contrary, a refund of taxes is considered “solely a matter of governmental grace, . . . and any person seeking such relief must bring himself clearly within the terms of the statute authorizing the same.” Asmer v. Livingston, 225 S.C. 341, 344, 82 S.E.2d 465, 466 (1954) (internal citations omitted); see also C.W. Matthews Contracting Co., Inc. v. S.C. Tax Comm’n, 267 S.C. 548, 554, 230 S.E.2d 223, 226 (1976); Guar. Bank & Trust Co. v. S.C. Tax Comm’n, 254 S.C. 82, 173 S.E.2d

¹³ A nonclaim statute is one that creates a right of action and provides a time limit on exercising that right. It imposes a condition precedent, as the time element is part of the right of action. 54 C.J.S. Limitation of Actions §33 (updated May 2012).

367 (1970) (holding that the circuit court erred in extending the time periods under the statute because that is a legislative and not a judicial function). Therefore, the South Carolina Supreme Court held in TNS Mills, Inc. v. S.C. Dep't of Revenue, 331 S.C. 611, 623, 503 S.E.2d 471, 478 (1998) that the Department employee's erroneous interpretation of a statute was not binding on the courts, and that Department employees cannot make changes in the refund procedure established by the General Assembly or exceed the authorization granted by a statute. See also Argent Lumber Co., 182 S.E. at 95 ("[T]he agent of the tax commission could not alter, amend, or change the statute law of this state, either orally or by written agreement . . ."). The United States Supreme Court further explained that an employee of the government has no authority to waive or extend a refund period except to the extent authorized by the governing statute. U.S. v. Garbutt Oil Co., 302 U.S. 528 (1938) (Officers of the government have no power to waive statutes of limitations; and Commissioner cannot consider untimely filed returns); see also Dickow v. United States, 740 F. Supp. 2d 231, 237 (D. Mass. 2010) aff'd, 654 F.3d 144 (1st Cir. 2011) cert. denied, 132 S. Ct. 1046 (2012) ("The Executor cannot rely upon the IRS' failure to advise him of the denial to justify his purported conclusion that his second request had been granted where, as here, the IRS clearly did *not* have the authority to issue such extension.").

The only case cited by Duke Energy that involved a refund claim was Anonymous Taxpayer v. S.C. Dep't of Revenue, 377 S.C. 425, 661 S.E.2d 73 (2008). However, the relief sought by the taxpayer in that case was based on the contention that the taxpayer's right to retirement benefits was in the nature of a contract. The Supreme Court's discussion of the statute of limitations in Anonymous Taxpayer was predicated upon the taxpayer's argument that there "was a contract providing for continuing performance, thus the limitations period began anew each year." The Court noted long ago that statutes of limitations could be waived with respect to actions based on contract. See Heyward v. S.C. Tax Comm'n, 240 S.C. 347, 351, 126 S.E.2d 15, 17 (1962) ("We have held that the State may be subject to the doctrine of estoppel in its contractual relations."). Nevertheless, the Court did not hold that refund claims are in the nature of a contract and, in fact, has held the opposite. See id.; see also C. W. Matthews Contracting Co., 267 S.C. at 554, 230 S.E.2d at 226 (a tax refund claim is created by statute and is not in the nature of a debt collection claim).

In sum, since no employee or agent of the Department has any authority to waive the authorization granted by Section 12-54-80, Form FS-43 could grant no more rights than those

permitted by this statute. Thus, any statement made by a Department employee, either verbally or in writing, agreeing to waive the time to request a refund, which was inconsistent with Section 12-54-80, was outside of that employee's authority. Consequently, I conclude that the Forms FS-43 executed before August 1, 1995, and any other statements, written or oral, given by DOR's employees, were ineffective in extending the statutory filing period for Duke Energy's refund claims or in waiving that period.

Moreover, even under section 12-54-85(F)(1), with the exception of situations where there are changes made to taxable income reported to the IRS, or when the IRS changes a corporation's taxable income, "claims for . . . refund must be filed within three years of the time the return was filed, or two years from the date of payment, whichever is later. If no return was filed, a claim for refund must be filed within two years from the date of payment." S.C. Code Ann. § 12-54-85(F)(1) (1995). Also, "[a] claim for refund can be amended prior to, but not after, the expiration of the time for filing the claim for refund under Section 12-54-85(F)." *Id.* § 12-60-470(H). Read together, these sections lead to the conclusion that once a refund period expires under the terms set forth by the legislature, that period of time cannot be revived by the consent of the Department or otherwise; rather, any amendments must be made prior to the expiration of the statutory period for filing refund claims. See *Am. Legion Post 15 v. Horry County*, 381 S.C. 576, 582, 674 S.E.2d 181, 183-84 (Ct. App. 2009) (holding in part that the three-year limitations period under section 12-54-85(F)(1) barred a taxpayer's action seeking a refund). Thus, even after the RPA took effect on August 1, 1995, and the Department received its new power to extend the period for filing refund claims, the Department was unable to use this power to revive refund claims periods that had expired due to the close of the three-year limitations period applicable to the income tax years ending 1990 through 1994 or due to failure to pay under protest and file a claim for a refund within thirty (30) days for the tax years ending prior to 1990.

Equitable Estoppel

Duke Energy similarly asserts that the Department should be estopped from asserting its "statute of limitations." The basis for this contention is that the Department employees purportedly viewed Form FS-43 as waiving the statutory refund limitations period, and that Duke Energy "agreed to the waivers because the Department represented verbally and in writing that the statute of limitations was extended for both tax assessments and tax refund claims."

As with waiver of a statute of limitations, the courts have recognized that the estoppel doctrine is limited in reviewing tax claims. As a general rule, "the doctrine of estoppel will not be applied to deprive the government of the due exercise of its police power, or to effect public revenues or property rights, or to frustrate the purpose of its laws or thwart its public policy." Heyward v. S.C. Tax Comm'n, 240 S.C. 347, 351, 126 S.E.2d 15, 17 (1962) (emphasis added). In the only South Carolina appellate decision touching upon taxation issues and equitable estoppel, the Court of Appeals held that equitable estoppel did not apply to bar a county from asserting the statute of limitations as a defense to refunding admissions fees paid in connection with bingo games. Am. Legion Post 15, 381 S.C. at 583, 674 S.E.2d at 184.

Also, to invoke estoppel in this case, the Department employees must be authorized to change the procedure for obtaining a refund. However, in Texaco, Inc. v. Wasson, the South Carolina Supreme Court explained that the Department was not estopped from assessing additional taxes based on the use of an improper accounting method even though Department employees had expressly and in writing authorized the taxpayer to use that method "until such time as the South Carolina Tax Commission grants permission to change such method." 269 S.C. 255, 264-65, 237 S.E.2d 75, 79 (1977). Similarly, in TNS Mills, Inc., the taxpayer contended that the Department had the authority to grant a property tax exemption retroactively. Its contention was based in part on a memorandum prepared and issued by a Department employee opining that a recently-enacted statute gave the Department authority to accept exemption applications at any time. The South Carolina Supreme Court rejected that contention, holding instead that "[a]lthough [the employee] believed the Department had the authority to grant retroactive exemptions, and exemptions may have been granted under this erroneous view, neither the Commission nor the courts are bound by his erroneous interpretation." 331 S.C. at 621-22, 503 S.E.2d at 477; see also S.C. Coastal Council v. Vogel, 292 S.C. 449, 357 S.E.2d 187 (Ct. App. 1987) ("The public cannot be estopped ... by the unauthorized or erroneous conduct or statements of its officers or agents which have been relied on by a third party to his detriment.").

In addition, the authority that Duke Energy itself cited supports a conclusion that the Department is not estopped from rejecting actions taken by its employees that are not authorized by statute. Duke Energy cited Quail Hill, LLC v. County of Richland and quoted the following language from that case: "A governmental body is not immune from the application of the doctrine of estoppel where its officers or agents act within the proper scope of their authority."

387 S.C. 223, 236, 692 S.E.2d 499, 506 (2010) (italics omitted). However, Duke Energy only quoted the first part of the pertinent language. The entire relevant passage was quoted by the Court as follows:

A governmental body is not immune from the application of the doctrine of estoppel *where its officers or agents act within the proper scope of their authority ... The public cannot be estopped, however, by the unauthorized or erroneous conduct or statements of its officers or agents which have been relied on by a third party to his detriment.*

Quail Hill, 387 S.C. at 236, 692 S.E.2d at 506 (italics in original) (quoting DeStefano v. City of Charleston, 304 S.C. 250, 257-58, 403 S.E.2d 648, 653 (1991)). That passage followed the Court's recognition at the beginning of the paragraph: "As a general rule, estoppel does not lie against the government to prevent the due exercise of its police power or to thwart the application of public policy." Id. (quotation marks omitted).

Following the above precedents, the Court ultimately held that: "For reasons ... discussed [in the opinion], we believe the Court of Appeals erred in reversing the circuit court's grant of summary judgment to County as to Quail Hill's claim of equitable estoppel." Id., 387 S.C. at 237, 692 S.E.2d at 506. In other words, the Supreme Court in Quail Hill affirmed that the government was not estopped from contesting erroneous statements made by its staff. See id., 387 S.C. at 238, 692 S.E.2d at 507 ("[W]e agree with County's argument that the RU zoning classification was a mistaken statement of law and, thus, could not be used to estop County from enforcing it."). That holding is entirely consistent with the holdings of Texaco, Heyward, and TNS Mills and, in fact, relies on the same rationale stated by the Court in Heyward — that the government cannot be estopped from exercising its police power. Compare id., 387 S.C. at 236, 692 S.E.2d at 506 (discussing police power rationale for not applying estoppel to governmental entities) with Heyward, 240 S.C. at 351, 126 S.E.2d at 17 (holding that "estoppel will not be applied to deprive the government of the due exercise of its police power, or to effect public revenues or property rights").

Thus, I conclude that the Department is not estopped from invoking the correct refund limitations period, even if Department employees believed they had the authority to allow the taxpayer to extend the time in which a claim for refund could be filed. This court clearly does not wish to shield a governmental agency from the doctrine of equitable estoppel where its agents act within the scope of their authority. Rather, this Court recognizes that however

Duke Energy seeks to characterize the evidence presented in response to the Department's summary judgment motion, the Department's employees did not have the authority to create an unauthorized refund procedure. Moreover, execution of Forms FS-43 by Department employees can provide the taxpayer with no greater remedies than those provided by the governing statutes for refund claims and the like. It is upon these principles that the court in Phillips held that "[w]hile equitable principles may extend the time for commencing an action under statutes of limitation, **nonclaim statutes impose a condition precedent to the enforcement of a right of action and are not subject to equitable exceptions.**" Supra. (citing Estate of Decker, 684 N.E.2d at 1139) (emphasis added).

In fact, even if estoppel was applicable here, Duke Energy failed to set forth a genuine issue of material fact as to its meeting those requirements. "To prove estoppel against the government, the relying party must prove: (1) the lack of knowledge and of the means of knowledge of the truth of the facts in question; (2) justifiable reliance upon the government's conduct; and (3) a prejudicial change in position." S.C. Dep't of Transp. v. Horry County, 391 S.C. 76, 83, 705 S.E.2d 21, 25 (2011). Furthermore, "[o]nce the party moving for summary judgment meets the initial burden of showing the absence of a genuine issue as to any material fact, the nonmoving party may not simply rest on the mere allegations contained in the pleadings." Grant v. Mount Vernon Mills, Inc., 370 S.C. 138, 142, 634 S.E.2d 15, 17 (Ct. App. 2006). "Rather, the nonmoving party must come forward with specific facts showing there is a genuine issue for trial." Id. (quoting Peterson v. W. Am. Ins. Co., 336 S.C. 89, 94, 518 S.E.2d 608, 610 (Ct.App.1999)). Here, there is no dispute that Duke Energy could have referenced the governing refund statutes and learned that Department employees cannot extend the time periods set forth in the applicable refund statutes. See Am. Legion Post 15, 381 S.C. at 583; 674 S.E.2d at 184. Moreover, I do not find that the Form FS-43 misinformed Duke Energy that it could file an amended tax return requesting a refund after the statutory timeframe.

Equitable Tolling

Duke Energy contends that the Department should be equitably tolled from requiring Duke Energy to comply with the statutory time frame within which to file a refund because the Department's employees induced Duke Energy to file belatedly. In support of this remedy, Duke Energy contends that it agreed to the waivers because the Department represented that the statute of limitations was extended for both tax assessments and tax refund claims.

“[T]he doctrine of equitable tolling may be applied to toll the running of the statute of limitations.” Hooper v. Ebenezer Sr. Servs. & Rehab. Ctr., 386 S.C. 108, 115, 687 S.E.2d 29, 32 (2009) (quoting 54 C.J.S. Limitations of Actions § 115 (2005)). As explained above, however, the statute requiring that refunds be filed within specific timeframes creates a condition precedent to seeking that remedy and thus is not subject to the equitable remedies for statutes of limitations. See Phillips, supra. Thus, equitable tolling is not a proper remedy in this case. Cf. United States v. Brockamp, 519 U.S. 347 (1997) (holding that the statutory limitations period on tax refund claims under the applicable provision of the Internal Revenue Code does not authorize equitable tolling).

Even if, *arguendo*, equitable tolling could apply here, in Hooper, the South Carolina Supreme Court explained that “equitable tolling is a doctrine that should be used sparingly and only when the interests of justice compel its use.” 386 S.C. at 117, 687 S.E.2d at 33. Here, however, in an attempt to invoke this extraordinary remedy, Duke Energy submitted affidavits and deposition testimony that reference the belief by Department employees that Duke Energy could seek a “refund” based upon extensions granted by the executed Forms FS-43. However, those affidavits do not contain an averment by any Department employee that he or she specifically stated to a Duke Energy representative that Duke Energy’s time to seek a “refund” was extended by Form FS-43. More importantly, there is no reference that any Department employee stated that Duke Energy could file an amended tax return seeking a refund based upon a new basis. Nor is there any sworn testimony by a Duke Energy representative that he or she was misdirected by a Department employee.

Therefore, I conclude that equitable tolling does not lie in this case.

Conclusion

Finally, the context of Duke Energy’s request is important in recognizing the proper resolution of this issue. Duke Energy asserts that there are disputed facts regarding this issue because some of the Department’s employees viewed Form FS-43 as extending the period during which a taxpayer could seek a refund. However, statements to that effect do not answer the issue in this case. This case is not simply about whether Duke Energy can seek a refund based upon a tax review that had been held open pending the Department’s determination of the proper tax to assess. Rather, Duke Energy originally filed as a manufacturer using the three-factor formula. Now, it seeks a refund, not based upon the initial filing, but based upon an amended tax return

using the single-factor gross-receipts apportionment formula – an entirely different basis. Duke Energy's amended return also now includes the gross receipts from the sale of its securities and other capital investments, which further includes the principal.

Duke Energy interprets Form FS-43 as not only allowing it to question its initial filing but as allowing it to file a new (amended) tax return and claim an entirely new basis for a refund. The plain reading of the tax statutes and review of the affidavits and deposition testimony submitted by Duke Energy fail to establish a genuine issue of material fact regarding the request of Duke Energy. In other words, though there are statements regarding the right of Duke Energy to seek a refund, no evidence was presented that any Department employees interpreted Form FS-43 as allowing a taxpayer to file an amended return on an entirely different basis than the original return and then seek a refund based on that amended return.¹⁴ Therefore, the Department's Motion for Summary Judgment as to the issue of the timeliness of Duke Energy's amended income tax return filings is granted.

II. Apportionment Method

The next issue is whether Duke Energy is a "manufacturer" and therefore required to use the multi-factor apportionment formula pursuant to S.C. Code Ann. § 12-6-2250 (****) (applicable to tax years after 1995)/ Section 12-7-1140 (applicable to tax years prior to 1996); or whether Duke Energy was required to use the single-factor gross-receipts formula pursuant to Section 12-6-2290 (****) (applicable to tax years after 1995)/ Section 12-7-1190 (applicable to tax years prior to 1996). Duke Energy argues that it is not a manufacturer, even though it filed its original corporate income tax returns under this status. Duke Energy contends that it is actually a seller of services, and therefore amended its tax return filing using the single-factor gross receipts formula.

During the tax periods at issue, taxpayers whose principal business in South Carolina was "(a) manufacturing . . . goods and materials within this State . . ." had to apportion their income using a three-factor formula composed of property, payroll, and sales. S.C. Code Ann. § 12-6-2250 (applicable to tax years after 1995); S.C. Code Ann. § 12-7-1140 (applicable to tax years prior to 1996). All other taxpayers (except certain specific industries not relevant here) had to

¹⁴ Review of the record does not even establish the validity of the Form FS-43 agreements for tax years 1978 through 1983. In fact, Duke Energy has even conceded that it has not located the executed Form FS-43 agreements for tax years 1978 through 1983.

apportion their income using a single-factor gross-receipts apportionment formula. S.C. Code Ann. § 12-6-2290 (applicable to tax years after 1995); *Id.* § 12-7-1190 (applicable to tax years prior to 1996). "Manufacturing" is not, and was not during the tax periods at issue, statutorily defined for South Carolina apportionment law purposes.¹⁵

Based on the record, I find that genuine issues of material fact exist necessitating an evidentiary hearing as to whether Duke Energy, based on its activities within the State, falls under Section 12-6-2250 as a "manufactur[er]," or whether Duke Energy is a seller of services, or otherwise falls under none of the above-categories, and is therefore required to apportion its income to South Carolina based on the single-factor gross-receipts apportionment formula pursuant to Section 12-6-2290 (applicable to tax years after 1995)/ Section 12-7-1190 (applicable to tax years prior to 1996). Accordingly, the Court denies the Department's Motion for Summary Judgment with respect to this issue.

III. Gross Receipts

The final issue is whether Duke Energy was allowed, in its calculation of corporate income tax owed to South Carolina, to include in the apportionment formula the return of principal from its sales of securities and other capital investments. Duke Energy argues that "gross receipts" in the gross receipts factor of the denominator of the single-factor gross-receipts apportionment formula and "sales" in the sales factor of the denominator of the three-factor apportionment formula include the entire amount of return capital from a sale of securities or other capital investments, **including the return of principal**. The Department, however, argues that gross receipts and sales include only the net proceeds from sales of securities or other capital investments.

South Carolina law provides that a taxpayer required to apply the single-factor gross-receipts apportionment formula must do so "using a fraction in which the numerator is gross receipts from within this State during the taxable year and the denominator is total gross receipts from everywhere during the taxable year." *See* S.C. Code Ann. § 12-6-2290 (****) (applicable for tax years beginning after 1995); *see also id.* § 12-7-1190 (****) (applicable for tax years

¹⁵ "Manufacturing" is not statutorily defined, but it is discussed in *Columbia Ry., Gas & Elec. Co. v. S.C. Tax Comm'n*, 134 S. C. 319, 132 S.E. 611 (1926), a case in which the South Carolina Supreme Court held that a company engaged in the business of generating electricity was properly considered a "manufacturer" for purposes of a particular statute that imposed a corporate income tax on "a corporation engaged in the business of manufacturing."

prior to 1996).¹⁶ “Gross receipts” was not defined for South Carolina apportionment law purposes during the tax periods at issue.

For purposes of the multi-factor apportionment formula¹⁷ the sales factor consists of “[t]he ratio of sales made by such taxpayer during the income year which are attributable to this State to the total sales made by such taxpayer everywhere during the income year” S.C. Code Ann. § 12-7-1170 (****) (for tax years prior to 1996).¹⁸ The term “sales” includes: “(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.” *Id.*¹⁹

“The language of a tax statute must be given its plain ordinary meaning in the absence of an ambiguity therein. . . . [I]f a legislative intent is clearly apparent from the language of the statute there is no occasion for resort to the rule of statutory construction.” Beach v. Livingston, 248 S.C. 135, 139, 149 S.E.2d 328, 330 (1996) (internal citation omitted). “If the statute is ambiguous, however, courts must construe the terms of the statute.” S.C. Energy Users Comm. v. S.C. Pub. Serv. Comm’n, 388 S.C. 486, 491, 697 S.E.2d 587, 590 (2010) (internal citation omitted). “A statutory provision should be given a reasonable and practical construction consistent with the purpose and policy expressed in the statute.” Lockwood Greene Eng’rs, Inc. v. S.C. Tax Comm’n, 293 S.C. 447, 449, 361 S.E.2d 346, 347 (Ct. App. 1987). “When faced with an undefined statutory term, the term must be interpreted in accordance with its usual and customary meaning.” *Id.* at 492, 697 S.E.2d at 590 (internal citation omitted). “Courts should

¹⁶ Even though the Court finds as a matter of law that Duke Energy’s filings of tax refund claims for tax years ending 1978-1993 were untimely, and thus will not be considered here, the filing for tax year 1994 was timely, and thus statutes applicable to tax years prior to 1996 will be discussed.

¹⁷ Section 12-6-2250 (applicable to tax years after 1995) and Section 12-7-1140 (applicable to tax years prior to 1996).

¹⁸ For tax years after 1995, S.C. Code Ann. § 12-6-2280 (****) similarly provides that: “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.”

¹⁹ For tax years after 1995, S.C. Code Ann. § 12-6-2280 (B) (****) similarly provides that the term “sales in this State” includes sales of goods, merchandise, or property received by a purchaser in this State. The place where goods are received by the purchaser after all transportation is completed is considered 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.”

not merely consider the language of the particular clause being construed, but the undefined word and its meaning in conjunction with the purpose of the whole statute and the policy of the law." Id. Finally, "[s]tatutes should not be construed so as to lead to an absurd result." Kennedy v. S.C. Ret. Sys., 345 S.C. 339, 351, 549 S.E.2d 243, 249 (2001) (internal citation omitted).

Here, there is no genuine issue of material fact with regard to the Gross Receipts Issue. The sole question of law is whether Duke Energy could include the return of principal from its sales of securities and other investment transactions as part of the sales or gross receipts factors in the apportionment formula. This is a novel question in South Carolina, but is not unprecedented in some of our sister States.

The first approach to this issue was taken by New Jersey in Am. Tel. and Tel. Co. v. Dir., Div. of Taxation, 194 N.J. Super. 168, 476 A.2d 800 (App. Div. 1984). In that case, the New Jersey Supreme Court concluded that the inclusion of gross or full revenues from the short-term sale or redemption of investment paper in the denominator of the receipts fraction of the apportionment formula would lead to "absurd results" in that such inclusion would greatly distort the amount of business the taxpayer did within and without New Jersey and would thus defeat the intent and purpose of the apportionment statute. Id. at 172, 476 A.2d at 802. Both Indiana and Arizona have adopted similar rationales to the one used by the New Jersey court. See Sherwin-Williams Co. v. Ind. Dept. of State Revenue, 673 N.E.2d 849 (Ind. Tax 1996) (holding that "'gross receipts' for the purpose of the sales factor includes only the interest income, and not the rolled over capital or return of principal, realized from the sale of investment securities"); Walgreen Ariz. Drug Co. v. Ariz. Dep't of Revenue, 209 Ariz. 71, 97 P.3d 896 (App. 2004) (holding that the return of principal from the type of short-term investments at issue was not includable in the sales factor denominator).

The other approach to this issue was taken by Tennessee and California.²⁰ In Sherwin-Williams Co. v. Johnson, 989 S.W.2d 710 (Tenn. App. 1998), the chancellor had followed the same reasoning employed by the New Jersey and Indiana courts (and later the Arizona court), holding that "to include the principal in the sales factor denominator would distort the extent of Sherwin-Williams' business activities in Tennessee and other states in which it does business

²⁰ South Carolina's apportionment provisions, like those in New Jersey, Indiana, Arizona, Tennessee, and California, are based on the Uniform Division of Income for Tax Purposes Act (UDITPA).

and defeat the intent and purpose of the [apportionment] statute. . .” and that “the amount of return of principal on the sale or redemption of interest bearing securities related to its, [sic] working capital investments should not be included in the denominator of the sales factor.” Id. at 714. The Tennessee Court of Appeals, though finding the chancellor’s holding “logical and appealing,” nevertheless decided not to follow the “absurd result standard.” The court instead concluded that:

An absurd result is not necessary, for in spite of the plain language of the [sales factor statute], the commissioner may opt for a different scheme of assessment whenever the resulting apportionment does not fairly represent the taxpayer’s business in this state. The very absurdity of the result sought . . . lays a sound basis for the implementation of [the alternative apportionment method statute].

Id. at 714-15.

The California Supreme Court, in Microsoft Corp. v. Franchise Tax Bd., quoted this passage with approval as it went on to hold that “gross receipts” is not limited to net proceeds. 39 Cal.4th 750, 763, 139 P.3d 1169, 1177 (2006). Referencing California’s alternative apportionment method, the court concluded that “[t]he UDITPA contains an equitable relief provision so that, in cases where application of the statutory sales definition results in excessive distortion, an ‘absurd result’ may be avoided.”

After considering the two lines of reasoning set forth by our sister States, I conclude that the law of South Carolina favors the view expressed by the courts in New Jersey, Indiana, and Arizona.

As the Tennessee Court of Appeals correctly noted, “[i]f the words of a statute plainly mean one thing they cannot be given another meaning by judicial construction.” Johnson, 989 S.W.2d at 714-15 (internal citation omitted); see also Denman v. City of Columbia, 387 S.C. 131, 138, 691 S.E.2d 465, 468 (2010) (“Under the plain meaning rule, it is not the Court’s place to change the meaning of a clear and unambiguous statute.”). However, to rearrange the order of the court’s sentences, “This sound rule . . . is met by the equally well settled rule that: . . . ‘It is presumed that the legislature enacting a statute did not intend an absurdity, and such a result will be avoided by this court if the terms of the statute admit of it by reasonable construction.’” Johnson, 989 S.W.2d at 714 (internal citations omitted).

Alternative Apportionment Method

The Tennessee and California opinions rely upon the presupposition that “an absurd result is not necessary” because the Department “may opt for a different scheme of assessment

whenever the resulting apportionment does not fairly represent the taxpayer's business in this State." Microsoft, 39 Cal.4th at 763, 139 P.3d at 1177 (quoting Johnson, 989 S.W.2d at 715). South Carolina indeed has a similar provision. S.C. Code Ann § 12-6-2320(A) (2002) provided that:

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: separate accounting;

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

(Emphasis added).

I nevertheless find that the California and Tennessee cases, in relying upon this statutory option, miss an important distinction between the court's roles of statutory construction and application of the alternative apportionment provision. Though the alternative relief provision exists as a mechanism to correct problems caused by the application of the standard apportionment statutes (see Media Gen. Commc'ns v. S.C. Dep't of Revenue, 388 S.C. 138, 694 S.E.2d, 525 (2010)), the standard application statutes should not be so construed as to encourage excessive distortion simply because the alternative relief provision exists to remedy that distortion. In applying the principles of statutory construction, the court's function is, in part, to construe statutory law to avoid an absurd result. Ventures S.C., LLC v. S.C. Dep't of Revenue, 378 S.C. 5, 9, 661 S.E.2d 339, 341 (2008) ("[T]he Court will reject the plain meaning of the words used in a statute if it would lead to an absurd result. . . ."). If, as here, the proposed construction of a statute reaches an absurd result, our courts should recognize that absurdity and end the inquiry.

On the other hand, the function of the alternative apportionment provision is quite different. The alternative apportionment provision should be utilized only when the standard apportionment statute does not operate sensibly in a given case. As the Florida Supreme Court pointed out in Roger Dean Enters, Inc. v. State, "[t]here is a very strong presumption in favor of normal three-factor apportionment and against the applicability of the relief provisions. . . . Departures from the basic formula should be avoided except where reasonableness requires."

387 So.2d 358, 363 (internal citations omitted). Further, in St. Johnsbury Trucking Co. v. New Hampshire, the New Hampshire Supreme Court, in addressing very similar statutory language, held that:

The statutory provisions require that the three-factor formula will be used for apportioning business profits, and an alternative formula may be used if the statutory method of apportionment "does not fairly reflect the extent of the business activities of a business organization within this state." The legislature has, therefore, specified that an alternative formula is **the exception**, and the party who wants to use an alternative formula accordingly has the burden of showing that the alternative is appropriate.

118 N.H. 209, 212, 385 A.2d 215, 217 (1978) (emphasis added).²¹

In this case, to interpret the standard apportionment formula to include the return of principal in either the sales factor or gross-receipts factor of the denominator would engender an absurd application of the standard apportionment statute simply because another statute exists which allows for another means of accounting when the standard apportionment statute does not "fairly represent the extent of the taxpayer's business activity in this State." In other words, such an interpretation would create the very absurdity that courts are to avoid in their statutory construction. Rather than having Section 12-6-2320(A) available as a remedial back-up, a corporation would have nothing to lose and everything to gain by adding the return of principal to the denominator and thereby reducing the amount of taxes owed to South Carolina, regardless of whether the numbers accurately reflected the corporation's business activity within and without the State. As a result, the alternative apportionment statute, which was intended to be a remedy held in reserve for the relatively infrequent occasion that the standard formula did not result in a fair representation, would then become a standard follow-up to the application of the standard apportionment statute. Indeed, both statutes would become standard, because distortion of business activity representation would be fostered on the front end (through the principal-inclusive standard apportionment formula) so that it could, and necessarily would, be dealt with on the back end (through the alternative apportionment formula).²²

²¹ The following states have followed the holding in St. Johnsbury Trucking: Idaho - Union Pac. Corp. v. Idaho State Tax Comm'n, 83 P.3d 116, 120 (Idaho 2004); and Kentucky - Ruby Const. Co., Inc. v. Dep't of Revenue, 578 S.W.2d 248, 253 (Ky. Ct. App. 1978).

²² In its Memorandum in Opposition to the Department's Motion for Summary Judgment and in Support of its Cross-Motion for Partial Summary Judgment, Duke Energy argues that the definitions of "sales" and "gross receipts" set forth in S.C. Code Ann. § 12-6-2295 (2007) (effective for tax years beginning after 2006), shows the Legislature's intent to make a "drastic" change to the existing law based on its various inclusions in, and exclusions

Of course, this "best-case scenario" assumes that the Department will be able to detect when a business is including principal in the standard apportionment formula and will be able to pursue those cases. In reality, however, limited resources would dictate the exercise of more discretion in the application of the alternative apportionment method. Consequently, much, if not all, of the smaller amounts of tax revenue that the State would have received would become avoidable by including principal in the standard formula and hiding behind the newly-targeted "bigger fish" that would be including more principal in their formulas. In the aggregate, these small amounts, which the State would otherwise have gained but would instead lose through undetected inflation of the denominator and consequent underestimation of the taxes owed to the State, will equate to a rather sizeable sum lost to the State. Thus, the distortion that inevitably results from the inclusion of principal in the standard apportionment formula will pose problems for the Department and South Carolina, regardless of the size of the distortion. This potential for abuse by corporations and the futility of going through this extra-step process needlessly is reflected in a finding by the Arizona Court of Appeals that in most of the cases that the taxpayer cited to support the inclusion of the return of principal in the sales factor denominator of the standard apportionment formula, the courts "nonetheless approved exclusion of the principal from the sales factor denominator pursuant to their states' version of UDITPA's 'relief provision' [i.e., alternative apportionment method]." Walgreen, 209 Ariz. at 901-02, 97 P.3d 896 at 76-77 (citing Union Pac. Corp. v. Idaho State Tax Comm'n, 139 Idaho 572, 83 P.3d 116, 122 (2004); Am. Tel. & Tel. Co. v. State Tax Appeal Bd., 241 Mont. 440, 787 P.2d 754, 757-58 (1990); Johnson, 989 S.W.2d at 715). Microsoft, which was decided two years after Walgreen, can be added to this list, as it applied California's alternative apportionment method statute to

from, the definitions of "sales" and "gross receipts" that had previously not existed. According to Duke's argument, therefore, these inclusions and exclusions did not apply prior to the enactment of Section 12-6-2295. One of the inclusions would be "net gain from the sale of property used in the trade or business[, such as] intangible property used in the trade or business . . ." (Section 12-6-2295(A)(4) (emphasis added)), and one of the exclusions is the "repayment, maturity, or redemption of the principal of a loan, bond, or mutual fund or certificate of deposit or similar marketable instrument . . ." Id. (B)(1) (emphasis added). According to the Supreme Court in Duvall, 377 S.C. at 46, 659 S.E.2d at 130: "When the Legislature adopts an amendment to a statute, th[e] Court recognizes a presumption that the Legislature intended to change the existing law. Nonetheless, a subsequent statutory amendment may also be interpreted as clarifying original legislative intent." (Internal citations omitted) (emphasis added). In this case, the inclusion and exclusion quoted above demonstrate that the Legislature intended to exclude the return of principal from the sale of securities and other capital investments in the apportionment formula. In light of all of the reasons discussed above as to why the return of principal was excluded from the apportionment formula prior to the enactment of Section 12-6-2295, it is evident that the Legislature intended Section 12-6-2295 to clarify the existing law.

“fairly represent the extent of the taxpayer’s business activity in this state” after the court included principal in the sales denominator of its standard apportionment formula.²³ Thus, any benefits from this principal-inclusion method seem to be vastly outweighed by the great cost of revenue that this State would face through continuous underestimation of taxes due to distortions.

Logical Definition of Gross Receipts

The term “gross receipts” does not plausibly include the return of principal from the sale of securities and other capital investments. “Gross income”, at least in the context of self-employment or self-owned businesses, is defined as “gross receipts minus ordinary and necessary expenses required for self-employment or business operation. . . .” Spreeuw v. Barker, 385 S.C. 45, 65, 682 S.E.2d 843, 853 (Ct. App. 2009) (citing S.C. Code Ann. Regs. 114-4720(A)(4) (Supp. 2008)). This definition would logically apply to other types of businesses, too. According to this definition, gross receipts equal gross income plus ordinary and necessary expenses of business operations. The South Carolina Supreme Court in Roper v. S.C. Tax Comm’n, Title 65-Section 251 of the 1952 Code of Laws of South Carolina also defined “gross income” as: “the income of a taxpayer derived from . . . interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit” 231 S.C. 587, 598, 99 S.E.2d 377, 382 (1957) (emphasis added); see also S.C. Code Ann. § 12-7-415 (****) (adopting the Internal Revenue Code’s (I.R.C.) determination of gross income with modifications specified in Section 12-7-430 (which are not relevant here)); I.R.C. § 61(a) (****) (generally defining corporate gross income as “all income from whatever source derived” and covering many of the same categories mentioned in Roper)²⁴; S.C. Code Ann. § 12-6-1110 (****). The Court went on

²³ Paradoxically, the court went on to justify this decision to apply the alternative method statute because it was “unable to accept, even for a moment, the notion that more than 11 percent of [taxpayer’s] entire unitary business activities should be attributed to *any* single state solely because it is the center of working capital investment activities that are clearly only an incidental part of one of America’s largest, and most widespread, businesses.” This rationale highlights the precise reason why principal from the sale of securities and other capital investment activities should not be included in the standard apportionment formula in the first place: the inclusion of principal causes distortions as to the amount of business activity actually performed in a State, which, in turn, have to be remedied.

²⁴ Nowhere in South Carolina’s statutory law or in the federal statutory law adopted by South Carolina is principal from investments listed as part of gross income. In fact, principal would later be excluded in S.C. Code Ann. § 2295(B)(1) (2007), which became effective for tax years after 2006. Also, it is worth noting that even in the context of child support, gross income does not include principal in the return from the sale of investments. Indeed, the inclusion of “capital gains” in the list of items considered part of gross income for child support purposes

to point out that "the word 'income' as used in a tax statute, is to be taken in its ordinary sense of gain or profit." *Id.* (reaffirmed as "well-settled" in *Scott v. S.C. Tax Comm'n*, 262 S.C. 144, 148, 202 S.E.2d 854, 856 (1974)). Because gross income includes "all income," and income, being gain or profit, excludes principal, then gross income necessarily excludes principal. Therefore, the only remaining question is whether "ordinary and necessary expenses of business operations" includes principal.

Principal, by definition, cannot be an expense of a business operation. Since ordinary and necessary business expenses are subtracted from gross receipts to yield gross income, and neither business expenses nor gross income include principal, it is impossible for gross receipts to include principal. Put another way, because gross receipts are equivalent to gross income plus ordinary and necessary business expenses, and neither gross income nor business expenses include principal, gross receipts, being the sum of those two parts, cannot include principal.²⁵ Inversely, Duke Energy contends that the principal is a component of the gross receipts it received. If gross receipts were also a component of gross income, then, according to Duke Energy's argument, gross income must include principal. However, inclusion of principal in gross income would create an absurd result. Generally, the taxable income of a business is its gross income minus any deductions that are allowed by state law.²⁶ Principal is not an item that is specifically excluded from gross income. *See* 26 U.S.C.A. Subt. A, Ch. 1, Subch. B, Pt. III. Thus, the logical extension of Duke Energy's argument is that taxable income includes the

necessarily implies the exclusion of principal from the return of investment sales. *See* S.C. Code Ann. Regs. 114-4720(A)(2) (2012).

²⁵ For examples in the I.R.C. of exclusion of principal from gross receipts, *see* I.R.C. § 165(g)(3)(B) (****) (in the context of determining whether a corporation is affiliated with a taxpayer, "in computing gross receipts for purposes of [calculating the percentage of gross receipts that have come from particular sources], gross receipts from sales or exchanges of stocks and securities shall be taken into account *only to the extent of gains* therefrom.") (emphasis added); *id.* § 1362(d)(3) (in the context of a small business corporation's termination of its election to be an S corporation, where its passive investment income exceeds twenty-five percent of gross receipts for three consecutive taxable years and the corporation has accumulated earnings and profits at the close of each of those years, when capital assets (other than stocks or securities) are disposed of, "gross receipts from such dispositions shall be taken into account *only to the extent of the capital gain net income* therefrom[;] and in the case of sales or exchanges of stock or securities, gross receipts shall be taken into account *only to the extent of the gains* therefrom.") (emphasis added); and *id.* § 1244 (in the context of calculating the percentage of gross receipts from particular sources for determining whether "stock" means stock in a domestic corporation for determining losses on small business stocks, "gross receipts from the sales or exchanges of stock or securities shall be taken into account *only to the extent of gains* therefrom.") (emphasis added).

²⁶ I.R.C. § 63(a) (****).

principal and the gain. Consequently, taxpayers would be taxed not only upon the specific gains from the principal but upon the return of the principal itself.²⁷

Furthermore, a corporation's South Carolina gross income and taxable income is computed as determined under the I.R.C. with the modifications as provided in the South Carolina Tax Code. See S.C. Code Ann. §§ 12-6-580 (****) and 12-7-415 (****). The I.R.C. provides that except in the case of individuals who do not itemize deductions, "taxable income" is defined as "gross income minus the deductions allowed by this chapter (other than the standard deduction)." I.R.C. § 63(a) (****); see also U.S. v. Foster Lumber Co., 429 U.S. 32, 36-37 (1976) (recognizing this definition for taxable income as applicable to the corporate respondent in that case). For the reasons given above, gross income does not include principal. Consequently, principal cannot be included in taxable income, the remainder of gross income following deductions (other than the standard deduction). Indeed, because principal is also not a deduction allowed by state law, principal cannot even be included in the calculation of taxable income.²⁸

Therefore, because income is the gain or profit realized from principal, gross income, and thus taxable income, necessarily exclude principal.

Logical Definition of Sales

It is equally implausible to include principal from the sale of securities and other capital investments in the definition of "sales" for purposes of the standard apportionment formula. A major difference between the Tennessee case and the present case is that Tennessee's standard apportionment statute defined "the term 'sales' to include all gross receipts of the taxpayer not otherwise allocated under the Excise Tax Law." Johnson, 989 S.W.2d at 713 (emphasis in original). Likewise, the California standard apportionment statute included "all gross receipts" in the definition of "sales." South Carolina's standard apportionment statute defines the term

²⁷ In light of the above analysis, the application of the holding in Roper v. S.C. Tax Comm'n, 231 S.C. 587, 99 S.E.2d 377 (1957) is even more pertinent.

²⁸ It is worth noting that in Foster Lumber Co., the U.S. Supreme Court reasoned that the inclusion of "gains derived from dealing in property" as part of "all income from whatever source derived" in the definition of gross income under I.R.C. Section 61(a) meant that taxable income, which includes gross income according to Section 63(a), also therefore included capital gains as well as ordinary income, in the absence of a specific exclusion of capital gains. 429 U.S. at 37. The Court's inclusion of capital gains impliedly excludes principal from gross income and thus taxable income.

"sales," but this definition does not include "gross receipts."²⁹ Instead, under its definition of "sales," "[i]f 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." (Emphasis added). This phrase "income-producing" is used to modify "activity" several other times in the definition of "sales." "Income" means "an actual gain or actual increase of wealth." See Scott v. S.C. Tax Comm'n, 262 S.C. 144, 148-49, 202 S.E.2d 854, 856 (1974) (Bussey, J., dissenting) (citing 85 C.J.S. Taxation 1096, p. 730). This emphasis on income production suggests that principal is excluded from the definition of "sales."³⁰ Moreover, this limitation of "sales" to the net income derived therefrom is not a novel interpretation. Indeed, our own Supreme Court has approved of an apportionment formula "whereby [a business's] sales, payroll, and property in South Carolina were divided by its national net sales, payroll, and property." See Eastman Kodak Co. v. S.C. Tax Comm'n, 308 S.C. 415, 416, 419, 418 S.E.2d 542, 542, 544 (1992) (holding in part that safe harbor lease transactions that were part of a corporation's business "were properly included in the denominator of the apportionment formula in computing [that corporation's] national net income from payroll, property, and sales.") (emphasis added). The Supreme Court in Texaco, Inc. v. Wasson, referring to S.C. Code Ann. § 12-7-1140 (****), the immediate predecessor to Section 12-6-2250 (****), further noted that "[u]nder the [three-factor] apportionment method, a corporation's entire net income is apportioned to this state by applying to that entire net income a percentage based on the 'three-factor formula' of property, payroll, and sales in this state to the corporation's total property, payroll, and sales." 269 S.C. 255, 259, 237 S.E.2d 75, 76 (1977) (emphasis added). The Court also noted that this apportionment was of the "net income" remaining after the direct allocation of certain items listed under Section 12-7-1120 (****) (currently Section 12-6-2220 (****)). Id. at 266, 237 S.E.2d at 80 (emphasis added). Using this

²⁹ "Sales" and "gross receipts" were later further defined together by S.C. Code Ann. § 12-6-2295 (2007) (effective for tax years beginning after 2006). However, the years at issue here are 1978-2001. Further, because the Court finds as a matter of law that the refund claims filed for tax years ending 1978-1993 are untimely, the only years that will be considered for the gross receipts issue will be tax years ending 1994-2001.

³⁰ Though Duke Energy is a nonresident corporation, it is worth noting that South Carolina taxable income for nonresident individuals, nonresident trusts, nonresident estates, and nonresident beneficiaries include only amounts attributable to, among other things, "income from intangible personal property, including annuities, dividends, interest, and gains that is derived from property employed in a trade, business, profession, or occupation carried on in this State." It is interesting that nowhere is "principal" mentioned as an inclusion in taxable income.

interpretation and limiting the sales factor in the denominator of the three-part apportionment formula to net income is the more sound application of the apportionment formula.

The conclusion in this case is further supported by the fact that in the context of consolidated returns filed by multiple corporations conducting business within and without the State, the returns included in the sales factor of the standard apportionment formula must "contain such other information necessary to compute the net income of each taxpayer properly attributable to the state so that South Carolina can impose a tax on the taxpayers concerned." Emerson Elec. Co. v. Wasson, 287 S.C. 394, 396-97, 339 S.E.2d 118, 120 (1986) (discussing S.C. Code Ann. § 12-7-1570 (****) (for tax years prior to 1996), the predecessor of § 12-6-5020 (****) (for tax years after 1996)) (emphasis altered). This infers that when a single corporation also conducts business within and without the State, its net income only, and not principal, is included in the sales factor for purposes of apportioning the amount of corporate income taxes the State could impose on that corporation. See, e.g., Eastman Kodak Co., 308 S.C. at 416, 418 S.E.2d at 542 (Kodak included only the net income in the sales factor in the denominator of the apportionment formula).

Criticism of the "Absurd Results Standard"

The California Supreme Court in Microsoft criticized the proponents of the "absurd results standard," in part, because "[i]n each case, the same language governs both sales of off-the-shelf products and sales of securities. *AT&T* [(the New Jersey case)] and its progeny offer no explanation why in one instance that language should require inclusion of gross proceeds and in the other require inclusion of only net proceeds." 39 Cal.4th at 763, 139 P.3d at 1177.³¹ Nevertheless, the resolution of this issue has been clarified in South Carolina by the Supreme Court's holding in Hay v. Leonard, 212 S.C. 81, 46 S.E.2d 653 (1948).

Hay involved a challenge to the validity of Charleston County's levying an annual license tax for the privilege of engaging in each and every business and occupation in Charleston County, except in the City of Charleston. In reaching its decision, the South Carolina Supreme Court explained the reason why merchandise, or "off-the-shelf products," includes gross proceeds in its taxation, and the Court's reasoning suggests why the sale of securities would not include gross proceeds. The Court explained: "the [license] tax is not on the property itself, it is

³¹ This is the first of the "two problems" that the California Supreme Court had with the "absurd results" cases. The second problem will be discussed in the immediately-following paragraph.

on the **privilege of dealing with it**. The value of such privilege is measured by the gross receipts therefrom, and this is a familiar and valid method of ascertaining such value." Id. at 97, 46 S.E.2d at 660 (emphasis added). A merchant is required to possess a license in order to have the privilege of dealing in merchandise; and the tax is on this privilege, not on the merchandise. This is why "[t]he sale of all merchandise includes previous taxation" Id.; see also State ex rel. Roddey v. Byrnes, 219 S.C. 485, 514, 66 S.E.2d 33, 45 (1951) ("In general, the sales tax [a form of excise tax], is [, like a license tax,] an imposition upon the privilege of the business of selling at retail and measured by the amount of business done"). The sale of securities is altogether different in that a license is not required to purchase or sell securities,³² and no sales tax is imposed upon the sale of securities.³³ Therefore, here there exist no "privilege" grounds upon which to include principal in the gross receipts, as the value received from the sales of the securities for tax purposes would be measured by the capital gains, not by the principal. The principal would consist of the business's "idle cash" that would presumably have been taxed already.

Conclusion

This Court hereby follows New Jersey, Indiana, and Arizona in adopting the "absurd results" approach to interpreting South Carolina's standard apportionment statute and therefore rejects Duke Energy's attempt to include the return of principal in the denominator of the standard apportionment formula. In sum, the alternative apportionment formula exists to remediate any nonsensical application of the standard apportionment formula. However, that remediation should not be the result of a court's addition, through its failure to apply the rules of statutory interpretation, of a component to the standard apportionment formula that neither exists in the statute nor was intended by the Legislature. The absurdity that the alternative apportionment formula is intended to remediate is when a taxpayer follows the standard apportionment formula but the result is nevertheless an unfair representation of the extent of the taxpayer's business activity in the State. Construing the purpose of the alternative provision to avoid an absurd use of the standard apportionment statute clearly could open the door to the abuse of the standard apportionment statute and an excessive need to apply Section 12-6-

³² This statement does not include securities brokering.

³³ Capital gains tax is imposed upon the sale of securities (assuming a profit is made from the sale). This tax is imposed on the profit, or "gains," made on the capital originally invested, not on the returned principal.

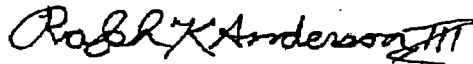
2320(A). Furthermore, to use the alternative apportionment provision as a means to avoid absurdity resulting from an interpretation of the standard apportionment provision that is not envisioned by the tax laws places upon the State a burden of policing tax returns that simply should not exist.

Importantly, it is not the amount of distortion that determines absurdity here. If it was, then there would exist an issue of material fact in this case, and indeed in every such case, as to the amount of distortion that would result from the inclusion of principal, and a hearing would be necessary to obtain facts whereby the degree of distortion could be measured so as to determine whether the results of principal inclusion would be absurd in this case. But such a case-by-case determination is not necessary where, as here, principal cannot, as a matter of law, be included in sales or gross receipts for purposes of the standard apportionment formula. Thus, no hearing is necessary on the gross receipts issue, and the Department's Motion for Summary Judgment as to this issue is therefore granted for the reasons set forth above.

ORDER

THEREFORE, IT IS HEREBY ORDERED that: (1) the Department's Motion for Summary Judgment with respect to the Timeliness Issue is **GRANTED**; (2) the Department's Motion for Summary Judgment with respect to the Apportionment Method Issue is **DENIED**; and (3) the Department's Motion for Summary Judgment with respect to the Gross Receipts Issue is **GRANTED**, and Duke Energy's Cross-Motion for Partial Summary Judgment as to this same issue is therefore **DENIED**.

IT IS SO ORDERED.



Ralph K. Anderson, III
Chief Administrative Law Judge

August 9, 2012
Columbia, South Carolina

CERTIFICATE OF SERVICE

I, E. Harvin Belser Fair, hereby certify that I have this date served this Order upon all parties to this cause by depositing a copy hereof, in the United States mail, postage paid, in the Interagency Mail Service, or by electronic mail to the address provided by the party(ies) and/or their attorney(s).

E. Harvin Belser Fair

E. Harvin Belser Fair
Judicial Law Clerk

August 9, 2012
Columbia, South Carolina

NEXSEN|PRUET

August 20, 2012

Briani Bennett Mellen
Associate
Admitted in SC, NC

VIA HAND DELIVERY

The Honorable Ralph K. Anderson III
South Carolina Administrative Law Court
Edgar A. Brown Building
1205 Pendleton Street, Suite 224
Columbia, SC 29201

Re: Duke Energy Corporation v. South Carolina Department of Revenue
Case No. 10-ALJ-17-0270-CC

Dear Judge Anderson:

Enclosed please find one original and one copy of the following documents to be filed in the above matter.

1. Motion for Reconsideration of the Court's Order Granting the South Carolina Department of Revenue's Motion for Summary Judgment as to the Waiver and Gross Receipts Issues; and
2. Duke Energy's Memorandum of Authorities in Support of the above Motion.

Please return the file stamped copy to us via our courier. Copies of this filing are being served on counsel of record.

If there are any questions, or if the Court requires anything further, please let me know.

Very truly yours,



Briani Bennett Mellen

Enclosures

cc: Tracey C. Green, Esquire
John M. S. Hoefer, Esquire
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EXHIBIT B

STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

DUKE ENERGY CORPORATION,

Petitioner,

vs.

SOUTH CAROLINA DEPARTMENT OF
REVENUE,

Respondent.

Docket No.: 10-ALJ-17-0270-CC

DUKE ENERGY'S MOTION FOR
RECONSIDERATION OF THE
COURT'S ORDER GRANTING THE
SOUTH CAROLINA DEPARTMENT
OF REVENUE'S MOTION FOR
SUMMARY JUDGMENT AS TO THE
WAIVER AND GROSS RECEIPTS
ISSUES

Pursuant to Rule 29(D) of the Rules of Procedure for the South Carolina Administrative Law Court and Rule 59(e) of the South Carolina Rules of Civil Procedure, Duke Energy Corporation ("Duke Energy") respectfully submits this Motion for Reconsideration in connection with the Court's Order of August 9, 2012, ruling *inter alia* that, as a matter of law, (1) Duke Energy's refund claims for the tax periods 1978-1993 were untimely, and (2) Duke Energy is not permitted to include its gross receipts from sales of securities in the denominator of its apportionment formula ("Gross Receipts Issue").

As more fully set out in the attached Memorandum of Authorities filed contemporaneously herewith, Duke Energy respectfully submits that the Court should reconsider its ruling with respect to (1) the Waiver Issue because an evidentiary hearing is necessary to resolve the material facts in dispute with respect to that issue, and (2) Gross Receipts Issue because Duke Energy is entitled to a judgment as a matter of law on

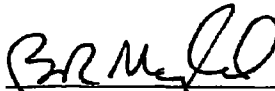
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that issue as South Carolina law requires Duke Energy to include all of its receipts from sales of securities in apportioning its income to South Carolina.

Respectfully submitted this 20 day of August 2012.



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STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

DUKE ENERGY CORPORATION,

Petitioner,

vs.

SOUTH CAROLINA DEPARTMENT OF
REVENUE,

Respondent.

Docket No.: 10-ALJ-17-0270-CC

DUKE ENERGY'S MEMORANDUM
OF AUTHORITIES IN SUPPORT OF
ITS MOTION FOR
RECONSIDERATION OF THE
COURT'S ORDER GRANTING THE
SOUTH CAROLINA DEPARTMENT
OF REVENUE'S MOTION FOR
SUMMARY JUDGMENT AS TO THE
WAIVER AND GROSS RECEIPTS
ISSUES

INTRODUCTION

Pursuant to Rule 29(D) of the Rules of Procedure for the South Carolina Administrative Law Court and Rule 59(e) of the South Carolina Rules of Civil Procedure, Duke Energy Corporation ("Duke Energy") respectfully requests that the Court reconsider its Order of August 9, 2012, ruling that, as a matter of law, Duke Energy's refund claims for the tax years 1978 through 1993 are untimely ("Waiver Issue"), and Duke Energy is not permitted to include its gross receipts from sales of securities in the denominator of its apportionment formula ("Gross Receipts Issue").

FACTUAL AND PROCEDURAL BACKGROUND

The South Carolina Department of Revenue ("Department") filed a Motion for Summary Judgment ("Department's Motion") asking this Court to rule, *inter alia*, that, as

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a matter of law, (1) Duke Energy's refund claims for the tax years 1978 through 1993 are untimely, and (2) Duke Energy was permitted to include only the net proceeds from sales of securities in its South Carolina corporate income tax apportionment formula. Duke Energy filed a Reply and Cross-Motion for Partial Summary Judgment (Duke Energy's Cross-Motion) opposing the Department's Motion and asking this Court to rule, *inter alia*, that (1) genuine issues of material fact exist regarding the Waiver Issue that necessitate an evidentiary hearing, and (2) Duke Energy was required to include the entire proceeds from such sales of securities in its apportionment formula.

A hearing on the Department's Motion and Duke Energy's Cross-Motion was held on June 26, 2012. At the hearing, each party presented arguments in support of its position regarding the Waiver and Gross Receipts Issues.

On June 29, 2012, this Court held a telephone conference and informed the parties of the Court's decision (1) to grant the Department's Motion with regard to the Waiver Issue and to deny the Duke Energy's Cross-Motion with respect to the same issue, and (2) to grant Duke Energy's Cross-Motion with regard to the Gross Receipts Issue and to deny the Department's Motion with respect to the same issue. With regard to the Gross Receipts Issue, the Court further informed the parties that at the evidentiary hearing currently scheduled for September 4-10, 2012, the Department will have an opportunity to argue that South Carolina's alternative apportionment provision may apply and will have an opportunity to present evidence to support its position that the inclusion of the principal in Duke Energy's apportionment formula was distortive.

However, on August 9, 2012, this Court entered the Order in this summary judgment proceeding *granting* the Department's Motion with regard to the Gross Receipts Issue. The Order provided the following bases for its decision:

1. The inclusion of the principal from sales of securities in the standard apportionment formula would encourage excessive distortion or inevitably result in distortion.
2. The inclusion of the principal from sales of securities in the standard apportionment formula would produce an absurd result because it would lead to inevitable distortion and thus an increased application of the alternative apportionment statute.
3. "Gross Receipts," as used in the gross-receipts formula, does not include the principal from sales of securities because such amounts are not included in "gross income"/"taxable income."
4. "Sales," as used in the sales factor under the multi-factor apportionment formula, does not include the principal from sales of securities because "net income" excludes such amounts.

In the transmittal electronic mail of this Court's Order, the clerk of the Court noted:

Though Judge Anderson requested Duke Energy to submit a Proposed Order granting summary judgment to Duke Energy regarding the gross receipts issue, after further research and consideration he decided that the proper decision was to grant summary judgment to the Department.

For the reasons discussed below, Duke Energy respectfully moves this Court to vacate its Order and issue an order denying the Department's Motion with respect to the

Waiver Issue and granting Duke Energy's Cross-Motion with regard to the Gross Receipts Issue.

STANDARD OF REVIEW

Rule 29(D) of the Rules of Procedure for the South Carolina Administrative Law Court and Rule 59(e) of the South Carolina Rules of Civil Procedure, provide that the Court may grant a motion for reconsideration as a means to correct alleged errors, reconsider a possible misapprehension of an earlier argument, or revisit a previously raised argument. *Elam v. S. Carolina Dep't of Transp.*, 361 S.C. 9, 22, 602 S.E.2d 772, 779 (2004). As set forth below, this motion should be granted.

ARGUMENT AND CITATION OF AUTHORITY

I. The Court Erred in Concluding that Duke Energy's Refund Claims for the Tax Periods 1978-1993 Are Untimely as a Matter of Law.

The Department entered into an agreement with Duke Energy to extend the statutory period of time that the Department could assess tax and Duke Energy could seek a refund. The agreement between the Department and Duke Energy to waive the statute of limitations was reached verbally and in writing. Whether the Department agreed to extend the time for Duke Energy to file refund claims is a question of fact. *City of N. Myrtle Beach v. Lewis-Davis*, 360 S.C. 225, 599 S.E.2d 462, 466-67 (Ct. App. 2004). Form FS-43 authorizes the Department to extend the statute of limitations for assessments *and* refunds. Thus, the existence of the Waivers, their effect, and their impact on the arguments raised by the Department are all factual issues that need to be determined as part of an evidentiary hearing before this Court.

Furthermore, the Department is estopped from arguing that Form FS-43 has no effect. Moreover, the statute of limitations was tolled during the tax years at issue and

Duke Energy's refund claims for the tax years 1978 -1993 should be allowed as timely. Accordingly, for these reasons and the reasons stated in Duke Energy's Cross-Motion, Duke Energy respectfully request that the Court amend its Order with regard to the Waiver Issue and conduct an evidentiary hearing to resolve the material facts in dispute with regard to that issue.

- II. The Court Erred in Concluding that Duke Energy Is Not Permitted to Include the Principal from Sales of Securities in Its Apportionment Formula.**
- 1. The Court Erred in Concluding that the Inclusion of the Principal from Sales of Securities in the Standard Apportionment Formula Would Encourage Distortion or Inevitably Result in Distortion.**

In determining the meaning of the term "gross receipts" and "sales," the Order stated that including the principal from sales of securities in the sales factor denominator or the gross-receipts factor denominator is improper because, in part, it would "inevitably" result in "distortion," "distortion of business activity representation," and "continuous underestimation of taxes due to distortions." ALC Order at 29-30. The Court reasoned that if all of the receipts from sales of securities were includable in the standard apportionment formula, "a corporation would have nothing to lose and everything to gain by adding return of principal to the denominator and thereby reducing the amount of taxes owed to South Carolina," which the Order qualified was a "potential for abuse by corporations." *Id.*

This analysis is misplaced. The only issue before the Court was whether, as a matter of law, the principal realized from sales of securities was included in the standard apportionment formula. Whether the inclusion of the principal results in distortion is an entirely separate and inherently factual question, to be addressed only after the standard

apportionment formula results have been determined. *See generally Media Gen. Commc'ns., Inc. v. South Carolina Dep't of Revenue*, 388 S.C. 138, 147-48, 694 S.E.2d 525, 529 (2010). In other words, distortion falls under the second part of a two-part analysis. Under part one, if a transaction is a "sale"/"gross receipt" for purposes of the sales factor/gross-receipts factor of the standard apportionment formula, then it must be included in the taxpayer's apportionment formula. If such an inclusion is found to distort the revenue generating activities of the taxpayer, then part two of the analysis - the alternative apportionment statute - provides a specific mechanism for parties to deviate from the standard apportionment provision. *See CarMax Auto Superstores West Coast, Inc. v. South Carolina Dep't of Revenue*, 397 S.C. 604, 611, 725 S.E.2d 711, 714 (S.C. Ct. App. 2012).

Notably, the Court itself recognized this two-part analysis during the summary judgment hearing:

The Court: Well, when you say it does not provide a reasonable basis, is that analysis more one that should be made in the **second stage** of - by this case or is that one that is more - I know you're going to say "yes," so it's more proper in determining what the statute says.

...

The Court: Because if it does result in something that's absurd, then you would find that the apportionment - the standard apportionment formula is one that should not be used and it would invoke the statute to allow you to use the more appropriate formula, is that not ...

...

Mr. Greene: If - yeah. If you - for instance, if you reach that conclusion, that gross receipts covers these types of transaction, the return of somebody's principal within 30 days is a gross receipt, it has to be added to the apportionment basis, then yes, we would go to the **next step**.

(Testimony Trans. 141:17-:23; 143:15-:18; 143:23-144:4; 144:5-:11, Exhibit A (emphasis added).)

In its Order, however, the Court subsumed distortion arguments (part two of the inquiry) into its analysis of the standard apportionment formula (part one of the inquiry) and held that “distortion [would] inevitably result[] from the inclusion of principal in the standard apportionment formula.” ALC Order at 29.

Not only is the Court’s analysis in direct conflict with South Carolina law, but it also renders South Carolina’s alternative apportionment statute set forth in S.C. Code Ann. section 12-6-2230 meaningless. The alternative apportionment statute is a “relief mechanism,” which authorizes a party to apply an alternative method to “effectuate an equitable apportionment of the taxpayer’s income” when the standard apportionment formula does not fairly represent the taxpayer’s business activities in the State. *Media Gen. Commc’ns*, 388 S.C. at 151, at 531. The Court’s reasoning presumes that the inclusion of principal is inherently distortive and the Court’s remedy of that distortion was its limited construction of the standard apportionment formula. The Court, thus, imputed an alternative apportionment mechanism into the standard apportionment provision. That was not, and could not have been, the intent of the Legislature in enacting both statutes.

South Carolina canons of statutory construction mandate that a statute must be construed in a manner that “no word, clause, sentence, provision or part shall be rendered surplusage, or superfluous, for the General Assembly obviously intended the statute to have some efficacy, or the Legislature would not have enacted it into law.” *CFRE, LLC v. Greenville County Assessor*, 395 S.C. 67, 74, 716 S.E.2d 877, 881 (2011) (internal

quotations omitted). The standard apportionment formula statutes are intended to provide a reasonable representation of taxpayers' business activities in South Carolina. S.C. Code Ann. § 12-6-2210. The alternative apportionment statute is intended to provide a remedy for any inequities that may result from the application of the standard apportionment statute. Contrary to the Court's suggestion, the application of alternative apportionment cannot be said to constitute mere "futility of going through this extra-step process needlessly." ALC Order at 29. The Court is required by South Carolina law to apply the standard apportionment statute in a manner that gives full effect to the legislative intent of enacting the alternative apportionment statute and does not render it meaningless. *CFRE*, 395 S.C. 67, 716 S.E.2d 877. Therefore, the Court should reconsider and amend its holding.

2. The Court Erred in Holding that the Inclusion of the Principal from Sales of Securities in the Standard Apportionment Formula Would Produce an Absurd Result.

- i. The Order erroneously determined that the inclusion of the principal in the standard apportionment formula produces an absurd result because it is inherently distortive.**

The Court's Order determined that the inclusion of the principal from sales of securities in sales factor or gross-receipts factor denominator would produce an absurd application of the standard apportionment formula because it would lead to inevitable distortion of business activity representation. ALC Order at 28. The Order appears to conflate the "absurd result" analysis under the standard apportionment method and the distortion analysis under the alternative apportionment method.

As discussed above, a determination of distortion is inherently a factual issue to be addressed only *after* the standard apportionment formula results are determined. *Media*

Gen. Commc'ns., 388 S.C. 138, 694 S.E.2d 525; *CarMax Auto Superstores*, 397 S.C. at 611, 725 S.E.2d at 714. The Court must first apply South Carolina's apportionment provisions – including a calculation of the sales factor. Distortion is determined only after the apportionment results are calculated. See *CarMax Auto Superstores*, 397 S.C. at 611, 725 S.E.2d at 714.

This Court's application of its view of statutory construction – that a statute should not be interpreted to produce an "absurd result" – presupposes that the inclusion of the gross receipts in the apportionment factor is absurd. Concluding that inclusion of all of the receipts from the sales of securities produces an absurd result requires a factual inquiry of the nature of the taxpayer's activities in South Carolina, a comparison of that activity to the apportionment results (with and without gross receipts), and a factual finding that such a comparison produces an absurd result in most if not all cases. None of these steps were followed by this Court.

Duke Energy's inclusion of all of its gross receipts does not produce an absurd result or otherwise contradict the purpose of the standard apportionment statute. And certainly there is no evidence that including all of the receipts from sales of securities in the sales factor or gross-receipts factor denominator produces an absurd result in most, if not all, cases. The purpose of the standard apportionment formula is to reasonably represent the proportion of taxpayers' business carried on within South Carolina. S.C. Code Ann. § 12-6-2210; *Eastman Kodak Co. v. South Carolina Tax Comm'n*, 308 S.C. 415, 419, 418 S.E.2d 542, 544 (1992). In fact, the standard apportionment formula is intended to only provide a "rough approximation" of the income attributable to business activity in each state. *Covington Fabrics Corp. v. South Carolina Tax Comm'n*, 264 S.C.

59, 66-67, 212 S.E.2d 574, 577-78 (1975). This Order contains no analysis regarding why including all receipts from sales of securities in the gross-receipts/sales factor denominator is distortive or at a minimum does not (or could not) roughly approximate a taxpayers' business activity in South Carolina.

Duke Energy's sales of securities were conducted as part of its ordinary business operations. And as Duke Energy can prove at trial, and its experts have testified during depositions, including all of its receipts in its sales factor denominator using the standard apportionment formula reasonably represents the proportion of its business carried on in South Carolina. Thus far, there has been no evidence whatsoever to show that including all of the receipts from sales of securities in the sales factor denominator produces an absurd result for Duke Energy or any other taxpayer.

A court is permitted to deviate from a statute's plain language only when "the result would be so patently absurd that it is clear that the Legislature could not have intended such a result." *Harris v. Anderson County Sheriff's Office*, 381 S.C. 357, 363, 673 S.E.2d 423, 426 (2009) (internal citations and quotations omitted). The South Carolina Supreme Court has cautioned that "[a] merely conjectural absurdity is not enough; the result must be so patently absurd that it is clear that the General Assembly could not have intended such a result." *South Carolina Dep't of Revenue v. Blue Moon of Newberry*, 397 S.C. 256, 261, 725 S.E.2d 480, 484 (2012); *see also South Carolina Coastal Conservation League v. South Carolina Dep't of health & Envrtl. Control*, 2003 SC ENV LEXIS 12 (S.C. Admin. L. Ct. 2003) ("To justify a departure from the letter of the law ... the absurdity must be so gross as to shock the general moral or common sense. And there must be something to make plain the intent ... that the letter of the statute is

not to prevail.' Indeed, an adjudicating body should be less than quick to depart from the meaning of literal language when the controversy between the parties arises from differing views on policy. A provision 'is not absurd merely because it does not comport with one's notion of what constitutes good policy.'" (citing *Crooks v. Harrelson*, 282 U.S. 55, 59-60 (1930), and *Chapman v. Higbee Co.*, 319 F.3d 825 (6th Cir. 2003)).

In *Blue Moon of Newberry*, the South Carolina Supreme Court refused to adopt the Department's restricted interpretation of the plain language of a regulation promulgated by the Department, which permitted the sale of alcoholic beverages by nonprofit organizations only to "bona fide guests of members of such organizations." 397 S.C. at 258, 725 S.E.2d at 482. The regulation provided that "bona fide guests" are those "who accompany a member onto the premises or for whom the member has made prior arrangements with the management of the organization." *Id.* The Department took the position that the term "bona fide implies that the guest have some degree of familiarity or camaraderie with the member." *Id.* at 263, 484. The court rejected the Department's view on the grounds that "the plain language of the regulation contains no support of this, and the ordinary definition of bona fide does not require it." *Id.* at 264, 485. The court opined that to adopt the Department's position would constitute an "improper narrowing of the regulatory definition based on some notion of what a bona fide guest *should* be, not what the regulation actually provides. For us to do so therefore would require the abdication of our role as the interpreter of a regulation and the assumption of the position of a drafter." *Blue Moon of Newberry*, 397 S.C. at 264, 725 N.E.2d at 485 (emphasis original; internal citations omitted). Similarly in the instant

case, the Court should not restrict the meaning of "gross receipts" and "total sales" when the language of the statute does not contain or require any limitations.

The Department further argued that a broad interpretation of the term "bona fide guest" would "'eviscerate' the purpose of the regulation, which is to limit those who may consume alcohol on the premises of private clubs," and produce "an absurd result as it [will] effectively allow[] a private club to be open to the public." *Id.* at 265, 485. The court acknowledged that the plain language of the regulation "may permit some organizations to push the envelope on what it means to be 'private,'" but it nevertheless concluded that "we are not convinced the result is so absurd that we can ignore the regulation's plain language." *Id.* The court agreed with the lower court's dissent:

If the Department of Revenue has an issue with how the regulation itself defined "bona fide guest," then it may promulgate a new regulation as appropriate upon proper notice to the public. Until then, other businesses which follow the unambiguous language of the regulation should not be punished as a result.

Id. at 265, at 485.

Corporate treasury departments that sell securities on a regular basis are not a new phenomenon. And the Department has not argued that Duke Energy's sales of securities are in any way special or unique. Instead, the Department (and this Court) takes issue with the fact that the inclusion of principal from Duke Energy's sales of securities in its apportionment formula "does nothing more than artificially inflate the denominator of either the sales factor or gross receipt factor and thereby decrease the amount of income subject to tax in South Carolina." Resp. Mem. In Supp. of Motion for Sum. Judg. At 34; ALC Order at 28. Not only is there no requirement that taxpayers pay the *most* taxes as discussed in section 2.iii below, but the South Carolina's highest court has rejected this

reasoning. In *Eastman Kodak Co. v. S.C. Tax Comm'n*, 308 S.C. 415, 420 (1992), the South Carolina held that in apportioning its general business income from photography equipment and film processing to South Carolina, Kodak properly included receipts from safe harbor leasing transactions¹ in the denominator of its apportionment formula. Similar to Duke Energy's treasury function transactions, the safe harbor leasing "was a means of gaining working capital and increasing cash flow for all of plaintiff's business operations." *Id.* at 418-9 (quoting *National Service Industries v. Powers*, 98 N.C.App. 504, 391 S.E.2d 509 (N.C. App. 1990)). The South Carolina Tax Commission (now the Department) pointed out that "[t]he result is that Kodak, despite having virtually no safe harbor presence in South Carolina seeks to reduce its South Carolina taxable income by over 33% in 1984 and by over 90% in 1985." Tax Comm'n Brief. at 21 (Exhibit B); see also Richland County Ct. of Common Pleas at 25 (Exhibit C). The South Carolina Supreme Court disagreed with the Tax Commission (and the lower court) and held that:

This Court has held that the apportionment formula is a reasonable basis for establishing the income tax of corporations which, like Kodak, do business on a multistate level. *Covington Fabrics v. S. C. Tax Comm'n*, 264 S.C. 59, 212 S.E.2d 574 (1975). Since the safe harbor lease transactions were a part of Kodak's general business, they were properly included in the denominator of the apportionment formula in computing Kodak's national net income from payroll, property, and sales. The fact that a very small percentage of the leased assets are located in South Carolina is accounted for in the numerator of the apportionment formula in which Kodak's payroll, property,

¹ "These transactions ... allowed one corporation to transfer tax benefits to another corporation in the following scenario: One corporation (the lessee) needs special assets, generally equipment, but cannot utilize the related investment tax credits and depreciation deductions. The lessee corporation seeks a relationship with another corporation (the lessor, here Kodak), who makes an initial payment on the asset, then leases it back to the lessee. The lessee makes all other payments on the asset and retains legal title; however, the lessor utilizes the tax benefits associated with the asset." *Eastman Kodak*, 308 S.C. at 417.

and sales in this state are computed. Therefore, the apportionment formula reflects a "reasonable representation" of Kodak's business in this state.

Id. at 419.

Similarly, Duke Energy's sales of securities are connected with its trade or business and the Department has not argued otherwise. Thus, the inclusion of the principal from sales of securities in Duke Energy's apportionment formula does not produce a result that is so absurd to require the Court to ignore the plain meaning of the apportionment statutes. *See Capco of Summerville, Inc. v. J.H. Gayle Constr. Co.*, 368 S.C. 137, 144, 628 S.E.2d 38, 42 (2006) ("However, although we are troubled by this result, we are not at liberty to rewrite the statutes, and any amendment must come from the Legislature.")

Presumably, the South Carolina Legislature was troubled by the inclusion of the principal in the sales factor, which led to its changing the statute to exclude receipts. In 2007, the South Carolina Legislature substantially changed the apportionment formula by defining, for the first time, the terms "gross receipts" and "sales" and statutorily providing a list of transactions that are included in the gross-receipts/sales factor at gross, at net, or not at all. S.C. Code Ann. § 12-6-2295. This legislative change made clear that the sales of securities are excluded from the factor entirely. This Court's conclusion that "it is evident that the Legislature intended Section 12-6-2295 to clarify the existing law" cannot withstand a challenge as the Department (and this Court) allowed the sales of Duke Energy securities to be included at net – not excluded all together as the statutory regime now requires.

- ii. **The Order erroneously determined that the inclusion of the principal in the standard apportionment formula would lead to an increased**

application of the alternative apportionment formula and thus an absurdity.

The Order reasoned that the inclusion of the principal from sales of securities in the standard apportionment formula would produce an absurd result because the alternative apportionment statute would “become a standard follow-up to the application of the standard apportionment statute.” ALC Order at 28. The Order’s reasoning is misapplied. Whether the inclusion of the principal in the **standard apportionment formula** produces an absurd result does not require evaluation of the **alternative apportionment statute**.

The Order’s reasoning was also based on the mistaken presumption that the inclusion of the principal in the apportionment formula would always result in distortion. As discussed above, the determination of distortion is a factual inquiry which cannot be presumed to exist as a matter of law. Thus, the alternative apportionment provision would come into play only in unusual circumstances when, after conducting a factual analysis, the inclusion of the principal in the standard apportionment formula does not fairly represent (or is not a rough approximation of) the in-state business activities of a specific taxpayer, for a specific period.

Not only is the Order’s analysis misapplied, but it is impermissibly based on grounds not raised by the parties. The South Carolina Supreme Court has held that a trial court lacks authority to grant relief *sua sponte* on a ground not raised by a party. *See, e.g., State v. Dicapua*, 383 S.C. 394 (2009); *Southern Ry. Co. v. Coltex, Inc.*, 285 S.C. 213 (1985). The South Carolina Supreme Court allows courts to act *sua sponte* in very limited circumstances, typically involving the propriety of a court’s subject matter jurisdiction: “It is well settled that, but for a very few exceptional situations not present

here, an appellate court cannot address an issue unless it was raised to, and ruled upon by, the trial court." *Smith v. Phillips*, 318 S.C. 453, 455 (1995); *Lewis v. Local 382, IBEW*, 335 S.C. 562 (1999); *see also Lake v. Reeder Constr. Co.*, 330 S.C. 242, 248 (Ct. App. 1998) ("[L]ack of subject matter jurisdiction can be raised at any time, can be raised for the first time on appeal, and can be raised *sua sponte* by the court.").

The alternative apportionment argument contained in the Order (i.e., the function of the alternative apportionment provision and the effect of the inclusion of the principal in the standard apportionment formula on the alternative apportionment provision), a factual inquiry, was not raised by either party during the extensive briefing or at the summary judgment hearing. ALC Order at 26-30. In its Order, the Court devoted more than three pages to a discussion focusing on the notion that including the principal from sales of securities in Duke Energy's standard apportionment formula would lead to an increased application of the alternative apportionment statute and thus result in an absurdity. ALC Order at 28. This Court's line of reasoning is *sua sponte* decision-making and thus, Duke Energy respectfully asks the Court to vacate this portion of the Order.

- iii. **The Order erroneously determined that the inclusion of the principal in the standard apportionment formula would produce an absurd result because it would have negative impact the State's revenue collection and threaten administrative convenience.**

In reaching its decision that including all receipts in the standard apportionment formula leads to an "absurd result," the Court stated that a holding to the contrary would produce "continuous underestimation of taxes" and "equate to a rather sizeable sum lost to the State." ALC Order at 29-30. The Court also stated that the Department might not be able to detect [lost revenue] due to its "limited resources." *Id.* The Court further

engaged in a cost benefit analysis and held that “any benefits from this principal-inclusion method seem to be vastly outweighed by the great cost of revenue that this State would face through continuous underestimation of taxes due to distortions.” ALC order at 30. Each of these bases by the court are inappropriate and irrelevant in determining the meaning of the statute.

First, the Department has not submitted any evidence to this court that including the gross receipts from the sales of securities in the sales factor denominator would produce a continuous underestimation of taxes. Indeed, in many cases, depending on the size of the taxpayer, the location of its business operations, the type of industry it is in, and a variety of other factors, including all of the taxpayer’s gross receipts will fairly reflect its business activities. The plain meaning of a statute is not absurd simply because it results in less tax being paid. There is simply no rule of statutory construction that requires that taxpayers pay the *most* taxes. In fact, the Fourth Circuit has cautioned that:

“It cannot be said that giving effect to the plain meaning of the language would bring a result that is irrational or absurd, however much we may disagree with its necessity or wisdom. We have no right to fetter a broad provision with conditions not expressed and not essential to the execution of the law, for courts are not free to rewrite legislative enactments to give effect to the judges’ ideas of policy and fitness or the desirability of symmetry in statutes.”

United States v. Shirah, 253 F.2d 798, 800 (4th Cir. 1958).

With regard to the Department’s “limited resources”, it is unclear why the Department’s resources to test for distortion as part of its standard audit processes should be relevant when interpreting a statute. This is especially true in cases where there has been no showing that simply applying the standard apportionment formula and including

a taxpayers gross receipts produces anything but a fair reflection of most taxpayers' business activities in the State.

Furthermore, none of the above arguments were raised by the parties in their briefs or at the hearing and thus, it was improper for the Court to consider the administrative convenience and revenue implications to the State *sua sponte*.

3. The Court Erred in Interpreting the Meaning of "Gross Receipts" Based on the Definition of "Gross Income."

The Court erroneously determined that "gross receipts" excluded the principal from sales of securities because "gross income, and thus taxable income, necessarily exclude principal." ALC Order at 32. "Gross receipts" as used in the apportionment statutes and gross income/taxable income discussed by the Court relate to two entirely different tax concepts. A taxpayer's "gross income"/"taxable income" determines the total amount of money that can be subject to tax. *Media Gen. Commc'ns*, 388 S.C. at 145, 694 S.E.2d at 528. In contrast, "gross receipts" as used in the South Carolina income apportionment provisions determines the portion of that "gross income"/"taxable income" upon which the taxpayer would be subject to tax in South Carolina where business income is generated. *Id.* To describe the concepts colloquially, if gross income/taxable income is a cake, the gross-receipts apportionment provision would determine how many slices of the cake South Carolina is entitled to.

The South Carolina apportionment formula is designed to represent the extent of Duke Energy's business activities in South Carolina. The Court's reliance on the definition of "gross income"/"taxable income" in construing "gross receipts" results in a construction not intended by the Legislature.

As the Court correctly notes, "gross income" equals gross receipts expenses and other deductions, and "taxable income" equals gross income less any deductions allowed by state law. If "gross receipts" for purposes of the apportionment statute were interpreted to exclude expenses and all deductions granted by the State, then the apportionment formula would not be a reasonable representation of a taxpayer's business activities in the State as two identical businesses may be entitled to different deductions (e.g., economic development deduction). Accordingly, the Court's reliance on "gross income"/"taxable income" to limit the definition of "gross receipts" as used in the apportionment statute was an error.

Additionally, this chain of reasoning was not advanced by the parties in their briefs or during the summary judgment hearing and thus, it was improper for the Court to raise this issue *sua sponte*.

4. The Court Erred in Interpreting the Meaning of "Sales" Based on the Principle of "Income-Producing Activity."

The Court concluded that the principal from sales of securities was excluded from the term "sales" because the definition of the term contained the following language: "[i]f 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." ALC Order at 33. The Court focused on the term "income" from the phrase "income-producing activity" and held that because income means "an actual gain or actual increase of wealth," then sales must mean "net" sales. ALC Order at 33.

At the outset, "income-producing," as used in the sales factor statute, is a cost-based sourcing principle applied in sourcing receipts to South Carolina for purposes of determining the numerator of the apportionment factor. The concept of income-producing activity has no bearing on the definition of "total sales" and whether the principal from sales of securities should be included in the sales factor denominator.

The Court cited to *Texaco* in support of its holding. Once again, however, the Court appears to conflate the concept of taxable income with the concept of apportioning income. The *Texaco* court was clear that "a corporation's entire net income is apportioned to this state by applying to that entire net income a percentage based on the 'three-factor formula' of property, payroll, and sales in this state to the corporation's total property, payroll, and sales." *Texaco, Inc. v. Wasson*, 269 S.C. 255, 259, 237 S.E.2d 75, 76 (1977). The *Texaco* court's reference to "net income" is a reference to the cake, and not how much of the cake South Carolina is entitled to. It is the "percentage" the court referenced that would actually determine how much of the cake would be attributed to South Carolina. The definition of "sales" in the instant case is only relevant for purposes of determining the apportionment "percentage," and not the taxable "net income." In other words, net income is the base to which the apportionment formula is applied to, to determine the portion of the base South Carolina is entitled to tax. Therefore, the concept of "net income" has no relevance to the issue before the Court here, i.e., the definition of "sales" for purposes of the apportionment statute.

The Court also relies on *Eastman Kodak Co. v. S.C. Tax Comm'n*, 308 S.C. 415, 418 S.E.2d 542 (1992). However, this case is simply irrelevant. The issue before the *Eastman Kodak* court was whether receipts from certain transactions were business

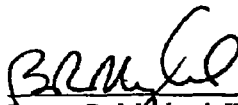
income and thus includable in the apportionment formula denominator, or non-business income and thus allocable. The court held that the receipts at issue constituted business income and were properly includable in the apportionment formula. The Court correctly noted the use of the phrase "net sales, payroll, and property" by the *Eastman Kodak* court. However, the court used the same phrase two additional times without the term "net." *Id.* at 419. Moreover, the issue of whether the receipts from the transactions were included at "gross" or "net" was not before the Court.

Further, this argument was not raised in the briefs of either party or during the hearing and therefore, it was improper for the Court to raise this issue *sua sponte* and rely on it in making its decision.

CONCLUSION

For all of the above reasons, the Court should grant Duke Energy's Motion for Reconsideration and vacate its prior opinion as reflected in its Order with respect to the Waiver and Gross Receipts Issues.

Respectfully submitted this 20 day of August 2012.



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STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

DUKE ENERGY CORPORATION,

Petitioner,

vs.

SOUTH CAROLINA DEPARTMENT OF
REVENUE,

Respondent.

Docket No.: 10-ALJ-17-0270-CC

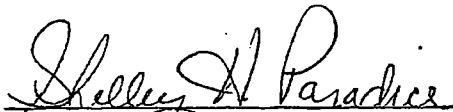
CERTIFICATE OF SERVICE

The undersigned, being an employee of Nexsen Pruet, LLC, hereby certify that on the 20th day of August, 2012 the following document were served upon the following by hand delivery:

1. Duke Energy's Motion for Reconsideration of the Court's Order Granting the South Carolina Department of Revenue's Motion for Summary Judgment as to the Waiver and Gross Receipts Issues; and
2. Duke Energy's Memorandum of Authorities in Support of Motion for Reconsideration of the Court's Order Granting the South Carolina Department of Revenue's Motion for Summary Judgment as to the Waiver and Gross Receipts Issues.

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FILED

AUG 20 2012

SC ADMIN. LAW COURT



Exhibit A

STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT DIVISION
Docket No. 10-ALJ-17-0270-CC

Duke Energy Corporation,)

Petitioner,)

v.)

South Carolina Department of)
Revenue,)

Respondent.)
-----)

(C O Y)

MOTIONS HEARING

Tuesday, June 26, 2012
9:56 a.m. - 2:22 p.m.

The hearing before the Honorable Ralph King Anderson, III, was taken at the Edgar A. Brown Building, 1205 Pendleton Street, Suite 224, Columbia, South Carolina, on the 26th day of June, 2012 before Cassandra E. Vance, Court Reporter and Notary Public in and for the State of South Carolina.

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1 MR. GREEN: Thank you, Your Honor.

2 THE COURT: All right.

3 REPLY ARGUMENT BY MR. GREEN:

4 MR. GREEN: Thank you, Your Honor. I just have a
5 few points.

6 You've obviously heard and read a lot for this,
7 so I will not going into great detail on the
8 issues. I'll just try to respond to a few
9 things that I noted. I think I'll go in
10 reverse order.

11 There's been some discussion about the nature
12 of the agency precedent here. It didn't deal
13 with this precise issue. I mean, that's
14 readily apparent. It did, however, deal with
15 intangibles. We're dealing with intangible
16 transactions here and, more particularly, we're
17 dealing with products that are essentially
18 loans, they're repos, or loan in exchange
19 for -- secured by a security.

20 As found by the *General Motors* case, commercial
21 paper really is a short-term loan. A municipal
22 bond is a loan. It is a loan and it is an
23 agreement to pay money in the future. They may
24 have a security nature, but it is a loan to pay
25 an amount and those are the type of

1 transactions that we're dealing with here.
2 The taxpayer's argument is to include the
3 principal from the return of that loan here,
4 which is the same as the type of transaction
5 the intangibles address in the prior agency
6 rulings.
7 So we'd submit, Your Honor -- and we'd submit
8 that even aside from the agency precedent,
9 frankly, by applying the material -- or the
10 authorities and sources we've referenced in our
11 brief, it would lead you to the same
12 conclusion, which is that including principal
13 in transactions such as these is inappropriate
14 and does not provide a reasonable basis on
15 which to determine income properly reported in
16 South Carolina.
17 THE COURT: Well, when you say it doesn't provide a
18 reasonable basis, is that analysis more one
19 that should be made in the second stage of --
20 by this case or is that one that is one that is
21 more -- I know you're going to say "yes," so
22 it's more proper in determining what the
23 statute says.
24 MR. GREEN: Admittedly, Your Honor, they're probably
25 a pretty similar analyses, frankly. I think

1 the reason that you can consider it here partly
2 is the agency precedent. Partly is -- and, in
3 fact, I think we cited -- I'm sorry, Your
4 Honor?

5 THE COURT: If I find agency precedent, I have to
6 find compelling reasons to go otherwise.

7 MR. GREEN: Yes, sir.

8 THE COURT: But if the statute is clear on its face,
9 then that would be compelling reasons.

10 MR. GREEN: If you --

11 THE COURT: If it's plain, plainly says "gross" ...

12 MR. GREEN: Gross receipts.

13 THE COURT: Receipts, yeah.

14 MR. GREEN: Yes, Your Honor. Yes, if you found the
15 statute plain on its face, that is true. I
16 would submit, however, that your interpretation
17 is not to take the gross receipts in isolation
18 from that statute, but interpret along that
19 statutory framework, which is determining a
20 factor, a factor to determine the amount of
21 income to be reported to South Carolina that
22 under 2210 provides a reasonable basis. I
23 forget exactly the language. We've obviously
24 quoted it ad nauseum in our brief.

25 THE COURT: Yeah.

1 MR. GREEN: That provides a reasonable -- I think
2 the cases that we've cited that I mentioned in
3 my earlier presentation is that you interpret
4 it in light of the framework and not just take
5 that term out in isolation. And I think you're
6 also not supposed to do interpretations that
7 lead to absurd results.

8 THE COURT: Okay.

9 MR. GREEN: We submit that it would be an absurd
10 result that making short-term securities
11 transactions, which it's undisputed there's
12 never been a loss, and then getting that money
13 back and that goes in the denominator, that is
14 an absurd result.

15 THE COURT: It is a result, though, for which the
16 existing statutory framework provides a remedy
17 for if it would be an absurd result. Is it
18 not, though?

19 MR. GREEN: There --

20 THE COURT: Are you following what I'm getting at?

21 MR. GREEN: I am following, yes, sir. I think I am,
22 Your Honor.

23 THE COURT: Because if it does result in something
24 that's absurd, then you would find that the
25 apportionment -- the standard apportionment

1 formula is one that should not be used and it
2 would invoke the statute to allow you to use
3 the more appropriate apportioning formula, is
4 that not ...

5 MR. GREEN: If -- yeah. If you -- for instance, if
6 you reach that conclusion, that gross receipts
7 covers these types of transactions, the return
8 of somebody's principal within 30 days is a
9 gross receipt, it has to be added to the
10 apportionment basis, then yes, we would go to
11 the next step.

12 THE COURT: Well, what I'm getting at is, you're
13 asking me to look at the statute as a whole.
14 They could equally be asking me to look at the
15 statute as a whole to accomplish their result,
16 too. So that's what I'm trying to figure: Who
17 gets the whole?

18 MR. GREEN: Understood, Your Honor. And we
19 obviously think we're entitled to the whole --

20 THE COURT: And who falls in it?

21 MR. GREEN: We obviously think we're entitled to
22 that.

23 THE COURT: I guess one side gets W-H-O-L-E and the
24 other falls into H-O-L-E.

25 MR. GREEN: Yes, Your Honor. Yes, Your Honor.

1 But determining -- we would submit that
2 determining the definition of that term in the
3 first place, because you're doing it in the
4 context of a factor. The alternative
5 apportionment deals with what happens if that
6 factor's applied. So we submit that you're
7 interpreting in the context of the factor in
8 light of 2210.

9 THE COURT: And not?

10 MR. GREEN: And then based on agency precedent,
11 obviously.

12 THE COURT: And why would 22...

13 MR. GREEN: I think 10, which provides a reasonable
14 basis for determining income in this state.
15 Isn't it 2210?

16 THE COURT: Well, make sure you got the right one,
17 so I can go back and look at all this.

18 MR. GREEN: Yes, 12-6-2210: If a taxpayer's
19 transacting or conducting business within or
20 without the State, income tax is imposed upon
21 a base which reasonably represents the
22 proportion of the trade or business carried on
23 within this state.

24 And I submit to Your Honor, you know, it's more
25 than just me saying, "Oh, that's a great

Exhibit B

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of Brief
Can't even
read it on
microfilm

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STATEMENT OF ISSUES ON APPEAL¹

I.

Did the Trial Court correctly conclude that Kodak's inclusion in its apportionable income of the losses from safe harbor leasing activities was improper when the Court found such losses are allocated by S.C. Code Ann. § 12-7-1120(3) (Supp. 1990) to the states in which the property is located since the losses resulted from rental property not connected with Kodak's business?

¹ Not all issues addressed by the Trial Court are on appeal. Three have been abandoned. The Trial Court found (Tr., pp. 18-20) a portion of the 1984 refund claim was untimely and thus improper. Kodak's Brief (ftn. 2, pp. 6-7) states its 1984 claim is abandoned for the additional loss of \$230 million. Additionally, the Trial Court ruled (Tr., pp. 36-40) that its holdings did not violate Interstate Commerce, Equal Protection or Due Process. Kodak, in its Statement of Issues on Appeal, does not identify any of these issues as being appealed. Rule 207(b)(1)(B), SCACR, states no point will be considered on appeal which is not set forth in the statement of issues on appeal. Likewise, no argument on such issues is made in the Brief. Matters which are neither identified as an issue nor argued in the brief are deemed abandoned and are not before this Court. Gold Kist, Inc. v. Citizens & Southern National Bank of S. C., 286 S.C. 272, 333 S.E.2d 67, 70 (App. 1985). Finally, the Trial Court (Tr., pp. 16-18) held subject matter jurisdiction was present since the matter was a payment under protest suit under § 12-47-220 rather than a claim for refund under § 12-47-440. The Tax Commission does not challenge this determination and makes no argument on this ruling.

II.

Did the Trial Court correctly conclude that Kodak's application of the apportionment method is improper where it leads to a result that is contrary to the legislative intent established by the reasonableness test of S.C. Code Ann. § 12-7-250 (1976) and where such method improperly joins the non-unitary safe harbor leasing activities with other unitary activities of Kodak?

III.

Did the Trial Court correctly conclude that Kodak's alternative view that it is allowed to claim the depreciation resulting from the safe harbor rental property is incorrect where the depreciation deduction is a related expense to the rental losses and must be treated in the same manner as all other related income and expenses?

STATEMENT OF THE CASE.

In this action, commenced on July 6, 1989, Eastmar Kodak Company (Kodak or taxpayer) seeks a refund under South Carolina Code Ann. § 12-47-440 (1976) of income tax in the amount of \$1,202,639 under one theory of the case and \$1,090,624 under an alternative theory. The taxes in dispute result from an audit of and subsequent claims for refund on the 1984 and 1985 tax years of Kodak. The taxpayer claimed losses from rental activity resulting from what are commonly called "safe harbor leases." The Tax Commission found that the losses could not be used as a part of Kodak's apportionable income, but rather, that such losses were allocated to the states where the rental properties were located. Additionally, the Tax Commission found that even if the losses were apportionable, only an inconsequential portion of the loss was attributable to South Carolina so that the refund sought must be denied.

The matter was heard by Judge Lockemy in a non-jury trial in Richland County on June 6, 1990, with additional arguments heard on October 17, 1990. In the Trial Court, the taxpayer advanced its view that the losses were part of Kodak's apportionable income and in the alternative that it should be allowed to deduct the depreciation associated with the leases. The Tax Commission asserted the rental losses were not apportionable, but rather, should be allocated to

the states where the property was located. Further, the Tax Commission asserted that even if apportionment of the rental losses were proper, the rental activity was not part of Kodak's unitary business and thus such losses were not apportioned to South Carolina. Finally, as to Kodak's alternative argument, the Tax Commission asserted the depreciation deductions were not allowable in South Carolina since they were required to be allocated or apportioned in the same manner as the rental losses.

Judge Lockemy's Order, issued and filed on December 12, 1990, denied the taxpayer's refund request. The Court held the rental losses were allocated to the place where the rental property was located, the depreciation was treated in the same manner, and even if apportionment were proper for the rental losses such did not result in a refund to the taxpayer since the safe harbor rental activity was not unitary with Kodak's other activities.

On January 9, 1991, the taxpayer appealed the Order of Judge Lockemy. On that same date, the taxpayer served its Notice of Appeal on the Tax Commission.

ARGUMENT I

KODAK'S INCLUSION OF THE LOSSES FROM ITS SAFE HARBOR LEASING ACTIVITIES IN ITS APPORTIONABLE INCOME IS IMPROPER SINCE SUCH LOSSES ARE ALLOCATED BY S.C. CODE ANN. § 12-7-1120(3) (SUPP. 1990) TO THE STATES IN WHICH THE PROPERTY IS LOCATED SINCE THE LOSSES RESULT FROM RENTAL PROPERTY NOT CONNECTED WITH KODAK'S BUSINESS.

South Carolina does not tax all of the income of a taxpayer. Rather, after determining that a taxpayer is subject to South Carolina's taxing statutes, the concern becomes one of deciding how much of the taxpayer's income is taxable in South Carolina. For a taxpayer like Kodak, the first applicable statute in addressing this problem is § 12-7-1120. That section and its subsections identify designated classes of income less related expenses which are assigned or allocated to locations specified in the statute. In the instant case, the parties have disagreed on the application of one of the subsections, § 12-7-1120(3).

The following items of income shall be specifically and directly allocated in accordance with the following provisions before apportionment of the remaining net income and such items shall not be included in any factor of the apportionment formula:

(3) Rents received from the lease or rental of real estate or tangible personal property, royalties received from tangible property, where the property leased or rented was not used in or was not connected with the trade or business of the taxpayer during the income year, less all related expenses, shall be allocated to the state in which the property was located at the time the income was derived.

That provision allocates rental income less related expenses to the "state in which the property was located" as long as the rental property is "not used in . . . or connected with the business." The Trial Court correctly found the elements of this statute are satisfied and that allocation of the safe harbor rental losses is proper.

A. The Losses In Dispute Are Due to Rental Income From Property Located Outside of South Carolina.

Subsection (3) of the statute is applicable if rental income is in issue. The Trial Court found that both the 1984 and 1985 tax returns show rental income and related expenses resulting in a rental net loss from the safe harbor activities. (Tr., p. 26) Additionally, Kodak, at page 2, Statement of the Case, Initial Brief of the Appellant, states that:

[d]uring the years in question, expenses associated with the leases exceeded the rental income thereby producing a loss from these transactions.

Thus Kodak agrees that the first element of the statute is satisfied in that it states that the income is rental income and expense, and further, it makes no argument that the income here in dispute is anything other than rental income and related rental expenses yielding a rental loss.

Additionally, the Trial Court factually held that both the rental property and the rental income were located outside the state except for a minute amount having no real impact on the refund sought by Kodak. The cost of the property used to generate the safe harbor rental income for the 1984 and 1985 tax years was over \$2 billion with all property located outside the state except for only \$32,000 having a physical location in South Carolina. (Tr., pp. 14, 24) In the same vein, the rental income from the safe harbor leasing was over \$200 million, all of which, was outside the state except for approximately \$10,000 in South Carolina. (Tr., pp. 14, 24)

Finally, the Trial Court in an effort to clearly establish this point asked counsel for Kodak the following:

In other words, we're dealing with lease income received by Eastman Kodak from property located outside of the State?

The response by counsel was: "That is correct." (Tr., p. 43)

B. The Rental Property Is Not Connected With The Business Of The Taxpayer.

Having determined the income is rental and is from property located outside the state, the statute requires that the rental property not be used in or connected with the business of the taxpayer. The Trial Court applied the proper legal standard and factually made a correct determination that the rental properties were not used in or connected with Kodak's business.

1. The Application of the Phrase "Not Connected With the Business" Is Based on a Common Sense Approach Applied To The Facts Of Each Case On A Case By Case Basis.

a. The Development Of The Legal Standard.

The legal standard for applying the phrase "not connected with the business" has been established in Texaco, Inc. v. Wasson, 269 S.C. 255, 266, 237 S.E.2d 75, 80 (1977), and reiterated in M. Lowenstein Corp. v. South Carolina Tax Commission, 298 S.C. 93, 378 S.E.2d 272, 275 (S.C. App. 1989).

Texaco, [supra] sets forth a common sense approach which, [is to be] applied to the facts of the instant case, . . .

This common-sense approach has been applied on a case by case basis, and thus far, two opinions of the appellate courts have addressed the issue. A third case, Dalton v. South Carolina Tax Commission, ___ S.C. ___, 367 S.E.2d 459, 464 (S.C. App. 1988), raises the issue, but there the court found:

. . . the taxpayers have asserted to this Court that none of the properties are in or connected with a business.

Accordingly, the Court was not required to examine the factual background, but rather, relied upon the taxpayers' admission in finding there was no connection of the assets with the business.

The common-sense approach as applied in Texaco, supra, found that royalties from salt and sulfur deposits were connected with Texaco's business, and thus such income was not allocated, but rather was apportioned. The facts demonstrated that the properties upon which the deposits were found were acquired for Texaco's exploration process. Rather than discovering oil and gas, Texaco discovered salt and sulfur. Since the properties were part of the exploration properties, i.e., a part of the exact business in which Texaco was engaged, the Court had no trouble finding the properties were connected with the business.

The application of the common-sense test was more involved in M. Lowenstein, supra, since the property that was tested for the "not connected with" phrase was an intangible. There the court had to establish what factors could "connect" the intangibles (the demand notes) to a business. The court first reviewed the facts concerning demand notes and found numerous instances where the business activities were coordinated to both create the notes and to utilize the note repayments and note income in the day-to-day business of the taxpayer. Under such circumstances, the Court was again correct in finding the common-sense approach required the income from the intangibles to be apportioned on the basis that the intangibles (the demand notes) were connected to the business. Thus

the common sense test is a factual one to be applied on a case by case basis.

b. The Adoption Of I.R.C. Section 168
Did Not Nullify The Common-Sense
Connection Standard Of § 12-7-1120(3).

Kodak argues in its Brief at pages 19-21 that the adoption of § 168(f)(8) of the Internal Revenue Code (I.R.C.) makes § 12-7-1120(3) inapplicable to rental income from safe harbor leasing. It first bases this view on asserting there is a conflict between S.C. Code Ann. § 12-7-700(8) (1976) and § 12-7-1120(3) (Kodak's Brief, pp. 19-20), and second, it argues § 12-7-1120(3) is inapplicable since as a matter of law the adoption of I.R.C. § 168(f)(8) makes the safe harbor assets connected with the business of Kodak. (Kodak's Brief pp. 20-21) Kodak is incorrect in both assertions.

It is settled that the deduction sections of S.C. Code Ann. § 12-7-700 are not in conflict with the provisions of § 12-7-1120(3). Dalton v. South Carolina Tax Commission, supra. There a taxpayer claimed a deduction for interest paid and ignored the allocation provisions of § 12-7-1120(3). The court held that the interest deduction claimed by the taxpayer was improper and that § 12-7-1120(3) allocated the interest deduction to the state where the rental property related to the interest expense was located. Thus the court clearly established that there was no con-

conflict between § 12-7-700 and § 12-7-1120(3), and if there were a conflict, it would be § 12-7-1120(3) that controlled over § 12-7-700.

The adoption by South Carolina of I.R.C. § 168(f)(8) did not make safe harbor assets "connected with the business." This position advanced by Kodak shows a fundamental misunderstanding of the apportionment and allocation system in South Carolina. Kodak believes that as a matter of law, the mere adoption of I.R.C. § 168 requires the apportionment of safe harbor income. It does not offer any legislative history to support this conclusion but instead relies upon the view that I.R.C. § 168 placed Kodak in the shoes of the lessee. Kodak reasons that since the federal tax attributes are attributed to Kodak, then it is proper to make "the assumption that the assets are used in Kodak's business." (Kodak's Brief, p. 21) The fallacy of this "assumption" is that the I.R.C. has no requirement that assets be used in the business for purposes of allocating income. Rather, there is no requirement that income be allocated or apportioned under the I.R.C. to decide in what state the taxpayer's income was earned. The I.R.C. has no concept relevant to whether assets are connected with a business or not for purposes of finding where the income is earned. Thus the mere adoption of a federal statute that is unconcerned with "connected" or "not connected" can be no ba-

sis for an "assumption" that the assets are used in a business. In fact, the better assumption is to recognize that the General Assembly knows quite well how the allocation and apportionment statutes operate. Had the Legislature wanted all safe harbor activities apportioned it could have easily stated its desire in the statute. The fact that there is no mention of a method is reason enough to believe the General Assembly intended to apply the normal rules of allocation and apportionment without establishing an assumption of apportionment.

2. The Factual Findings Of The Trial Court Are Decisive Of This Issue And Establish That The Rental Properties Are Not Connected With The Taxpayer's Business.

a. The Standard Of Review Is The "Any Evidence" Standard Used For Actions At Law.

Before reviewing the factual basis for the court's conclusion, it is significant to note the standard of review to be exercised by an appellate court. In actions at law, the appellate court may not find facts in accordance with its own view of the preponderance of the evidence, but rather, the Lower Court must be affirmed where there is "any evidence" to support its findings. Townes Associates, Ltd. v. City of Greenville, 266 S.C. 81, 221 S.E.2d 773 (1976). The current action seeks the recovery of taxes. In South Carolina an action to recover taxes is not in the same nature as a common law action, but rather:

[t]he right to recover taxes from the State was created by statute [with] the statutory recovery of taxes paid to the government [being] a unique proceeding.

C. W. Matthews Contracting v. South Carolina Tax Commission, 267 S.C. 548, 230 S.E.2d 223, 225 (1975).

The Trial Court held that the instant case was before the court as a payment under protest since the taxpayer was audited and its funds involuntarily withheld. These actions prompted Kodak to protest the retention and to bring this suit to recover the funds. Such actions for recovery of taxes paid under protest have been held to be actions at law and subject to the "any evidence" standard of review. Citadel Foundation v. South Carolina Tax Commission, 279 S.C. 443, 308 S.E.2d 797 (1983); and M. Lowenstein, supra, at fn. 1, p. 273.

- b. The Evidence Before The Court Was Sufficient To Conclude The Assets Were Not Connected With The Business.

When the Trial Court examined the evidence presented to it, it applied the common-sense approach of Texaco, supra, and found there was insufficient proof to show the safe harbor rental properties were connected to the business, and thus, found that allocation was the proper result. The Trial Judge found evidence of a lack of a connection in that when the annual reports described Kodak's business there was no mention of the safe harbor leases, not-

withstanding the fact that the safe harbor assets represented over 16% of Kodak's total assets. (Tr., p. 27) Surely such an activity of this magnitude would be described in the annual report as part of Kodak's business. Additionally, the Trial Judge found further lack of connections to the business in that the testimony and evidence established that Kodak had inconsequential management duties and that it had no maintenance duties over the rental properties. (Tr., p. 27) Significantly, the court found that Kodak did not even have legal title to the property and that the lessee could sell the property without permission from or notice to Kodak. (Tr., p. 27) Based on the totality of the evidence and testimony, the Trial Court correctly found the safe harbor rental property was not connected with the business of Kodak.

c. Kodak Incorrectly Asserts That As A Factual Matter The Safe Harbor Assets Are Connected With Kodak's Business.

Kodak argues in its Brief that the evidence before the court was sufficient to show the safe harbor assets here in dispute are connected to Kodak's business. (Kodak's Brief, pp. 22-29) Kodak, however, has avoided the analysis required to determine if the safe harbor assets are connected with its business. Instead of examining the real issue of whether the safe harbor assets themselves are connected with Kodak's business, Kodak has created an issue that is

not before the court by analyzing whether the tax benefits resulting from the assets have been of assistance to Kodak. This misconception by Kodak is discussed in this section.

Kodak asserts the test of M. Lowenstein Corp. v. South Carolina Tax Commission, supra, is satisfied and that such test can be used to determine when its safe harbor assets are connected with a business. (Kodak's Brief, pp. 22-26) Such a view is incorrect.

While Lowenstein, supra, does set forth a view of when an asset is connected with a business it is important to note that Lowenstein dealt with determining when an intangible asset was connected with a business. There the court was concerned with notes and bonds that generated interest and gains. In determining whether the intangible was "connected" to the business or not, the court found six indirect evidences of connection to the ordinary business. These connections established the intangibles were used as an integral part of the regular business. The court's attention is called to the fact that the cases cited by Kodak at pp. 24-26 in its Brief deal with a court determining whether an item is sufficiently integrated with the taxpayer's ordinary business so as to be a part of that business. The cases cited by Kodak, of which the following are representative, deal with determining if an asset is an integral part of the normal business so as to be included in the

[REDACTED]

income of that business. None address the issue of whether rental property is part of a business: Great Lakes Pipe Line Co. v. Com. of Taxation, 138 N.W.2d 612 (1965), interest income from securities used regularly in the business; Montgomery Ward & Co. v. Com. of Taxation, 151 N.W.2d 294 (1967), interest from intangibles with the interest regularly placed in ordinary activities of the business; Xerox Corp. v. Comptroller of Treasury, 428 A.2d 1208 (1981), loans to a subsidiary used in the furtherance of the parents' business; Holiday Inns, Inc. v. Olsen, 692 S.W.2d 850 (1985), interest from notes and short term investments used in the normal business; Champion Int. Corp. v. Bureau of Rev., 540 P.2d 1300 (1975), the income from intangibles was used for future business needs; Qualls v. Montgomery Ward, 585 S.W.2d 18 (1979), income from intangibles in form of notes was used for business inventory purchases; Atlantic Richfield Co. v. State, 601 P.2d 628 (1979), gain on sale of stock; W. R. Grace and Co. v. Com. of Revenue, 393 N.E.2d 330 (1979), gain on a stock sale; People ex rel. Cone v. Graves, 5 N.Y.S.2d 621 (1938), gain on sale of stock exchange Membership; District of Columbia v. Pierce, 462 A.2d 1129 (1983), insurance proceeds from plant facility integral to the business; Welded Tube Co. v. Commonwealth, 515 A.2d 988 (1986), gain on sale of plant integral to the business.

The Lowenstein test is not satisfied in Kodak's case. The regular business of Lowenstein was the manufacture of textile products and the testimony in that case was that the intangibles (the bonds) were issued "because the company needed the funds to put into their operations." Thus the intangibles were part of the operations and integral to the regular business of the taxpayer. Likewise, as to the business of Clark-Schwebel, the notes were repaid on intervals to coincide with the need for cash in the regular business of making fiberglass. The situation present in Lowenstein is not present in this case since the court here is not dealing with either an intangible or assets that are integral to Kodak's business.

First, this action does not deal with intangibles. Kodak's focus on the intangibles of the tax benefits does not answer the question. The question in the instant case is whether the rental assets are connected to Kodak's business and not whether the intangible tax benefits are connected. If the Court were asked to decide the right of South Carolina to tax the gain on the sale of the tax benefits as was the court in Portland General Electric v. Dept. of Revenue, 11 Or. Tax 78 (1988), then it would be relevant how those intangible tax benefits were connected with Kodak's business. But here the question is the right of South Carolina to tax the rental income generated by tangi-

ble assets. Lowenstein's test of deciding when an intangible is connected to the business has very little relevance to deciding when rental assets are connected to Kodak's business.

Second, if it is assumed that the Lowenstein test does apply to the determination of whether tangible property is connected to a business, it is important to understand how the intangibles in Lowenstein, unlike the instant matter, were connected to the business of the taxpayer. There the notes were part of a virtually daily transaction scheme under which the notes were used to cover the daily cash needs of Clark-Schwebel. Clearly, the notes were integral to the business of Clark-Schwebel, and thus, there was no other logical decision than to find the notes were connected with the business. Likewise, the bonds were integral to the operations of Lowenstein.

In the instant case, the same conclusion cannot be reached. Here Kodak has no daily contact with the leased property, and in fact, as the testimony showed by both the witnesses for Kodak and the South Carolina Tax Commission, there is no contact with the assets. Rather, the "lessee" is the owner of the asset and can sell the property without any consent or permission of Kodak. This lack of involvement is underscored by the uncontradicted fact that the leases are pure fictions.

[REDACTED]

In summary as to Kodak's argument that it has factually shown the connections necessary to defeat the allocation of § 12-7-1120(3), the Court is aware that factual determinations are within the province of the Trial Court, not the Appellant Court. Kodak, in the view of the Trial Court, was unable to show the necessary connection between the rental assets and the business of Kodak. Because of such determinations by the Trial Court, Kodak may not now retry the facts. Further, the issue here is not one of showing that the tax benefits (pure intangibles) are connected with its business. Rather, the issue in this case is one of showing when tangible rental property is connected with a business.

It cannot be stated too forcefully. The property that is in dispute is rental property producing a rental loss. It is not some intangible tax benefit that South Carolina seeks to tax. It is rental income. The income that Kodak reported on its returns is rental income. It is rental property that Kodak must show is connected to its business. It has not done so and its refund claim must be denied.

ARGUMENT II

KODAK'S APPLICATION OF THE APPORTIONMENT METHOD IS IMPROPER SINCE IT LEADS TO A RESULT THAT IS CONTRARY TO THE LEGISLATIVE INTENT ESTABLISHED BY THE REASONABLENESS TEST OF S.C. CODE ANN. § 12-7-250 (1976) AND SINCE KODAK'S METHOD IMPROPERLY JOINS THE NON-UNITARY SAFE HARBOR LEASING ACTIVITIES WITH OTHER UNITARY ACTIVITIES OF KODAK.

A. The Legislative Intent of S.C. Code Ann. § 12-7-250 (1976) To Tax A Reasonable Base Of the Taxpayer's Activities In South Carolina Is Defeated By Kodak's Apportionment Method Since An Excessively Large Reduction In The Tax Base Is Created By A Negligible Degree of Safe Harbor Activity In South Carolina.

1. The Facts Of This Action Demonstrate That The Trial Court Correctly Adopted An Approach That Carries Out The Legislative Intent and Rejected The Approach That Defeated That Intent.

The Court's attention is directed to what is most likely obvious but perhaps has not been clearly stated. The bedrock question in this appeal is which party's theory of the case best carries out the intent of the General Assembly. It is established that the intent of South Carolina's allocation and apportionment statutes is to tax a reasonable portion of the taxpayer's income. Hertz Corp. v. South Carolina Tax Commission, 246 S.C. 92, 142 S.E.2d 445, 446 (1965); and Lockwood Greene Engineers, Inc. v. South Carolina Tax Commission, 293 S.C. 447, 361 S.E.2d 346 (1987). It is the Tax Commission's belief that no matter how persuasive a position appears there can be no correct decision that does not embody this intent.

Kodak's theory of this case leads to untenable and artificial results. The facts show that Kodak is a taxpayer with a multi-billion dollar business generating extensive income from the use in this state of millions of dollars of payroll, property and sales. (Tr., pp. 12, 24) It has generated losses through the legal fiction of owning billions

of dollars of assets under nonexistent leases. (Tr., pp. 14, 15; pp. 24, 25) Under these leases there is virtually no safe harbor presence in South Carolina since there is less than \$10,000 of rental income and less than \$32,000 of rental property in this state. (Tr., pp. 14-15; 24) The result is that Kodak, despite having virtually no safe harbor presence in South Carolina seeks to reduce its South Carolina taxable income by over 33% in 1984 and by over 90% in 1985. (Tr., pp. 25) It is the Trial Court's conclusion that Kodak's theory of this case does not tax a reasonable portion of the taxpayer's income in South Carolina. In light of the unreasonable result reached by Kodak, the Trial Court correctly applied a theory that taxed Kodak only on the activity actually present in the state. Based on the factual findings from the evidence and testimony produced in this matter, the decision of the Trial Court to deny the refund of 1.2 million dollars is proper and should be upheld. The answer to the issue of what result best accomplishes the intent of the General is one that can be reached by quantifying and categorizing the evidence as we have outlined above. However, an even more basic approach is just as reliable in a case such as this one where the total picture is so easily seen. When faced with defining obscenity, Justice Potter Stewart wrote in Jacobellis v. State of Ohio, 84 S.Ct. 1676, 1683 (1964) " . . . I know it when I see it . .

" We suggest that this court is able to use the same test in determining whether a 90% reduction in taxable income due to nonexistent leases violates the legislative intent to tax a reasonable portion of a taxpayer's income. Having presented this background, the arguments raised by Kodak in its Brief are addressed in the remainder of this section.

2. The Trial Court Correctly Found Kodak's
Application Of The Apportionment Formula
Created An Unreasonable Result Inconsistent
With The Intent of § 12-7-250.

Kodak argues that the inclusion of the safe harbor rental losses as a part of Kodak's apportionable income does not produce an unreasonable result within the meaning of § 12-7-250. (Kodak's Brief, pp. 12-18) Kodak appears to base its argument on two positions with one being legal in nature and the other factual. First, and as a legal position, Kodak argues that § 12-7-250 cannot create a new method of apportionment. (Kodak's Brief, pp. 12-14) Second, and as a factual position, Kodak argues the Trial Court incorrectly analyzed the evidence to conclude Kodak's apportionment method leads to an unreasonable result. (Kodak's Brief, pp. 14-18) Each of these positions is addressed below.

- a. The Trial Court Did Not Hold That
§ 12-7-250 Creates A Method Of
Apportionment Different From That
Established By The Apportionment Formula.

Kodak argues the Trial Court held § 12-7-250 gives ". . . authorization for a computation other than that produced by specific application of the terms of the income tax apportionment formula . . ." (Kodak's Brief, p. 12) Kodak then argues this holding by the Trial Court is incorrect since the three-factor formula has been shown to produce a reasonable result in such cases as Covington Fabrics Corp. v. South Carolina Tax Commission, 264 S.C. 59, 212 S.E.2d 579 (1975); and Moorman Manufacturing Co. v. Blair, 437 U.S. 267 (1978), (Kodak's Brief, pp. 12-14)

The Tax Commission does not argue that the three-factor formula gives an unreasonable result. Rather, the Tax Commission asserts that a reasonable result is reached only when the allocation and apportionment statutes are correctly applied. The fallacy with Kodak's argument is that the Trial Court did not hold that § 12-7-250 established a method different from the terms of the apportionment formula. Rather, the Trial Court tested the approaches suggested to it by the parties and determined that Kodak's method was inconsistent with the intent of the statutes. This holding of the Court is explained below.

The Trial Court was faced with two methods of determining Kodak's base of income subject to tax. The method advanced by the Tax Commission was based on allocating the rental losses to the state where the property was located un-

der § 12-7-1120(3) and then apportioning the remaining income. The taxpayer's method denied that the allocation section was applicable and instead argued that all of Kodak's income should be apportioned. In response to Kodak's view, the Tax Commission asserted that even if the allocation sections were not applicable, Kodak was incorrectly applying the apportionment method since the safe harbor rental income was a separate non-unitary activity which was required to be apportioned separately.

In light of these differing views, the Court held that the General Assembly clearly intended to tax a reasonable base of income and that such intent was embodied in the language of § 12-7-250. (Tr., p. 22) After hearing testimony and receiving evidence on the activities of Kodak and the activities of the safe harbor lease transactions, the Court held the approach advanced by Kodak was inconsistent with the legislative intent and thus rejected Kodak's analysis of South Carolina's allocation and apportionment system. The Court did not create a new method for computing South Carolina's tax liability. It did not ignore existing statutes or disregard or rewrite the three-factor formula. Rather, it simply applied the existing statutory framework consistent with the intent of the General Assembly.

When a taxpayer's approach leads to a result that does not tax a reasonable portion of the taxpayer's activity, then that approach is not consistent with the

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very purpose of the taxing statutes and must be rejected. The legislative intent must prevail. Peoples National Bank of Greenville v. South Carolina Tax Commission, 250 S.C. 187, 156 S.E.2d 769 (1967). (Tr., p. 22)

No new computation was created. Rather, Kodak's computation was rejected.

b. The Factors Relied Upon By The Trial Court Are Appropriate Indicators of Reasonableness.

Kodak at pages 14-18 of its Brief seems to argue that the Trial Court was incorrect in its analysis of what is necessary to show Kodak's approach gave an unreasonable base upon which to impose South Carolina's tax. Before demonstrating the Trial Court's analysis is correct, it must be noted that the Trial Court was not attempting to arrive at a precise mathematical model. Rather, its objective was general in nature and sought only to review the activities of the taxpayer with a view toward determining the extent to which those activities were carried on in South Carolina. From this general understanding, the Court then determined if the reduction in Kodak's tax liability due to the safe harbor activities was reasonable.

The approach used by the Trial Court involved a comparison. First, the court determined the extent of Kodak's non-safe harbor activities in the State and found the evidence showed Kodak had extensive payroll, property, and sales in South Carolina. (Tr., pp. 23, 24) Second, the

court determined the extent of the safe harbor activities in South Carolina by using the same measuring tool, i.e., the payroll, property, and sales of such activities. However, this time the court found the evidence showed there was virtually no safe harbor activity in South Carolina. (Tr., p. 24)

Having concluded that the safe harbor activities were minimal in South Carolina, the Trial Court then sought to determine the extent to which the safe harbor activities affected the tax and thus the "base" upon which South Carolina imposed its tax. The Court found the evidence established that the safe harbor activities caused a 33% reduction of Kodak's income in 1984 and a reduction of over 90% in 1985. (Tr., p. 25) Such large reductions were not consistent with the minimal safe harbor activities within the state. Based upon this analysis, the Trial Court held that Kodak's apportionment method violated the intent of the apportionment law since it did not tax a reasonable base of Kodak's activities in this state.

Such an approach is entirely proper since our apportionment statutes are premised on the basis that the income of a taxpayer is deemed earned in South Carolina to the extent that its payroll, property, and sales are in this state. Since the safe harbor payroll, property, and sales were minimal in South Carolina, it was reasonable to expect

that such would cause only a minimal affect on South Carolina's taxable base. When Kodak's method of apportionment created a tremendous reduction in the base as a result of only a minimal activity, the Court properly concluded Kodak's method was improper.

B. The Apportionable Income Of Kodak Cannot Include The Rental Losses From The Safe Harbor Leases Since The Safe Harbor Leasing Activities Are Not Unitary With Kodak's Other Activities.

Kodak asserts the apportionment formula includes the losses from the safe harbor activities in its total income and thus allows the safe harbor losses to offset the normal business income of Kodak. (Kodak's Brief, pp. 30-32) The law is well-settled that the apportionment formula is only proper for a multi-state taxpayer when the businesses of that taxpayer are unitary.

[F]ormulary apportionment . . . is constitutionally permissible only in the case of a unitary business.

ASARCO, Inc. v. Idaho State Tax Commission, 458 U.S. 307, 320 N. 14 (1982). If the activity is a separate and distinct activity, then the apportionment formula may not be applied to the combined activities but rather the separate activity must be taxed separately, as the condition implies. F. W. Woolworth Co. v. Taxation and Revenue Department of New Mexico, 458 U.S. 354, 372 (1982). Kodak as-

serts the safe harbor activity is combined with Kodak's business activity since "[s]imply put there was no separate [safe harbor leasing] business." (Kodak's Brief, p. 31) Kodak is mistaken. The Trial Court correctly held the safe harbor transactions do in fact constitute a separate non-unitary activity.

1. Kodak Incorrectly Argues That Common Management Makes The Safe Harbor Activities Unitary With Kodak's Business.

As the following statement shows, Kodak argues in its Brief at pages 30 and 31 that common management is present in relation to the safe harbor activities.

The Director of State and Local Taxes of Kodak stated that there was absolutely no corporate or business separateness with regard to the [safe harbor activities]. . . , the same corporate employees who performed other corporate duties (such as accounting, legal, and tax) also performed all duties associated with safe harbor leasing.

Kodak apparently seeks to show that the presence of this minimal common management creates a unitary relationship. Kodak is incorrect for at least two significant reasons.

First, as the Trial Court correctly stated (Tr., p. 32) the mere presence of common management is insufficient to create a unitary relationship. See Jaffe v. Department of Treasury, 431 N.W.2d 416 (1988), where the court held

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that the mere showing of common ownership of an advertising business and a cattle operation was insufficient to demonstrate a unitary business. Here the Trial Court found there was only inconsequential commonality insufficient to constitute a unitary operation.

Second, the very idea that Kodak exercised mutual management over both the safe harbor activities and over Kodak's business operations is incorrect. The Trial Court, after hearing the evidence and testimony, found the following:

The only role Kodak had in the safe harbor activities was the nominal duties of administrative tasks such as accounting and financial matters. Such minor tasks do not rise to the level of management necessary to find a unitary relationship. (Tr., p. 33)

The Trial Court was correct in finding there was insufficient management activities to constitute a unitary business.

2. Kodak Incorrectly Argues There Is a Unitary Relationship Between The Safe Harbor Activities And Kodak's Business Based On An Alleged Flow Of Value From The Rental Activities By Virtue Of The Tax Benefits Being Used By The Corporation As A Whole.

Kodak asserts that the safe harbor activities and Kodak's business operations are unitary since:

The record is clear that the deferred federal income taxes and tax credits which resulted from the safe harbor leases in

question were used by the company as a whole and that no separate division or department of Kodak benefited. (Kodak's Brief, p. 31)

The mere showing of a benefit to Kodak from the tax savings does not convert the safe harbor rental activity into a unitary activity with Kodak's other operations. The Trial Court correctly held the taxpayer must show there is an interdependence between one activity and the other so that one is dependent upon the other. (Tr., p. 34) Such is the second test of contribution/dependency in Exxon v. South Carolina Tax Commission, 273 S.C. 594, 258 S.E.2d 93 (1979). The mere showing of a benefit is insufficient and would result in virtually every activity of a taxpayer being unitary and thus proves far too much to be an acceptable test.

In fact it seems that Kodak is saying that since the tax benefits were helpful to the overall business, such should be enough to create a unitary relationship. This view has been specifically rejected by the United States Supreme Court in ASARCO, Inc. v. Idaho State Tax Commission, supra. There the state sought to tax a certain class of income by arguing the income was part of the unitary business. The state sought to prove a unitary business existed since the assets generating the income

contribute to or relate to or are some way in furtherance of the taxpayer's own trade or business.

ASARCO, supra, at p. 3114. The Court disagreed.

This definition of unitary business would destroy the concept. The business of a corporation requires that it earn money to continue operations and to provide a return on its invested capital. Consequently all of its operations, including any investment made, in some sense can be said to be "for purposes related to or contributing to the corporation's business." When pressed to its logical limit, this conception of the "unitary business" limitation becomes no limitation at all. When less ambitious interpretations are employed, the result is simply arbitrary.

* * * *

In this case, it is plain that the five dividend-paying subsidiaries "add to the riches" of ASARCO. But it is also true that they are "discrete business enterprises" that--in "any business or economic sense"--have "nothing to do with the activities" of ASARCO in Idaho.

ASARCO, supra, at p. 3115. Thus showing the tax benefits "add to the riches" of Kodak is not sufficient to create a unitary relationship. Here Kodak did not prove the existence of a dependency relationship between the safe harbor activities and Kodak's other activities other than "add[ing] to the riches" of Kodak. Accordingly, the Trial Court properly held no unitary relationship was established and the safe harbor losses could not be included in Kodak's apportionable income.

C. The North Carolina Case Of National Services Industries, Inc. v. Powers, 98 N.C. App. 504, 391 S.E.2d 509 (1990) is Distinguishable

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From the Instant Case.

In Kodak's Brief at pp. 27-30, 31, it is submitted that the North Carolina case of National Service Industries v. Powers, supra, is authority for holding that Kodak is entitled to apportion its losses from the safe harbor rental activity. There are at least two reasons that the result reached in North Carolina should not be applied in South Carolina. First, the case turned on the meaning of business income as used in the North Carolina statute which meaning South Carolina has specifically declined to adopt. Second, the issue of whether the safe harbor lease activity was unitary with the taxpayer's other activities, which issue was strenuously argued by both parties in the instant case, was not litigated in the North Carolina case but rather was stipulated. These two points are briefly discussed below.

First, the North Carolina case was based on the meaning of a statute that defined business income as:

. . . income from tangible and intangible property if the acquisition, management, and/or disposition of the property constitute integral parts of the corporation's regular trade or business operations.

G.S. 105-130.4(a)(1), N.C. Corporate Income Tax Act. Based on this statute the court stated:

Here, the lease arrangement was a means of gaining working capital and increasing cash flow for all of plaintiff's business operations. This is certainly an "integral part" of plaintiff's business operations.

[REDACTED]

National Service Industries, supra, at p. 512. Under South Carolina law, there is no such definition of business income. In fact, the definition of business income used by North Carolina comes from a model act called the Uniform Division of Income for Tax Purposes Act (see Vol. 7A Uniform Laws Ann. 91 (1978)), and our Supreme Court has specifically denied that South Carolina applies the literal language of that Act:

Appellant urges application of the broad definition of business income contained in the Uniform Division of Income for Tax Purposes Act. While the General Assembly elected to incorporate some of the language from the Uniform Act into Code § 12-7-1120(6), it did not adopt the Act's definition of business income.

Boyle Utilities, Inc. v. South Carolina Tax Commission, 273 S.C. 93, 254 S.E.2d 308, 309 (1979).

Since South Carolina has not adopted the business income test used by North Carolina, a case such as National Service Industries, supra, which is based on that test, is not proper authority for this court. Rather, this court must apply South Carolina's law which asks whether "... the property that produced the income is or is not connected with the business." M. Lowenstein Corp. v. South Carolina Tax Commission, supra. Under such a test, the focus is on the actual use of the property which produces the income in

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dispute. As fully discussed in Argument I, B., the rental property is not connected with the business.

Because of such, the rental loss under § 12-7-1120(3), must be allocated to the place where the rental property is located and may not be apportioned.

A second reason that the decision in National Services Industries, Inc., supra, should not be applied in Kodak's case is that the critical issue of whether the safe harbor activities were unitary with the taxpayer's other activities was not addressed. Rather, in the North Carolina case, the parties stipulated that issue. The court stated:

The parties have stipulated that the several operating arms of plaintiff's business are joined by a highly-centralized cash management and business operation. From this record we conclude that plaintiff's conglomerate corporation is a unitary business for tax purposes.

National Services Industries, Inc., supra, at p. 512. Obviously, no such stipulation is present in the Kodak case. Rather, a major disagreement between the parties is whether the safe harbor rental activity is unitary with Kodak's other activities. The Tax Commission believes that the facts of the case before this court show that the unitary tests of Exxon, supra, were not met. Thus even if the North Carolina case is of some relevance to South Carolina law, the case is still of little help since the facts in Kodak demonstrate that there was no satisfaction of the uni-

tary requirements established by Exxon, supra. Thus even if Kodak could apportion the rental losses, it could do so only as a separate activity which again would not allow the losses claimed by Kodak.

In summary, the North Carolina case is of no support to Kodak's position for two reasons. That case is based on a "business income" test which South Carolina has expressly declined to adopt; and second, that case assumed by stipulation that the safe harbor activities were unitary with the rest of the taxpayer's activities. Accordingly, the North Carolina case is distinguishable from the matter now before this court.

ARGUMENT III

KODAK'S ALTERNATIVE VIEW THAT IT IS ALLOWED TO CLAIM THE DEPRECIATION RESULTING FROM THE SAFE HARBOR RENTAL PROPERTY IS INCORRECT SINCE THE DEPRECIATION DEDUCTION IS A RELATED EXPENSE TO THE RENTAL LOSSES AND MUST BE TREATED IN THE SAME MANNER AS ALL OTHER RELATED INCOME AND EXPENSES.

Kodak asserts the Tax Commission has authorized taxpayer's to claim depreciation on safe harbor leases without concern for the allocation statutes and with no requirement to report the rental income or any other expense associated with the safe harbor transactions. Kodak asserts the South Carolina Tax Commission has allowed taxpayers to simply claim the depreciation deduction as a part of apportionable income. (Kodak's Brief, pp. 33-35) Kodak bases its view upon S.C. Code Ann. Regs. 117-63 (1976), and an article from

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Commerce Clearing House which explains the South Carolina Tax Commission's view on taxing safe harbor leases. Kodak's view ignores the plain language of S.C. Code Ann. § 12-7-700(8) (1976), the plain language of the regulation, the plain language of the Commerce Clearing House publication and the uncontradicted testimony of the South Carolina Tax Commission's witness.

First the statute which started the safe harbor treatment was § 12-7-700(8). That Section granted "... the same depreciation as allowed by Federal Internal Revenue Code Section 168(f)(8) and applicable regulations ...". The "applicable federal regulations" are found at Sec.168(f)(8)-7 of the federal regulations. There the regulations are specific that the lessor must include the rental income and the lessee must include any interest income. Further, the lessor claims the interest deduction and the lessee deducts the rental payment. Thus it is clear the General Assembly was not enacting a provision that limited safe harbor transactions to depreciation only.

South Carolina Tax Commission Regulation 117-63 is also no support for Kodak's view. The regulation plainly contemplates rental payments as income to one and an expense to the other by the following: "... the lessee will be entitled to a deduction for the lease payments ...". While it cannot be established for certain, it is reasonable to be-

lieve that the language "... for purposes of depreciation only ..." found in the regulation is intended to mean that safe harbor leases are not to be treated as real leases for any other purposes than for income tax purposes. For example, leases are subject to sales tax on the gross proceeds from the rental of tangible personal property. Edisto Fleets, Inc. v. South Carolina Tax Commission, 256 S.C. 350, 182 S.E.2d 713 (1971). The "for purposes of depreciation only" language would prevent the possible application of a sales tax to the artificial lease payments. Why the language is in the regulation has not been established by any evidence presented by Kodak, nor is any legislative history available to explain the wording. However, it must be remembered that in any event the regulation could not limit to depreciation only the scope of § 12-7-700(8) when that statute had adopted the full extent of safe harbor leases as established by the I.R.C. To so limit the statute would create an invalid regulation. Heyward v. South Carolina Tax Commission, 240 S.C. 347, 126 S.E.2d 15 (1962).

Further, the Commerce Clearing House publication has been grossly misconstrued by Kodak to support Kodak's position that it is allowed depreciation deductions against its apportionable income. That document explicitly says that interest income and expense and rental income and expense are to be claimed by the lessee and the lessor. To

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read such statements as support for Kodak's conclusion that only depreciation deductions are allowed by the South Carolina Tax Commission is a gross disregard of the full statements made in the Commerce Clearing House document.

Finally, the testimony of the South Carolina Tax Commission's witness proves there has never been a time when the Tax Commission only provided for depreciation on safe harbor assets. Ms. Law testified that the safe harbor leases had been construed since their beginning in 1983 as requiring the inclusion of rental income and interest income as well as allowing rental expense and interest expense. All safe harbor taxpayers in South Carolina have filed in this manner. In fact, Kodak filed its returns in this very manner and presented no evidence of instances when the South Carolina Tax Commission had required taxpayers to only include the depreciation generated by safe harbor leasing.

Based on the above, Kodak is incorrect in its view that it is allowed a deduction for the depreciation on the safe harbor leases. In addition, the Trial Court correctly held that the depreciation is a related expense to the rental income and must be allocated to the state where the property is located. (Tr., p. 41) Further, the Trial Court was correct in finding that even if apportionable such expense must be apportioned separately with the safe harbor rental income rather than applied to Kodak's apportionable income.

(Order, p. 41) In summary, the allowance of depreciation only as a deduction for safe harbor leases is improper and should be denied.

CONCLUSION

Based on the foregoing, this Court should affirm the Trial Court on all grounds. As a result, no refund should be ordered to Kodak in any amount.

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Attorneys for Respondent
South Carolina Tax Commission

Columbia, South Carolina
July 3, 1991.

THE STATE OF SOUTH CAROLINA

IN THE SUPREME COURT

DOCKET NO.

APPEAL FROM RICHLAND COUNTY

HONORABLE JAMES E. LOCKEMY, CIRCUIT COURT JUDGE

CASE NO. 89-CP-40-3213

Eastman Kodak Company,

Appellant,

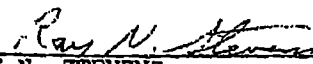
vs.

South Carolina Tax Commission,

Respondent.

CERTIFICATE OF COUNSEL

The undersigned certifies that this final Brief
complies with Rule 210(b), SCACR.


RAY N. STEVENS
Deputy Attorney General

July 3, 1991.

THE STATE OF SOUTH CAROLINA

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Eastman Kodak Company,

Appellant,

vs.

South Carolina Tax Commission,

Respondent.

CERTIFICATE OF MAILING

I, Ray N. Stevens, hereby certify that I have mailed, postage prepaid, three copies each of the Brief of Respondent, South Carolina Tax Commission, to John C. von Lehe, Jr., Esquire, and Stephen F. Groves, Esquire, Post Office Box 993, Charleston, South Carolina 29402, this 3 day of July, 1991.


RAY N. STEVENS
Deputy Attorney General

THE STATE OF SOUTH CAROLINA

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Appellant,

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RAY N. STEVENS
Deputy Attorney General

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JUL 3 1991
S. C. SUPREME COURT

THE STATE OF SOUTH CAROLINA

IN THE SUPREME COURT

DOCKET NO.

APPEAL FROM RICHLAND COUNTY

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CASE NO. 89-CF-40-3213

Eastman Kodak Company,

Appellant,

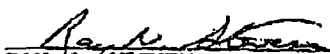
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complies with Rule 210(b), SCACR.


RAY N. STEVENS
Deputy Attorney General

July 3, 1991.

JUL 13 1991
S. C. SUPREME COURT



Exhibit C

STATE OF SOUTH CAROLINA)
COUNTY OF RICHLAND)

IN THE COURT OF COMMON PLEAS
Case No. 89-CP-40-3213

Eastman Kodak Company,

Plaintiff,

vs.

South Carolina Tax Commission,

Defendant.

O R D E R

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This court held an evidentiary non-jury trial in this matter on June 6, 1990 followed by a briefing period in which extensive briefs were filed by both parties. In an effort to fully clarify the positions developed at the trial and in the briefs, the court held an additional hearing on October 17, 1990. After considering the evidence produced and the arguments presented, the court finds the dispute raises two procedural issues and several substantive issues. The two procedural issues involve the subject matter jurisdiction of the court provided under S.C. Code Ann. Section 12-47-440 (1976) and the substantive issues involve a disagreement on what is the correct application of South Carolina's taxing scheme to the plaintiff, Kodak, for the tax years 1984 and 1985. After a review of the facts in this matter, the procedural issues are addressed followed by the court's address of the substantive issues.

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FACTUAL BACKGROUND

Kodak is a multinational corporation involved in the business of producing a variety of products including films, papers, chemicals, plastics, fibers, magnetic media, equipment for photographic and electronic imaging and for information management. It conducts its business worldwide including significant operations in South Carolina. Among other activities in South Carolina, Kodak has a manufacturing plant which is part of Kodak's Chemical Division. Kodak's business utilizes property located in South Carolina, which property in 1984 had a cost of almost \$384 million and in 1985 of over \$401 million. Expenditures were made for payroll in South Carolina for 1984 of almost \$39 million and for 1985 of over \$46 million. Further, the sale of products delivered to South Carolina customers for 1984 was over \$127 million and for 1985 was slightly over \$107 million.

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Kodak also reports income and expenses from an activity commonly referred to as "safe harbor leasing." A safe harbor lease is the creation of the Economic Recovery Act of 1981 and is codified within the Internal Revenue Code (I.R.C.) at Section 168(f)(8). There Congress sought to stimulate capital investment by allowing one company to use a lease "in form only" to transfer certain federal tax benefits to another taxpayer. During the trial of this case,

the evidence showed that a safe harbor lease involved three steps.

The first step in a safe harbor lease involves the purchase and nominal sale of qualifying property. A party (XYZ) which, for various reasons, is unable to utilize the federal tax benefits resulting from ownership of qualifying property, purchases the qualified property and takes legal title. (Assume the purchase price is \$1 million.) XYZ then "sells" the property to a party (in this case Kodak) who is able to utilize the federal tax benefits. At the time of the "sale" no legal title passes to Kodak and in fact no physical transfer of the property occurs. The purchase price paid by Kodak is \$1 million (the same amount that XYZ paid) which amount is paid as \$100,000 in money and a promissory note to pay \$900,000 in level payments over a fixed period. This gives rise to the second step in the transaction.

At the time of the "sale" of the property to Kodak, Kodak and XYZ enter into a "lease" in which Kodak leases the property back to XYZ in an amount and for a period which is exactly the amount and the period covered by the \$900,000 promissory note. Thus, no payments are required on the note and no payments are required on the lease since they cancel out each other. As a result of the sale and lease-back, for

federal tax purposes Kodak is treated as the "owner" of the property. As such it is entitled to claim deductions for depreciation, interest expense on the "note payments", and to receive a federal investment tax credit based on the "purchase price" of the property. Since Kodak is now the lessor of the property it also has rental income from the lease agreement. XYZ, as the lessee, has a deduction for the lease payment "paid" to the lessor and XYZ has interest income from the note.

The third and final step occurs at the end of the "lease." At that time XYZ "repurchases" the property from Kodak for the nominal sum of \$1 or in some cases for no consideration at all. As a result the "lease" is concluded, the note is paid in full, and XYZ, which never relinquished legal title in the first place, now takes "ownership" of the property from Kodak.

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Kodak entered into 34 safe harbor leases and the assets over which Kodak became the "lessor" consisted of such diverse property as power plants, railroad rolling stock, and paper mills. The assets involved in the safe harbor leasing were over \$2 billion with less than \$32,000 of the safe harbor assets located in South Carolina. Additionally, the safe harbor leases resulted in rental income of over \$200 million with less than \$10,000 derived from property in

South Carolina. Due to the deductible expenses of the safe harbor leases exceeding the rental income, Kodak had a loss from the activity in both 1984 and 1985. The losses gave rise to the dispute which is now before this court.

On its 1984 South Carolina tax return Kodak claimed a loss from its safe harbor rental activities and later filed a claim for refund seeking to show that its loss was even larger. Kodak's 1984 loss from safe harbor leases of \$426 million was used in 1984 to reduce its apportionable income¹ from \$1.3 billion to \$980 million. In 1985 Kodak's return reflected a safe harbor loss of \$326 million which was used to reduce its 1985 apportionable income from \$474 million to \$48 million. The Tax Commission has asserted the safe harbor losses can not be used to reduce the apportionable income. It is this dispute that has resulted in the issues alluded to previously in this Order.

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¹Apportionable income is the remaining net income after special classes of the taxpayer's income have been allocated to and taxed at specified locations. South Carolina then only taxes a portion of the apportionable income. That portion is found by determining the percentage of the taxpayer's total payroll, property and sales which are in South Carolina. That percentage is then multiplied against the total apportionable income to arrive at South Carolina's share of the apportionable income.

ISSUES

I. Subject Matter Jurisdiction Under
Section 12-47-440

A. The Impact of Bass, et al. v.
South Carolina Tax Commission
South Carolina Supreme Court
Op. No. 23216

On July 31, 1990 our South Carolina Supreme Court
issued a decision which stated the following:

Even were we to examine state law, the federal retirees would be barred from receiving a refund. The proper refund statutes under which the federal retirees should have proceeded are S.C. Code Ann. Sections 12-47-210 and 12-47-220 (1976), which require the taxpayer to pay under protest before bringing a refund action. [Footnote 5] We have previously stated that the exclusive remedy for the recovery of the erroneous assessment of income taxes is through these "pay under protest" statutes. See Perpetual Bldg. & Loan Ass'n. of Columbia v. South Carolina Tax Commission, 255 S.C. 523, 180 S.E.2d 195 (1971).

[Footnote 5] Section 12-47-440 under which the federal retirees proceeded, deals only with the recovery of license fees and taxes. See City of Columbia v. Glens Falls Insurance Company, 245 S.C. 119, 139 S.E.2d 529 (1964).

It is certainly true that the complaint in this matter alleges jurisdiction under Section 12-47-440.² It likewise seems clear that the court in Bass states that the refund route of Section 12-47-440 is not available for the recovery of income tax but rather that the "exclusive remedy for the recovery of the erroneous assessment of income taxes is through the 'pay under protest' statutes." This court holds that under the facts of the instant case this action is a "pay under protest" action.

The returns of Kodak were filed with the assertion that the safe harbor losses were properly used to reduce apportionable income. Kodak had paid estimated payments throughout the year and, according to its calculation of its tax liability, was entitled to a refund. However, before the overpayment of estimated taxes could be refunded to Kodak, the Tax Commission audited the returns and found that Kodak actually had a tax liability much greater than Kodak had calculated. Based on the Tax Commission's position Kodak's overpayments of estimated tax were not nearly so large as Kodak had calculated. Consequently, the Tax Commission

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²The Amended Complaint at paragraph 3 alleges subject matter jurisdiction under Section 12-47-440.

retained the vast majority of the estimated tax and refunded only a small portion. Kodak protested the audit adjustments and after exhausting its administrative remedies brought this action in a timely manner. Since the "refund" involved in this action resulted from an audit adjustment, there was no "voluntary payment" but rather such were payments under protest for which this court has jurisdiction.

B. The Timeliness Of The Claim For
Refund Under Section 12-47-440

While the audit adjustments by the Tax Commission were responsible for the entire tax dispute for the 1985 tax year, those adjustments were not responsible for the entire dispute for the 1984 tax year. For the 1984 tax year, Kodak filed a claim for refund when it learned that the Tax Commission recognized the validity of safe harbor leases entered into prior to January 1, 1983.³ Kodak filed its claim for

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³The Tax Commission had held that safe harbor leases entered into prior to January 1, 1983 were not recognized by South Carolina since the adoption of the safe harbor provisions of I.R.C. Section 168(f)(8) was not until January 1, 1983. However, on March 2, 1988, the Tax Commission, through its Policy Division, issued Technical Advice Memorandum #88-9 which advised that safe harbor leases were within South Carolina's adoption of I.R.C. Section 168(f)(8) even if entered prior to January 1, 1983.

refund on May 26, 1988 for the tax year 1984. In that claim it asserted that safe harbor leases entered into prior to January 1, 1983 created an additional loss from safe harbor leasing of approximately \$230 million. The Tax Commission denied the claim.

While it is arguable that the Bass decision precludes the assertion of this refund claim, the court finds it unnecessary to address this point since the court concludes it lacks subject matter jurisdiction over this claim even assuming Section 12-47-440 is an available remedy. It is well settled that the moving party has the burden of satisfying the jurisdictional requirements of a statute. Here Section 12-47-440 states:

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The provisions of this section . . . shall only be available where the application provided for here is made in writing to the Commission within a period of three years from the date the license fee or tax was due to have been paid.

The return for 1984 for Kodak was due on March 15, 1985. Thus, the refund claim was due by March 15, 1988 in order to be timely filed. The facts in the instant case show the claim was not filed until May 26, 1988. Since the refund claim for 1984 was not timely filed, Kodak has failed to satisfy the jurisdictional requirements of Section 12-47-440. This court holds that there is no subject matter jurisdic-

tion over that portion of this action which seeks a refund due to the \$230 million safe harbor lease losses of 1984.

II. The Application Of South Carolina's Taxing Method To Kodak's Safe Harbor Leasing

The application of South Carolina's taxing method to Kodak has raised a number of issues for this court to address. These issues involve a dispute over the interpretation of South Carolina's tax statutes and a challenge to the constitutionality of such statutes.

There are essentially three statutory interpretation issues raised in this action. First, the Tax Commission argues the losses here involved can not be used to reduce the apportionable income of Kodak since to do so violates the reasonableness test of S.C. Code Ann. Section 12-7-250 (Supp. 1989). Second, the losses are rental losses that must be allocated under S.C. Code Ann. Section 12-7-1120(3) (Supp. 1989), rather than apportioned as Kodak asserts. Finally, the Commission argues that even if neither the reasonableness test of Section 12-7-250 nor the allocation section of Section 12-7-1120(3) applies, the losses still cannot be used to reduce Kodak's apportionable income. The basis for this third argument is that the safe harbor leasing activity is not a unitary activity with Kodak's other activities. Accordingly, the safe harbor leasing

ing activity must be apportioned as a separate activity rather than combined with Kodak's other activities.

There are basically three constitutional issues raised. First, Kodak argues that allocating the losses under Section 12-7-1120(3) discriminates against interstate commerce by allowing the loss if the asset is in South Carolina but denying the loss if the asset is in another state. Second, Kodak argues that Equal Protection is violated by Section 12-7-1120(3) since Kodak asserts there is no rational basis for allowing the losses when the safe harbor assets are located within South Carolina, but excluding the losses when the assets are located outside South Carolina. Finally, Kodak argues that a failure to include Kodak's safe harbor losses in total apportionable income is a violation of Due Process.

After considering the evidence and argument the court agrees with the three positions advanced by the Tax Commission and further finds there is no constitutional violation as presented by Kodak. These views are more fully explained below.

A. Statutory Interpretations

1. The Requirements of Section 12-7-250

Section 12-7-250 (enacted as part of Act 731 in 1959) requires that the tax paid by a taxpayer be made ". . . upon a base which reasonably represents a portion of the trade or business carried on within the State." The purpose of Act 731 is to obtain the objective of reasonable allocation of income. Hertz Corp. v. South Carolina Tax Commission, 246 S.C. 92, 142 S.E.2d 445, 446 (1965) and Lockwood Greene Engineers, Inc. v. South Carolina Tax Commission, 293 S.C. 447, 361 S.E.2d 346 (1987). When a taxpayer's approach leads to a result that does not tax a reasonable portion of the taxpayer's activity, then that approach is not consistent with the very purpose of the taxing statutes and must be rejected. The legislative intent must prevail. Peoples National Bank of Greenville v. South Carolina Tax Commission, 250 S.C. 187, 136 S.E.2d 769 (1967).

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The reasonableness rule of Section 12-7-250 is demonstrated in Hercules, Inc. v. South Carolina Tax Commission, 279 S.C. 177, 304 S.E.2d 815 (1983). There the taxpayer sold a South Carolina manufacturing plant and generated a gain on the sale. The South Carolina Tax Commission taxed the gain as South Carolina income since Section 12-7-1120(4) states that gains from the sale of real property located in this State are allocated to South Carolina. However, the taxpayer objected and argued that to tax the entire gain vi-

olated Section 12-7-250. The argument, agreed to by the Court, was that since the gain resulted entirely from depreciation deductions which were only partially deducted in South Carolina, it was proper to tax only a portion of the gain. In other words, the gain was taxed only to the extent of the representative business carried on in the State.

Here, Kodak's treatment of the safe harbor leasing activities does not set a fair base which reasonably represents the taxpayer's business in South Carolina. Rather, the taxpayer's treatment distorts Kodak's business in South Carolina by inappropriately reducing the share of business carried on in South Carolina. This distortion was supported by the evidence presented to this court.

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In the 1984 and 1985 annual reports for Kodak, essentially two divisions are represented as carrying on Kodak's business: The Photographic and Information Management Division (PIMD) and Eastman Chemical Division (ECD). PIMD produces products such as films, papers, chemicals, magnetic media and equipment for photographic/electronic imaging and information management. The marketing and distribution of these products are made throughout the United States including South Carolina. ECD produces a diversity of chemicals, fibers, and plastics with one of Kodak's manufacturing plants located in Columbia, South Carolina. In fact, Ko-

dak's presence in South Carolina is extensive. Kodak had assets in South Carolina of \$384,000,000 in 1984 and \$401,000,000 in 1985. In addition, Kodak had gross receipts on sales delivered to customers in South Carolina of \$127,000,000 in 1984 and \$107,000,000 in 1985. The payroll of Kodak to its South Carolina employees is also significant. In 1984, Kodak's South Carolina payroll was \$39,000,000 and in 1985 was \$46,000,000. While the above activities show a significant involvement in South Carolina, by contrast, South Carolina's safe harbor activities are not significant.

In 1984, Kodak had over \$1.8 billion of property for which it was the purported lessor under safe harbor leases. That amount grew to over \$2 billion in 1985. Of this amount only \$31,416 was in South Carolina for 1984 and \$31,399 for 1985. The same minute presence in South Carolina of the safe harbor activity is demonstrated by the rental receipts from South Carolina. In 1984 there was only \$4,887 of rental income in South Carolina; in 1985 there was only \$4,801.

These findings demonstrate the safe harbor lease activity in South Carolina was minimal. To allow such minimal activity to greatly reduce Kodak's income from its other activities would exceed the bounds of the "reasonable base" re-

quired by Section 12-7-250. The extent of the reduction is shown by a comparison of the tax liability when the safe harbor lease transactions are included in Kodak's income with the tax liability when the safe harbor activities are not included.

Without the safe harbor losses, Kodak's income tax liability for 1984 is \$1,867,000. However, if the losses are allowed, Kodak reduces its tax liability by 33%. Without the safe harbor lease losses, Kodak's South Carolina tax liability is \$654,000 for 1985. However, Kodak's use of the safe harbor loss reduces South Carolina's tax liability to only \$59,000 and represents a decrease in its tax liability of over 90%. Such a reduction of Kodak's income by the minimal lease activities is a gross distortion of the true business activities of Kodak in South Carolina. Such must be avoided in order to comply with Section 12-7-250's requirement that South Carolina tax a reasonable portion of Kodak's income. Kodak's method of including the safe harbor lease losses in apportionable income does not satisfy Section 12-7-250 and this Court holds Kodak's request for a refund of \$1.2 million is denied.

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2. The Requirements of Section 12-7-1120(3)

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The South Carolina Code identifies several classes of income that are taxed in a specified manner. One of these classes is income from the rental of tangible personal property. Under Section 12-7-1120(3), the following income is allocated:

Rents received from the lease or rental of . . . property, . . . where the property leased or rented was not used in or was not connected with the trade or business of the taxpayer during the income year, less all related expenses, shall be allocated to the state in which the property was located at the time the income was derived.

Under this statute, the income is allocated if: 1) the income (less related expenses) is rental income and 2) the rental property is not used in or connected with Kodak's business.

a. Rental Income Is Involved.

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The first requirement is established. The income in dispute is rental income from property since the 1984 and 1985 tax returns both show rental receipts from the safe harbor activities. It is further established that the rental income has related expenses of depreciation and interest and that these expenses are responsible for the losses from the safe harbor activities. The final requirement is that the rental property not be used in or connected with the business of Kodak.

b. The Property Is Not Used In Or
Connected With Kodak's Business.

The safe harbor property is neither used in nor connected with the business of Kodak. The test for determining when property is connected with a business is a "common sense" approach. M. Lowenstein Corp. v. South Carolina Tax Commission, 298 S.C. 93, 378 S.E.2d 272 (1989). Here, the annual reports of Kodak establish that the business of Kodak is the production of films, papers, chemicals, plastics, fibers, magnetic media, equipment for photographic and electronic imaging and the service of information management. No mention of safe harbor leases is found anywhere in the annual reports' description of Kodak's business. Such lack of mention is especially noteworthy when the alleged safe harbor assets represent over 16% of Kodak's assets.

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Kodak's business as discussed previously in this Order has virtually no involvement with the property covered by the safe harbor leases. It has no management responsibilities over the property and it has no maintenance duties. The property can be sold by the lessee without permission or notice to Kodak. In fact, the property here in dispute is not even owned by Kodak. The common sense test of Lowenstein, supra, requires that a party at least own the property it is trying to say is connected with its business. Fur-

ther, the property is not used by Kodak in its business but rather is always in use by the party who is the nominal lessee.

In addition, this court finds that it is unreasonable to believe the General Assembly intended to find a "connection" to a business where the connection is based on a fiction. Here the safe harbor leases are fictitious transactions created by federal law under the Economic Recovery Act of 1981. The legislative history to this Act as shown in the Senate Report to The Tax Equity and Fiscal Responsibility Act of 1982, which act substantially amended the safe harbor rules, stated:

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Under the [safe harbor] rules certain transactions involving tangible personal property are treated as leases for Federal income tax purposes regardless of their nontax economic substance . . . Under these rules, by entering into a nominal sale and safe-harbor leaseback, a person who has acquired and will use the property can, in effect, sell some of the tax benefits associated with the property to a corporation, while retaining all other economic benefits and burdens of ownership. 1982 U.S. Code Cong. & Admin. News, p. 894.

Commentators who have examined safe harbor leases have reached the same conclusion.

This transaction [safe harbor leases] need be a sale only for federal income tax purposes: no attribute of ownership need pass to the lessor under local law. Ownership status for the lessor and characterization of the transaction as a lease are thus fictitious . . . Warren and Aurbach, Transferability of Tax Incentives and the Fiction of Safe Harbor Leasing, 95 Harvard Law Review 1752, 1762-1763 (1982).

Judicially the same result has been reached:

. . . a review of both the legislative history and the various commentators on this subject leads this Court to the conclusion that the reference to the term "lease" is illusory. In re Chateaugay Corporation, 102 B.R. 335, 343 (1989).

Except for the safe harbor leasing rules, such a transaction would have been laughed out of a tax forum. Even the safe harbor leasing provisions recognize that such a lease is treated as such "solely" for federal income tax purpose. Portland General Electric Co. v. Department of Revenue, 11 Or. Tax 78 (1988).

Thus, this court is convinced that the safe harbor "leases" of Kodak are purely fictional and cannot provide a connection to the business of Kodak.

c. Allocation Is Required

The evidence shows allocation is required. The income in dispute is rental income and is from property not connected with the business of Kodak. The result of the court's determination is that the rental loss is allocated to the place where the property is located. The property un-

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der the safe harbor leases is located outside South Carolina except for a small amount. In the instant case, in 1984, \$4,887 of rental income is from safe harbor property located in South Carolina and \$4,801 in 1985. Even assuming that the cost of these rental properties of \$31,400 is fully written off as a deduction over the two tax years (i.e., \$15,700 deduction each year), the loss from safe harbor activity allocated to South Carolina would be \$10,813 in 1984 (\$15,700 - \$4,887 = \$10,813) and \$10,899 for 1985 (\$15,700 - \$4,801 = \$10,899). All other losses from the safe harbor properties are allocated away from South Carolina. Thus, under the allocation requirement of Section 12-7-1120(3) the court finds the refund of \$1.2 million must be denied.

3. The Requirements of Sections 12-7-250
And 12-7-1140 For Apportionment

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While this court has found that allocation is required under Section 12-7-1120(3), the court is also convinced that even if Section 12-7-1120(3) were not applicable and even if Section 12-7-250 were not violated, Kodak would still be unable to apply its losses against its apportionable income. Instead, the apportionable income from the safe harbor activity would need to be computed separately.

The South Carolina income tax is imposed upon that part of "the trade or business carried on within this state." See Section 12-7-250. A single taxpayer, however, may carry on more than one business. In such a case, it is necessary to determine whether the income to be taxed is the income from all of the businesses or whether one or more of the businesses is separate. See for example, Exxon Corp. v. South Carolina Tax Commission, supra. Exxon establishes that the income from several businesses operated by the same taxpayer is subject to South Carolina taxation only where the businesses are part of a combined unitary business.

The Court established a two part test for finding a combined unitary business as follows:

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... the proper answer to the question of whether or not a business is unitary in nature is given in terms of whether or not the business possesses the characteristics of unity of ownership, unity of management and unity of operation and whether or not the activities of the business in question contribute to or depend on the other activities of the business. Exxon at p. 96.

Kodak argued to this court that its losses from its safe harbor activities are unitary with its other business activities and thus should be combined with Kodak's income from other operations. Under such a view, the loss is used to reduce Kodak's income and thus reduce its tax liability.

The law is well settled that the apportionment formula is only proper for a multistate taxpayer when the businesses of that taxpayer are unitary.⁴ If the activity is a separate and distinct activity, then the apportionment formula may not be applied to the combined activities but rather the separate activity must be taxed, as the condition implies, separately. F. W. Woolworth Co. v. Taxation and Revenue Department of New Mexico, 458 U.S. 354, 372, 102 S.Ct. 3128 (1982).

Kodak argued there was a minimal common management sufficient to create a unitary relationship. This court finds Kodak is incorrect for at least two significant reasons.

First, the mere presence of common management is insufficient to create a unitary relationship. In Jaffe v. Department of Treasury, 431 N.W.2d 416 (1988), the Court was faced with a taxpayer operating two activities: an advertising business and a cattle operation. The taxpayer wanted to

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. . . "[F]ormulary apportionment . . . is constitutionally permissible only in the case of a unitary business." ASARCO, Inc. v. Idaho State Tax Commission, 458 U.S. 307, 320 n. 14, 102 S.Ct. 3103 (1982).

reduce his Michigan advertising income by the losses from the cattle operation on the basis that the two activities were unitary. In denying the taxpayer's position, the Court held the management was of no significance.

. . . there was substantial evidence on the record that Jaffe's advertising and cattle operations were not functionally integrated or interdependent, and did not share economies of scale. This was evidenced by their only common denominator being Jaffe's control and operation of both businesses. Jaffe, supra, at 431.

Here the only element of commonality is that Kodak had limited duties in the safe harbor leases and that such duties were carried out by some of the same officials of Kodak. Such a limited role was insufficient in Jaffe, supra, and is also insufficient for South Carolina.

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Second, the view that Kodak exercised mutual management over the safe harbor activities and over Kodak's business operations is not supported by the evidence. The activity that is under review is the rental activity. That rental activity imposes no management duties upon Kodak. The evidence established that the leases are a fiction. The only role Kodak had in the safe harbor activities was the nominal duties of administrative tasks such as accounting and financial matters. Such minor tasks do not rise to the level of management necessary to find a unitary relationship.

Kodak asserted that the safe harbor activities and Kodak's business operations were unitary since the tax benefits were used by the company as a whole. The mere fact that Kodak benefited from the tax savings does not make the safe harbor rental activity unitary with Kodak's other activities. What is required is a showing of an interdependence that has one activity dependent upon the other activity. This is the meaning of the second test of contribution/dependency used by our Supreme Court in Exxon v. South Carolina Tax Commission, 273 S.C. 594, 258 S.E.2d 93 (1979). If the requirement were to show only a "benefit" to another activity, then virtually every activity of a taxpayer would be unitary. The tests used by Kodak prove far too much and cannot stand in light of Exxon, supra.

Kodak is unable to show ownership of the rental property. Kodak is also unable to show management in that it does not manage any of the safe harbor properties since the "lessee" has total responsibility for management. Kodak is unable to show how its operations of the chemical and photographic businesses are coordinated with or dependent upon the safe harbor rental activities. In fact, it appears to this court that Kodak essentially asserted that since the tax benefits were helpful to the overall business, such should be enough to create a unitary relationship. Not

only does Exxon, supra, disagree with this view but such has been rejected by the United States Supreme Court.

In ASARCO Inc. v. Idaho State Tax Com'n., supra, the state sought to tax a certain class of income by arguing the income was part of the unitary business of the taxpayer. The state argued that a unitary business is shown where the assets generating the income:

. . . contribute to or relate to or are some way in furtherance of the taxpayer's own trade or business. . . ASARCO, supra, at 3114.

The Court rejected this definition of "unitary" by stating the following:

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This definition of unitary business would destroy the concept. The business of a corporation requires that it earn money to continue operations and to provide a return on its invested capital. Consequently all of its operations, including any investment made, in some sense can be said to be "for purposes related to or contributing to the [corporation's] business." When pressed to its logical limit, this conception of the "unitary business" limitation becomes no limitation at all. When less ambitious interpretations are employed, the result is simply arbitrary. (ASARCO, Ibid.)

Under ASARCO, the mere showing that the tax benefits would "add to the riches" of Kodak is insufficient to create a unitary relationship. Kodak has failed to show that there is any real dependency between the safe harbor activities and

Kodak's business other than "add[ing] to the riches" of Kodak. The Dependency Test of Exxon, supra, is not satisfied, no unitary relationship is established, and thus the safe harbor rental losses are computed as a separate activity unavailable for offsetting Kodak's apportionable income.

B. Constitutional Interpretations

Kodak raised three constitutional challenges. Two challenges were to the Tax Commission's view that the safe harbor rental losses are allocated to the state where the rental property is located. Kodak asserted that such a view discriminates against Interstate Commerce in violation of the United States Constitution and violates the Equal Protection Clause as not having any rational basis to support the classification. Kodak also argued that Due Process was violated by not including the safe harbor losses in apportionable income. The court holds Kodak is mistaken in its constitutional views.

1. Interstate Commerce

Kodak asks this Court to declare the allocation section of Section 12-7-1120 in violation of the Interstate Commerce Clause on the ground that the statute on its face discriminates against interstate commerce. Kodak asserted the discrimination occurs since the statute gives "preferential taxation . . . to taxpayers who lease assets . . . located

within South Carolina" since the loss is available only when the asset is in South Carolina. (Kodak's brief, pp. 24-25)

Kodak has misconstrued the context of the statute. The statute is not a device for denying a deduction. Rather it is a means for determining where rental income is earned. The state has chosen to base its decision of where that income is earned by looking to the location of the asset that produced the rental income. The United States Supreme Court has explained that a statute like Section 12-7-1120(3) does not violate the Commerce Clause as long as the statute is "internally consistent."

In Armco Inc. v. Hardesty, 104 S.Ct. 2620 (1984), the Court struck down a West Virginia tax statute as discriminatory against interstate commerce over the state's view that there had to be a clear showing of actual discrimination. The Court said the following:

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... This [the state's test of actual discrimination] is not the test. In Container Corp. of America v. Franchise Tax Board, 463 U.S. 159, 169, 103 S.Ct. 2933, 2942, 77 L.Ed.2d 545 (1983), the Court noted that a tax must have "what might be called internal consistency--that is the [tax] must be such that, if applied by every jurisdiction," there would be no impermissible interference with free trade. . . . A similar rule applies where the allegation is that a tax on its face discriminates against interstate commerce. A tax that unfairly apportions income from other States is a form of discrimination against interstate commerce. . .

Section 12-7-1120(3) is internally consistent since if every state adopted the same statute there would be no more than all of the income taxed, i.e., there would not be any double taxation. Container Corp., supra, 103 S.Ct. 2933 at 2942. Here, Section 12-7-1120(3) does not allow for double taxation since the tax is due only in the state where the physical rental property is located. Intangible property can be located in only one state, there is no possibility that the same rental income could be taxed twice. Thus, there is no discrimination against Interstate Commerce.

2. Equal Protection

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Kodak also charged that the allocation statute is unconstitutional as a violation of the Equal Protection Clause on the ground there is no rational basis for the classification of taxing rental property based on where the property is located. The court finds Kodak is incorrect since the taxing of income at the place where the income is earned is a very rational basis for classification.

The law in our State concerning discrimination as to equal protection in a tax statute was stated in State v. Byrnes, 219 S.C. 485, 66 S.E.2d 33 (1951).

To invalidate a tax statute for discrimination, in the absence of specific constitutional inhibition, exemption from

its terms must be purely arbitrary, . . .
It was said in Marshall v. Tax Comm.,
supra, (178 S.C. at page 62, 182 S.E. at
page 98) upon the authority of numerous
cited decisions of the U.S. Supreme
Court: "The plaintiff must be able to
satisfy the court that the classifica-
tion (of income for State taxation) has
its origin in nothing better than whim
and fantasy and tyrannical exercise of
arbitrary power, before the tax in ques-
tion will be stricken down." . . .

Here the rational basis is that it is always proper to tax
income based on where that income is earned since a state
cannot tax income earned outside its borders. Lowenstein,
supra at p. 276. If the income is earned by the rental of
property located in another state, then it is proper to have
that income taxed in that state and obviously income earned
by property located in South Carolina is taxable here. Such
a rational basis is a valid reason for the classification
based on the location of the property. In fact,

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... it has long been settled that a
classification, though discriminatory,
is not arbitrary nor violative of the
Equal Protection Clause . . . if any
state of facts reasonably can be con-
ceived that would sustain it . . . Al-
lied Stores of Ohio, Inc. v. Bowers, 358
U.S. 522, 528, 79 S.Ct. 437 (1959).

Based on the above, there is no violation of the Equal Pro-
tection Clause by Section 12-7-1120(3).

3. Due Process

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The court finds there is no Due Process violation by not including Kodak's safe harbor losses with Kodak's apportionable income. The Due Process Clause allows taxing multistate income under a three-factor formula method where the income is unitary income. Mobil Oil Corp. v. Com. of Taxes of Vermont, 445 U.S. 425 (1980). Here the income of the safe harbor activities is multistate income and is thus subject to fair apportionment on the income of that activity. Likewise, the separate income from Kodak's other multistate activities are subject to fair apportionment. The court merely concludes that the safe harbor activities are not unitary with Kodak's other activities so that the two activities may not be combined. Under this view, fair apportionment is not violated since each activity is still apportioned based on the extent of the payroll, property, and sales which are incurred in South Carolina as compared to those incurred everywhere. The use of such an apportionment formula has been commonly upheld as a fair method of apportionment within the meaning of the Due Process Clause. See Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159 (1983); Mobil Oil, supra. Because of such, this court finds no violation of Due Process by not combining the safe harbor lease losses with Kodak's apportionable income from its other activities.

III. No Refund Results From The Alternative
Position That Depreciation Deductions Are
Allowed On The Safe Harbor Assets.

The Amended Complaint asserts in the alternative that the taxpayer is entitled to a refund of \$1,090,624 due to depreciation deductions on the safe harbor property involved in this action. There is no basis for granting such a refund.

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The deductions for depreciation are related expenses to the rental income from the safe harbor transactions. As such, the depreciation deductions form part of the rental losses allocated to the state where the rental property is located. Since the rental property is located outside of South Carolina, the depreciation deductions are likewise outside of South Carolina and thus are not deductions against South Carolina income.

Further, as explained previously in this Order, to allow the depreciation deductions would violate the reasonableness test of Section 12-7-250. Finally, and as also explained previously in this Order, the depreciation deductions are not deductible against South Carolina taxable income since the safe harbor leasing activity is not part of Kodak's unitary business. Because of such, the depreciation deductions would only be deductible against the safe harbor activities which essentially are all outside of South Carolina. Accordingly, Kodak's alternative position for a refund of \$1,090,624 is denied.

CONCLUSION

Based on the foregoing, this Court holds Kodak is denied the recovery of the taxes paid of \$1,202,639 and is denied a refund of \$1,090,624 on its alternative position.

AND IT IS SO ORDERED.

James E. Lockemy
JAMES E. LOCKEMY, JUDGE
Fourth Judicial Circuit

December 12, 1990

EXHIBIT C

**STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT**

Duke Energy Corporation,	)	
	)	Docket No. 10-ALJ-17-0270-CC
Petitioner,	)	
	)	
vs.	)	AMENDED ORDER GRANTING
	)	SUMMARY JUDGMENT IN PART AND
South Carolina Department of Revenue,	)	DENYING SUMMARY JUDGMENT
	)	IN PART
Respondent.	)	
	)	

Appearances:

For the Petitioners: Burnet R. Maybank, III, Esq.; Eric S. Tresh, Esq.; Jeffrey A. Friedman, Esq.; and Maria M. Todorova, Esq.

For the Respondent: Tracey C. Green, Esq.; John W. Roberts, Esq.; Harry Hancock, Esq.; and J. Abraham Gutting, Esq.

This matter is before the Administrative Law Court (ALC or Court) upon a Motion for Summary Judgment filed by Respondent Department of Revenue (Department) and a Cross-motion for Partial Summary Judgment filed by Petitioner Duke Energy Corporation (Duke Energy). The underlying case arises from the Department's denial of amended corporate income tax returns filed by Duke Energy in 2002 for income tax years 1978-2001.¹ In its Motion for Summary Judgment, the Department contends that prior to the effective date of the Revenue Procedures Act (RPA), August 1, 1995, it lacked authority to extend the limitation period during which a taxpayer could file a refund claim and therefore, as a matter of law, the Forms FS-43 executed by Duke Energy and the Department prior to that time were ineffective in extending the refund-claim filing periods, rendering Duke Energy's filing of amended corporate income tax returns for tax years ending 1978-1993 untimely.² The Department also contends that Duke Energy, as a matter of law, is a "manufacturer" under the applicable apportionment statute and must therefore use a multi-factor apportionment formula, consisting of property, sales, and

¹ These are the tax periods at issue in this case.

² Both parties stipulate that Duke Energy's amended return for tax year 1994 was timely filed.

FILED

October 11, 2012

SC ADMIN. LAW COURT

payroll factors, not a single-factor gross-receipts formula.³ The Department further contends that as a matter of law, Duke Energy cannot, in its calculation of corporate income tax owed to South Carolina, include in the apportionment formula the return of principal from its sales of securities and other investment transactions. Finally, Duke Energy, in its Cross-Motion for Summary Judgment, argues that it was required to include in the apportionment formula the return of principal from its sales of securities and other investment transactions.

A hearing regarding these motions was held before this Court on June 26, 2012, in Columbia, South Carolina. On August 9, 2012, the Court issued an Order in which it granted the Department's Motion for Summary Judgment as to the timeliness of Duke Energy's amended refund claims for tax years ending 1978-1993; denied the Department's Motion for Summary Judgment as to whether Duke Energy is considered a "manufacturer" under the applicable apportionment statute; and granted the Department's Motion for Summary Judgment as to Duke Energy's inclusion of the return of principal in its apportionment formula and denied Duke Energy's Cross-Motion for Partial Summary Judgment on this issue. On August 20, 2012, Duke Energy filed a Motion for Reconsideration of the Court's Order Granting the South Carolina Department of Revenue's Motion for Summary Judgment as to the Waiver and Gross Receipts Issues. The Department filed its Memorandum in Opposition to Duke Energy's Motion for Reconsideration on September 14, 2012. After careful consideration of the arguments made by both parties, the Court has amended its August 9, 2012 Order accordingly below.⁴

FACTUAL BACKGROUND

The Department began auditing Duke Energy's corporate income taxes for income tax year ending 1978. That audit was extended a number of times, over a period of years due to the

³ Between the tax years ending 1978-1993, taxpayers whose principal business in South Carolina was "(a) manufacturing or a 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," were required to apportion their income based on a multi-factor apportionment formula, consisting of property, sales, and payroll factors. S.C. Code Ann. § 12-6-2250 (applicable to tax years after 1995); S.C. Code Ann. § 12-7-1120 (applicable to tax years prior to 1996). In this case, no party argued that Duke Energy engaged in collecting, buying, assembling, or processing of goods and materials within South Carolina, or that Duke Energy engaged in selling, distributing, or dealing in tangible personal property within South Carolina. Therefore, the Court will only focus its discussion on whether Duke Energy was a manufacturer for purposes of Section 12-6-2250.

⁴ The Court notes that Duke Energy filed an appeal of the Court's original decision granting partial summary judgment "out of an abundance of caution." Following Duke Energy's filing of a Motion to Reconsider, this Court issued an Order staying its decision granting partial summary judgment. Therefore, there was no effective decision regarding the issues addressed in the parties' cross motions for Summary Judgment until the issuance of this decision.

pending results of an audit of Duke Energy by the Internal Revenue Service (IRS), and also due to the health issues experienced by the Department's auditor and changes in the Department's personnel. These extensions were approved by Forms FS-43, each entitled "Field Services Division – Consent to Extend the Time to Assess Tax." The first Form FS-43, executed in August 1988, pertained to the income tax years ending December 31, 1983 and 1984. Significantly, the income tax years ending December 31, 1978 through December 31, 1982 were incorporated into the executed Forms FS-43 in May 1996. Additional Forms FS-43 periodically were executed and additional income tax years added until the execution of the final Form FS-43 in June 2002.

In December 2002, Duke Energy filed amended corporate tax returns for the income tax years 1978-2001 seeking a total refund of \$126,240,645 plus interest.⁵ Duke Energy sought to change the apportionment formula – the mechanism for determining how much income is associated with Duke Energy's South Carolina's business activities – to the single-factor gross-receipts apportionment formula instead of the three-factor formula that it had previously used. It also sought to include the gross receipts, including the return of principal, from its sales of securities and other capital investments in the denominator of the gross-receipts formula for tax years 1978-1999.⁶ However, on February 4, 2010, the Department denied Duke Energy's refund claims, after which Duke Energy filed a request for a contested case hearing with this Court on March 3, 2010.

STANDARD OF REVIEW

Rule 68 of the Administrative Law Court Rules provides that "[t]he South Carolina Rules of Civil Procedure . . . may, in the discretion of the presiding administrative law judge, be applied in proceedings before the Court to resolve questions not addressed by these rules." ALC Rule 68. Rule 56(c) of the South Carolina Rules of Civil Procedure states that summary judgment is properly granted when the "pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to

⁵ This is the amount set forth by the Department. However, Duke Energy stated in its Memorandum in Opposition to the Department's Motion for Summary Judgment and in Support of Duke Energy's Cross-Motion for Partial Summary Judgment that the Department's refund calculations in its Memorandum were incorrect, and that damages would need to be resolved should the Court find in the Department's favor on any issue.

⁶ For 2000 and 2001, Duke Energy's original tax returns included receipts from sales of securities in the sales factor in the denominator of the three-factor formula.

any material fact and that any party is entitled to a judgment as a matter of law.” Rule 56(c), SCRCF.

“The purpose of summary judgment is to expedite disposition of cases which do not require the services of a fact finder.” George v. Fabri, 345 S.C. 440, 452, 548 S.E.2d 868, 874 (2001). “In determining whether summary judgment is proper, the court must construe all ambiguities, conclusions, and inferences arising from the evidence against the moving party. Byers v. Westinghouse Elec. Corp., 310 S.C. 5, 7, 425 S.E.2d 23, 24 (1992). Because it is a drastic remedy, summary judgment should be cautiously invoked to ensure that a litigant is not improperly deprived of a trial on disputed factual issues. Helena Chem. Co. v. Allianz Underwriters Ins. Co., 357 S.C. 631, 644, 594 S.E.2d 455, 462 (2004). However, “when plain, palpable, and indisputable facts exist on which reasonable minds cannot differ, summary judgment should be granted.” Bayle v. S.C. Dep’t of Transp., 344 S.C. 115, 120, 542 S.E.2d 736, 738 (Ct. App. 2001).

S.C. Code Ann. § 1-23-600(A) (Supp. 2010) grants jurisdiction to the ALC to hear contested cases under the Administrative Procedures Act. Additionally, Section 12-60-460 grants the ALC the authority to conduct contested case hearings in matters concerning tax assessment and refunds.

DISCUSSION

I. Timeliness of Duke Energy’s Amended Income Tax Return Filings

The Department asserts that Duke Energy did not timely file its request for tax refunds for tax years ending 1978-1993 and therefore this case should be summarily dismissed. Undisputedly, in every instance Duke Energy’s amended tax returns for tax years ending 1978-1993 do not meet the statutory deadline to file its amended tax returns. Duke Energy nevertheless argues that its amended tax returns for the disputed tax years were timely filed because the Forms FS-43 extended the statutory deadlines for filing claims for tax refunds and waived any refund limitation periods. In this case, there is no dispute that both parties executed a number of Forms FS-43 periodically between the years 1988 and 2002. The parties also stipulated in their respective memoranda regarding the motions for summary judgment and in the

hearing held before this Court on June 26, 2012 that the Form FS-43 executed on December 19, 1997 for the tax year ending 1994 effectively extended the period for filing a refund claim.⁷

Duke Energy argues that the execution of the Forms FS-43 covering the income tax years ending 1978-1993 extended the deadlines for filing claims for tax refunds and waived any refund limitation periods. Duke Energy also argues that because the Department could order a refund if it discovered that a taxpayer had overpaid a tax, a penalty, or interest, even after a refund limitation period, this allows Duke Energy to file a claim for a refund after the limitation period. The analysis of Duke Energy's arguments is addressed in three parts: A) Did S.C. Code Ann. § 12-54-80 grant authority to the Department to extend the time to file an amended tax return; B) did S.C. Code Ann. § 12-54-30 authorize Duke Energy to file an amended tax return requesting a refund beyond the statutorily-prescribed timeframe; and C) did the language in the Form FS-43 executed by the Department extend the time for Duke Energy to file an amended tax return?

A. Statutory Authority to Extend the Time to File an Amended Tax Return

Duke Energy contends that Section 12-54-80 authorizes a taxpayer to request a refund once an extension is granted pursuant to that provision. Section 12-54-80, which applied to the tax periods prior to August 1, 1995 (the enactment date of the Revenue Procedures Act (RPA)), provided:

If, before the expiration of the time prescribed in this section for the mailing of a notice of assessment, the taxpayer has consented in writing to the mailing of the notice after the time, **notice of assessment may be mailed** at any time prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

S.C. Code Ann. § 12-54-80 (1978) (repealed in 1995) (emphasis added).

In general, when interpreting a statute, the sole function of the Court is to determine and give effect to the intent of the legislature. Hodges v. Rainey, 341 S.C 79, 85, 533 S.E.2d 578, 581 (2000). The starting point in doing so should always be the text of the statute itself. Id. (holding that "[w]hat a legislature says in the text of a statute is considered the best evidence of

⁷ Pursuant to S.C. Code Ann. § 12-47-440 (****), which applied to the tax years ending 1990-1994, the period for filing a refund claim was three years. Moreover, S.C. Code Ann. § 12-6-4970(B), which was also applicable during these years, allowed a three-year time period for filing a refund claim for the tax year ending 1994 which would have begun on March 15, 1995. Therefore, because the filing of the Form FS-43 for the year 1994 was executed on December 19, 1997- after the enactment of the RPA and, and thus before March 15, 1998 - the period for filing a refund claim was still open. Consequently, the extension of the deadline was effective.

the legislative intent or will"); Wigfall v. Tideland Utils., Inc., 354 S.C. 100, 110, 580 S.E.2d 100, 105 (2003). In interpreting the text, the plain meaning rule requires that "words must be given their plain and ordinary meaning without resort to subtle or forced construction to limit or expand that statute's operation." State v. Leopard, 349 S.C. 467, 471, 563 S.E.2d 342, 344 (Ct. App. 2002). Finally, "[w]here the statute's language is plain and unambiguous, and conveys a clear and definite meaning, the rules of statutory interpretation are not needed and the court has no right to impose another meaning." Hodges, 341 S.C. at 85, 533 S.E.2d at 581.

Moreover, in considering this issue, this Court is further bound by the rules of statutory construction relating to tax law. For instance "[a] refund of taxes is solely a matter of governmental grace, . . . and any person seeking such relief must bring himself clearly within the terms of the statute authorizing the same. . . ." Asmer v. Livingston, 225 S.C. 341, 344, 82 S.E.2d 465, 466 (1954) (internal citations omitted); Guar. Bank & Trust Co. v. S. Carolina Tax Comm'n, 254 S.C. 82, 173 S.E.2d 367 (1970) ("A refund of taxes is solely a matter of governmental or legislative grace and any person seeking such relief must bring himself clearly within the terms of the statute authorizing the same."). The Court's analysis in Guaranty Bank, also offers guidance in this case. In Guaranty Bank, the taxpayer claimed it was entitled to recover income tax paid on gain from an involuntary conversion of property. However, the law at the time prescribed a specific timeframe in which the proceeds from the converted property must be reinvested. In construing whether the taxpayer's claim was timely the Court held that the "statutory language creating exemption from taxation will not be strained or liberally construed in favor of the taxpayer claiming an exemption, and he must, in order to be entitled to such exemption, clearly bring himself within the exemption on which he relies." 254 S.C. at 89, 173 S.E.2d at 370.⁸ Furthermore, in making that determination, the Court recognized its previous holding that "a taxpayer who seeks to take advantage of a tax deduction must meet the conditions of the statute creating such." Id.

Here, the plain language of Section 12-54-80 does not establish any authority to extend a taxpayer's right to seek a refund but rather allowed the Department, with the taxpayer's consent, to extend the time for it to mail its assessment of the tax owed by the taxpayer. Clearly, when

⁸ The court in Guaranty Bank, likewise held that "in order for a taxpayer to avail himself of a deduction in the calculation of a tax, he must bring himself squarely within the terms of the statute expressly authorizing it." 254 S.C. at 89-90, 173 S.E.2d at 370.

speaking of mailing an assessment, the statute is speaking to an action by the Department. Thus, the plain language of the form extends the timeframe for the Department to mail an assessment to the taxpayer.

Moreover, Section 12-54-80 does not use the word “refund” anywhere within that provision. As explained below, the legislature set forth specific provisions expressing the timeframe to seek a refund for tax years ending 1978-1993. In Spectre, LLC v. S.C. Dep’t of Health & Envtl. Control, 386 S.C. 357, 372, 688 S.E.2d 844, 852 (2010), the South Carolina Supreme Court held that: “Where there is one statute addressing an issue in general terms and another statute dealing with the identical issue in a more specific and definite manner, the more specific statute will be considered an exception to, or a qualifier of, the general statute and given such effect.” Here, it is incredulous that the legislature intended to grant an exception to the timeframe to seek a refund without even mentioning the term.

The Court nevertheless recognizes that the application of Section 12-54-80 could result in a refund of taxes paid by the taxpayer, but clearly such a refund would occur within the context of fulfilling the purpose of the statute. The purpose of Section 12-54-80 is to provide an option for the Department to extend the time during which the “notice of assessment may be mailed.” If, after the extension of time to make its determination, the Department decided that a taxpayer owed additional taxes, it would notify the taxpayer of that assessment and seek payment based upon that assessment. Conversely, if the Department’s assessment of the taxes owed was less than the taxes proffered by the taxpayer, the taxpayer would be refunded the difference.⁹ However, there is simply no language in Section 12-54-80 that provides that if the Department requests to extend its time to mail a notice of assessment—or determination of the taxes owed—this request, in turn, creates a right for a taxpayer to amend its previous filing and seek a refund upon its revised request.

This Court cannot simply by implication extend the time to file a refund request. Duke Energy must establish a statutory right to make that claim. To the contrary, Duke Energy failed to meet the required timeframes to request a refund for tax years 1978 to 1993. The timeframes for making those refund requests fell into two distinct regulatory periods: 1) 1978 to 1989; and 2) 1990 to 1993.

⁹ As addressed more fully below, S.C. Code Ann. § 12-54-30 (****) granted the Department the authority to issue a refund under those circumstances.

1. *Income Tax Years Ending 1978-1989*

The South Carolina Supreme Court set forth in Bass v. State that Section 12-47-440 only applied to property taxes and that "the exclusive remedy for contesting an alleged erroneous assessment of *income taxes* [is] by payment under protest of the tax claimed as illegal and a suit at law for recovery of the sum so paid, in accordance with Sections 65-2661 and 65-2662 of the Code. [predecessors of §§ 12-47-210 and 12-47-220]." 307 S.C. 113, 117, 414 S.E.2d 110, 112 (1992), (internal quotation marks omitted) (emphasis in the original), cert. granted, judgment vacated on other grounds by Bass v. South Carolina, 509 U.S. 916 and abrogated by Harper v. Virginia Dep't of Taxation, 509 U.S. 86 (1993); see also Perpetual Bldg. & Loan Ass'n of Columbia v. S.C. Tax Comm'n, 255 S.C. 523, 527, 180 S.E.2d 195, 197 (1971). Thus, the timeliness of Duke Energy's refund claims for the years 1978-1989 is governed by S.C. Code Ann. §§ 12-47-210 and 12-47-220 (****).¹⁰

Sections 12-47-210 and 12-47-220 required a taxpayer who sought to receive a refund of amounts paid to the state to expressly pay the taxes under protest and then institute an action in circuit court within 30 days after payment of the taxes. See S.C. Nat. Bank v. S.C. Tax Comm'n, 297 S.C. 279, 282, 376 S.E.2d 512, 514 (1989). Failure to pay the taxes under protest was fatal to a refund claim. See, e.g., City of Columbia v. Glens Falls Ins. Co., 245 S.C. 119, 139 S.E.2d 529 (1964). Here, there is no evidence that any of the payments for these years were made under protest. And even if the payments were made under protest, no action was filed in circuit court within 30 days after the payment was made. Rather, the refund claims were filed in the ALC well after the 30-day period expired.¹¹ Therefore, none of the refund claims filed for Duke

¹⁰ (****) is used in this order in lieu of statutory years because this case involves numerous tax years, and therefore the years of the applicable statutes are equally numerous and varying, and the law applicable during many years was unchanged. The statutory law can be divided into two yearly ranges: 1978-1995 and 1996-2001, as the law regarding this issue did not change during the first range, and then did not change during the second range after the RPA changes in 1995.

¹¹ There is also an additional reason for concluding the purported extensions of the corporate income tax years 1978-1982 are untimely. These years appeared for the first time on the face of the executed Form FS-43 effective May 30, 1996. Obviously, under either the modern era provisions or the pre-1995 provisions, these extensions were executed well after the refund periods had closed. See S.C. Code Ann. § 12-54-85 (three years from date return filed or two years after date of payment); S.C. Code Ann. §§ 12-47-210, -220 (pay under protest and file claim for refund within 30 days). The only available avenue for reviewing the taxable income of the years 1978-1982 therefore would have been the statutory provisions regarding an assessment based on a determination issued by the IRS. See S.C. Code Ann. § 12-54-85(D)(1); cf. S.C. Code Ann. § 12-54-80 (prior law). However, Duke Energy did not establish that the IRS issued a final determination within 180 days of May 30, 1996. Moreover, any extension attributable to an IRS determination in that circumstance would have been limited to the tax issues raised by the IRS. Because the allocation and apportionment issues raised by the taxpayers could not have been at issue in an IRS

Energy's 1978-1989 tax years were timely. I thus conclude that the refund claims for the tax years 1978-1989 also are barred from consideration by this Court.

2. Income Tax Years Ending 1990-1994

As explained above, in 1992 the South Carolina Supreme Court in Bass held that Section 12-47-440 only applied to property taxes and that the exclusive remedy for obtaining a refund of income taxes was Sections 12-47-210 and 12-47-220 (****). Id. However, the General Assembly thereafter amended Section 12-47-440 to expressly apply to income tax refund claims, but only for tax years beginning in 1990 and later. See Act No. 464, 1994 S.C. Acts, Section 3(B).

Section 12-47-440 provides for a three-year period of limitation in which to file a refund claim. Therefore, for the 1990-1994 tax years, Duke Energy was required to file its claims for refund within three years after its corporate income tax return was originally due. It is undisputed that Duke Energy filed its corporate income tax returns based on a calendar year. Thus, the returns and payment originally were due without regard to any extension on March 15th of the following year. S.C. Code Ann. §§ 12-6-4970(B) (effective for tax years beginning after 1995); 12-7-1640 (effective for tax years prior to 1996). The refund periods applicable to Duke Energy under Section 12-47-440 for the income tax years 1990-1994 were therefore as follows:

Income Tax Years	Return Originally Due	Close of Refund Period
1990	March 15, 1991	March 15, 1994
1991	March 15, 1992	March 15, 1995
1992	March 15, 1993	March 15, 1996
1993	March 15, 1994	March 15, 1997
1994	March 15, 1995	March 15, 1998

B. Section 12-54-30

In its Post-Trial Brief, Duke Energy nevertheless argues that during the tax years at issue S.C. Code Ann. § 12-54-30 (****) provided a different "mechanism" by which it could file an amended tax return requesting a refund. Section 12-54-30 provided in relevant part that: "If the commission discovers on examination of a return or otherwise that the tax, penalty, or interest paid by any person is in excess of the amount legally due, the commission may order a refund or give credit for the overpayment." The plain language of Section 12-54-30 permitted the

determination, the purported extensions of the 1978-1982 tax years are untimely for purposes of the issues before this Court.

Department to refund amounts discovered on examination of a return. See Anders v. S.C. Parole & Cmty. Corr. Bd., 279 S.C. 206, 305 S.E.2d 229 (1983) (“[T]he Court’s primary function in interpreting a statute is to ascertain the intention of the legislature, and when the terms of the statute are clear and unambiguous, the Court must apply them according to the literal meaning.”). Section 12-54-30 does not reference whatsoever the timeframe for a taxpayer to file a request for a refund. To the contrary, as set forth above, there were specific statutes that articulated the timeframe in which a taxpayer could file for a refund for tax years 1978 to 1993. As aforementioned, the statute which deals with an issue in a more specific and definite manner prevails over a statute which addresses the issue in general terms, Spectre, 688 S.E.2d 844. Furthermore, “[w]hen construing statutory language, the statute must be read as a whole, and sections which are part of the same general statutory law must be construed together and each one given effect.” Duvall v. S.C. Budget and Control Bd., 377 S.C. 36, 42, 659 S.E.2d 125, 127 (2008).

Thus, Section 12-54-30 allowed the Department to grant relief to a taxpayer if it discovered an overpayment on examination of a return or otherwise, even if a claim for refund would be untimely. It did not, however, change the fact that the taxpayer had to strictly comply with the provisions of the refund statutes if it wanted to file a claim for refund that would be subject to judicial review. See Hodges v. Rainey, 341 S.C. 79, 533 S.E.2d 578 (2000) (“The canon of construction ‘*expressio unius est exclusio alterius*’ or ‘*inclusio unius est exclusio alterius*’ holds that ‘to express or include one thing implies the exclusion of another, or of the alternative.’”). The logic of this interpretation of Section 12-54-30 was reflected in Argent Lumber Co. v. Query, 178 S.C. 1, 182 S.E. 93 (1935), overruled on other grounds by McCall by Andrews v. Batson, 285 S.C. 243, 329 S.E.2d 741 (1985). The Court in Argent Lumber held that under a statute similar to the one in the present case, the taxpayer had no right to judicial review of the Tax Commission’s refusal to grant the taxpayer a refund notwithstanding the Commission’s discovery of overpaid taxes and the Commission’s authority to grant refunds at the time of the tax periods at issue. The reason for this, aside from a lack of statutory authority at the time to compel the Commission to issue a refund of overpaid taxes, was that the taxpayer had failed to comply with the refund statute but instead waited more than ten years after the overpayment and almost four years after the amount of the claim was ascertained to bring suit. Id. at 94-95.

C. Form FS-43

In light of the statutory timeframes for filing an amended return requesting a refund, Duke Energy's case centers upon the implications of the Department's Form FS-43. Duke Energy contends that the Forms FS-43 executed in this case allowed it additional time to file a claim for a refund, an extension that would run for more than twenty years in some cases. At the outset, I do not find that the Forms FS-43 authorized a party to seek a refund after the statutory time for filing such a request.

The language contained in the Form FS-43 prior to August 1, 1995 was as follows:

This agreement extends the time **for mailing** the notice of assessment or refund of the above tax **pursuant to the provisions of Section 12-54-80** of the 1976 South Carolina Code of Laws, as amended.

(Emphasis added).

Clearly, when referencing the mailing of the notice of an assessment or refund, Form FS-43 is speaking to an action by the Department. Thus, the plain language of the form extends the timeframe for the Department to mail the notice of a refund or assessment to the taxpayer in keeping with Section 12-54-80. That purpose is reflected by the title of the Form FS-43: "Consent to Extend the Time to Assess Tax." The purpose also logically flows from the operation of the tax laws. Because a notice of assessment is issued and mailed by the Department, it necessarily follows that Form FS-43 applies only to extend the time in which the Department may issue and mail a notice of assessment or refund that it determines is due. Thus, the refund language in Form FS 43 refers **not** to allowing a taxpayer additional time in which to file a claim for a refund—which, as explained above, the statutory provisions did not permit—but to affording the Department additional time to review the taxpayer's records and issue a notice of assessment or refund, as it determines appropriate based on a review of the taxpayer's records.

Furthermore, Form FS-43 does not **infer** that a taxpayer has a right to amend its previous tax filing and seek a refund upon alternative grounds. Duke Energy's proposition is not supported by a specific statutory grant of the authority to extend the timeframe to file an amended request for a refund. Rather, Duke Energy reasons that the use of the term "refund" in the Form FS-43 language infers the grant of an extension to file its request for a refund. However, Form FS-43 reflects its limited purpose by referencing the time an assessment or refund is allowed "pursuant to the provisions of Section 12-54-80." As explained above, Section

extend the period for filing of refund claims, an extension of power which the General Assembly had theretofore limited to the deadline for mailing notices of assessment.

Moreover, “[a]n administrative agency has only the powers conferred on it by law and must act within the authority created for that purpose.” SGM-Moonglo, Inc. v. S.C. Dep’t of Revenue, 378 S.C. 293, 295, 662 S.E.2d 487, 488 (Ct. App. 2008). In fact, “[a]ny action taken by [the Department] outside of its statutory and regulatory authority is null and void.” Triska v. Dep’t of Health & Envtl. Control, 292 S.C. 190, 194, 355 S.E.2d 531, 533 (1987). Thus, even if Form FS-43 inferred that a taxpayer has a right to extend the timeframe to request for refund, the Department cannot exceed its statutory authority based upon that form.

In its Memorandum of Law in opposition to the Department’s Motion for Summary Judgment, Duke Energy further argues that because Form FS-43 does not reference Section 12-54-30, that statute does not apply to the Department’s determination in this matter. Putting aside the application of Section 12-54-30 in this case, the fallacy of Duke Energy’s assertion is referred to as “the fallacy of denying the antecedent” and is illustrated in a hypothetical syllogism as:

If A, then B.

Not A.

Therefore, not B.

Ruggiero J. Aldisert, Logic for Lawyers: A Guide to Clear Legal Thinking 160 (National Institute for Trial Advocacy 3d ed. 1997); see also Irving M. Copi, Introduction to Logic 295 (5th ed. 1978).

Stated in terms of syllogism, Duke Energy’s arguments proceed as follows:

If Form FS-43 had referenced Section 12-54-30, then that section would be applicable to determining the timeframe for a refund pursuant to Form FS-43.

Form FS-43 did not reference Section 12-54-30.

Therefore, Section 12-54-30 is not applicable to determining the timeframe for a refund pursuant to Form FS-43.

Other courts have also found this reasoning to be faulty. For instance, in Crouse-Hinds Co. v. InterNorth, Inc., 634 F.2d 690, 703 (2d Cir. 1980), the court held that:

The proposition that “A implies B” is not the equivalent of “non-A implies non-B,” and neither proposition follows logically from the other. The process of inferring one from the other is known as “the fallacy of denying the antecedent.”

634 F.2d at 703 (cited in Logic for Lawyers).

Moreover, logic dictates a conclusion contrary to Duke Energy's assertion. The failure to reference a provision that governs when the Department may issue a refund upon its own initiative does not suggest it is inapplicable. Nevertheless, the failure to reference any statute (including Section 12-54-30) that addresses the authority of the Department to issue refunds profoundly suggests that Form FS-43 was not addressing a taxpayer's authority to amend its tax returns and seek a refund, or the Department's authority to extend the timeframe within which a refund claim could be filed. If Form FS-43 was granting the authority to extend the time to make refund claims, it would not only reference the statute upon which that authority was granted, but would presumably do so with clarity rather than making the reference: "mailing of notice of assessment or refund." To the contrary, Form FS-43 was based upon Section 12-54-80, which governs the time period in which the Department could assess taxes – a provision that says nothing about refunds or extensions of time to file refund claims.

Waiver of a Statute of Limitations

Duke Energy also contends that the Department "waived" the "statute of limitations" for filing a refund. Duke Energy bases its contention upon the language of Form FS-43; upon the alleged grant by Department employees of an extension of the time during which to file a request for a refund; and upon Duke Energy's belief that the Department's Revenue Procedures reflected that right. Duke Energy contends that "[f]or years, the Department advised taxpayers that it had in place a policy to execute waiver agreements extending the statute of limitations for both assessments and refunds."¹³

However, the phrase "statute of limitations" invokes specific case law that is not applicable to this matter. Obviously, this case does not involve a "cause of action" in which the Court must first determine when the statute of limitations begins to run. In other words, it does not involve parties who possess the discretion to control when a cause of action may properly accrue. Rather, this case involves a determination of when the State of South Carolina grants a right to seek a refund pursuant to the existing tax laws. In Dep't of Conservation v. Co-De Coal Co., 388 S.W.2d 614 (Ky. 1965), the court aptly explained the distinction between a statute of

¹³ In its post-hearing brief, Duke Energy alleges that the Department had respected the "waiver" agreements it had with Duke Energy for tax years 1978-1994 by agreeing, in 2002, to offset refunds of its South Carolina corporate income tax for tax years 1978-1994 against the corporate income, license, and sales taxes for those same years, resulting in a net refund owed to Duke Energy. However, this allegation was based on an affidavit referred to as the "Monroe Affidavit," designated as "Exhibit A," that was not submitted prior to, or during, the hearing. Therefore, this Court will not consider this information in rendering its decision.

limitations and a statutory timeframe for filing a request for refund from a state. The court noted: “whereas a statute of limitations neither creates nor extinguishes any rights, but merely places a limitation upon the remedy (which can be waived or tolled), a limitation such as the one in question is a condition essential to the existence of the right.” Co-De Coal, 388 S.W.2d at 617 (internal citations omitted). The court added: “The bringing of the action within the limited time is a condition to the exercise of the right, and, if the condition is not complied with, there is neither right nor remedy.” Id. (internal citation and quotation marks omitted).

Indeed, this concept is supported by South Carolina case law. In Labruce v. City of N. Charleston, 268 S.C. 465, 234 S.E.2d 866 (1977), the appellants instituted an action to recover business license taxes paid under protest. The Court recognized that at that time, Section 65-2661 et seq., Code of Laws, 1962, provided the exclusive remedy for the recovery of contested taxes and held that “[s]trict compliance with the conditions precedent is prescribed when one invokes the statutory remedy.” 234 S.E.2d at 867. See also 4 S.C. Jur. Action § 13 (“One who invokes a statutory remedy must bring himself within the statute and comply with the conditions prescribed therein. Moreover, the Court of Appeals recently reiterated this principle, noting that a nonclaim statute (the sort at issue in the present case)¹⁴ differs from a statute of limitations in that a nonclaim statute creates no enforceable right of action “[u]nless the claim is filed within the prescribed time set out in the statute,” whereas a statute of limitations “creates a defense to an action brought after the expiration of the time allowed by law for the bringing of such an action.” Phillips ex rel. Barnett v. Quick, Op. No. 5003, 2012 WL 2913296 (S.C. Ct. App. filed July 18, 2012) (citing Estate of Decker v. Farm Credit Servs. Of Mid-Am. ACA, 684 N.E.2d 1137, 1138-39 (Ind. 1997)).

As a general rule, when a statute creates a new right and at the same time prescribes a remedy for enforcing the right, the prescribed statutory course must be followed by anyone claiming the right.”); 72 Am. Jur. 2d State and Local Taxation § 996 (“Strict compliance with conditions precedent is required to invoke the statutory remedy for recovery of contested taxes.”). When a statute both creates a cause of action and includes a time limit for its commencement, compliance with the time limit is a condition precedent to the maintenance of

¹⁴ A nonclaim statute is one that creates a right of action and provides a time limit on exercising that right. It imposes a condition precedent, as the time element is part of the right of action. 54 C.J.S. Limitation of Actions §33 (updated May 2012).

the action. 54 C.J.S. Limitations of Actions § 31 (updated October 2010). “Such a statutory time limit conditions the existence of the right of action, thereby creating a substantive, rather than procedural, limitation on the right. Bringing suit within the prescribed time is a condition of liability itself, not of the remedy alone.” Id.

Thus, the statutes that grant a South Carolina taxpayer a right to seek a refund are not statutes of limitations but rather conditions precedent to obtain a right to a refund. Accordingly, the courts have not adopted the doctrine of waiver involving tax claims. To the contrary, a refund of taxes is considered “solely a matter of governmental grace, . . . and any person seeking such relief must bring himself clearly within the terms of the statute authorizing the same.” Asmer v. Livingston, 225 S.C. 341, 344, 82 S.E.2d 465, 466 (1954) (internal citations omitted); see also C.W. Matthews Contracting Co., Inc. v. S.C. Tax Comm’n, 267 S.C. 548, 554, 230 S.E.2d 223, 226 (1976); Guar. Bank & Trust Co. v. S.C. Tax Comm’n, 254 S.C. 82, 173 S.E.2d 367 (1970) (holding that the circuit court erred in extending the time periods under the statute because that is a legislative and not a judicial function). Therefore, the South Carolina Supreme Court held in TNS Mills, Inc. v. S.C. Dep’t of Revenue, 331 S.C. 611, 623, 503 S.E.2d 471, 478 (1998) that the Department employee’s erroneous interpretation of a statute was not binding on the courts, and that Department employees cannot make changes in the refund procedure established by the General Assembly or exceed the authorization granted by a statute. See also Argent Lumber Co., 182 S.E. at 95 (“[T]he agent of the tax commission could not alter, amend, or change the statute law of this state, either orally or by written agreement . . .”). The United States Supreme Court further explained that an employee of the government has no authority to waive or extend a refund period except to the extent authorized by the governing statute. U.S. v. Garbutt Oil Co., 302 U.S. 528 (1938) (Officers of the government have no power to waive statutes of limitations; and Commissioner cannot consider untimely filed returns); see also Dickow v. United States, 740 F. Supp. 2d 231, 237 (D. Mass. 2010) aff’d, 654 F.3d 144 (1st Cir. 2011) cert. denied, 132 S. Ct. 1046 (2012) (“The Executor cannot rely upon the IRS’ failure to advise him of the denial to justify his purported conclusion that his second request had been granted where, as here, the IRS clearly did *not* have the authority to issue such extension.”).

The only case cited by Duke Energy that involved a refund claim was Anonymous Taxpayer v. S.C. Dep’t of Revenue, 377 S.C. 425, 661 S.E.2d 73 (2008). However, the relief sought by the taxpayer in that case was based on the contention that the taxpayer’s right to

retirement benefits was in the nature of a contract. The Supreme Court's discussion of the statute of limitations in Anonymous Taxpayer was predicated upon the taxpayer's argument that there "was a contract providing for continuing performance, thus the limitations period began anew each year." The Court noted long ago that statutes of limitations could be waived with respect to actions based on contract. See Heyward v. S.C. Tax Comm'n, 240 S.C. 347, 351, 126 S.E.2d 15, 17 (1962) ("We have held that the State may be subject to the doctrine of estoppel in its contractual relations."). Nevertheless, the Court did not hold that refund claims are in the nature of a contract and, in fact, has held the opposite. See id.; see also C. W. Matthews Contracting Co., 267 S.C. at 554, 230 S.E.2d at 226 (a tax refund claim is created by statute and is not in the nature of a debt collection claim).

In sum, since no employee or agent of the Department has any authority to waive the authorization granted by Section 12-54-80, Form FS-43 could grant no more rights than those permitted by this statute. Thus, any statement made by a Department employee, either verbally or in writing, agreeing to waive the time to request a refund, which was inconsistent with Section 12-54-80, was outside of that employee's authority. Consequently, I conclude that the Forms FS-43 executed before August 1, 1995, and any other statements, written or oral, given by DOR's employees, were ineffective in extending the statutory filing period for Duke Energy's refund claims or in waiving that period.

Moreover, even under section 12-54-85(F)(1), with the exception of situations where there are changes made to taxable income reported to the IRS, or when the IRS changes a corporation's taxable income, "claims for . . . refund must be filed within three years of the time the return was filed, or two years from the date of payment, whichever is later. If no return was filed, a claim for refund must be filed within two years from the date of payment." S.C. Code Ann. § 12-54-85(F)(1) (1995). Also, "[a] claim for refund can be amended prior to, but not after, the expiration of the time for filing the claim for refund under Section 12-54-85(F)." Id. § 12-60-470(H). Read together, these sections lead to the conclusion that once a refund period expires under the terms set forth by the legislature, that period of time cannot be revived by the consent of the Department or otherwise; rather, any amendments **must** be made **prior** to the expiration of the statutory period for filing refund claims. See Am. Legion Post 15 v. Horry County, 381 S.C. 576, 582, 674 S.E.2d 181, 183-84 (Ct. App. 2009) (holding in part that the three-year limitations period under section 12-54-85(F)(1) barred a taxpayer's action seeking a refund). Thus, even

after the RPA took effect on August 1, 1995, and the Department received its new power to extend the period for filing refund claims, the Department was unable to use this power to revive refund claims periods that had expired due to the close of the three-year limitations period applicable to the income tax years ending 1990 through 1994 or due to failure to pay under protest and file a claim for a refund within thirty (30) days for the tax years ending prior to 1990.

Equitable Estoppel

Duke Energy similarly asserts that the Department should be estopped from asserting its "statute of limitations." The basis for this contention is that the Department employees purportedly viewed Form FS-43 as waiving the statutory refund limitations period, and that Duke Energy "agreed to the waivers because the Department represented verbally and in writing that the statute of limitations was extended for both tax assessments and tax refund claims."

As with waiver of a statute of limitations, the courts have recognized that the estoppel doctrine is limited in reviewing tax claims. As a general rule, "the doctrine of estoppel will not be applied to deprive the government of the due exercise of its police power, or to effect public revenues or property rights, or to frustrate the purpose of its laws or thwart its public policy." Heyward v. S.C. Tax Comm'n, 240 S.C. 347, 351, 126 S.E.2d 15, 17 (1962) (emphasis added). In the only South Carolina appellate decision touching upon taxation issues and equitable estoppel, the Court of Appeals held that equitable estoppel did not apply to bar a county from asserting the statute of limitations as a defense to refunding admissions fees paid in connection with bingo games. Am. Legion Post 15, 381 S.C. at 583, 674 S.E.2d at 184.

Also, to invoke estoppel in this case, the Department employees must be authorized to change the procedure for obtaining a refund. However, in Texaco, Inc. v. Wasson, the South Carolina Supreme Court explained that the Department was not estopped from assessing additional taxes based on the use of an improper accounting method even though Department employees had expressly and in writing authorized the taxpayer to use that method "until such time as the South Carolina Tax Commission grants permission to change such method." 269 S.C. 255, 264-65, 237 S.E.2d 75, 79 (1977). Similarly, in TNS Mills, Inc., the taxpayer contended that the Department had the authority to grant a property tax exemption retroactively. Its contention was based in part on a memorandum prepared and issued by a Department employee opining that a recently-enacted statute gave the Department authority to accept exemption applications at any time. The South Carolina Supreme Court rejected that contention,

holding instead that “[a]lthough [the employee] believed the Department had the authority to grant retroactive exemptions, and exemptions may have been granted under this erroneous view, neither the Commission nor the courts are bound by his erroneous interpretation.” 331 S.C. at 621-22, 503 S.E.2d at 477; see also S.C. Coastal Council v. Vogel, 292 S.C. 449, 357 S.E.2d 187 (Ct. App. 1987) (“The public cannot be estopped ... by the unauthorized or erroneous conduct or statements of its officers or agents which have been relied on by a third party to his detriment.”).

In addition, the authority that Duke Energy itself cited supports a conclusion that the Department is not estopped from rejecting actions taken by its employees that are not authorized by statute. Duke Energy cited Quail Hill, LLC v. County of Richland and quoted the following language from that case: “A governmental body is not immune from the application of the doctrine of estoppel where its officers or agents act within the proper scope of their authority.” 387 S.C. 223, 236, 692 S.E.2d 499, 506 (2010) (italics omitted). However, Duke Energy only quoted the first part of the pertinent language. The entire relevant passage was quoted by the Court as follows:

A governmental body is not immune from the application of the doctrine of estoppel *where its officers or agents act within the proper scope of their authority ... The public cannot be estopped, however, by the unauthorized or erroneous conduct or statements of its officers or agents which have been relied on by a third party to his detriment.*

Quail Hill, 387 S.C. at 236, 692 S.E.2d at 506 (italics in original) (quoting DeStefano v. City of Charleston, 304 S.C. 250, 257-58, 403 S.E.2d 648, 653 (1991)). That passage followed the Court’s recognition at the beginning of the paragraph: “As a general rule, estoppel does not lie against the government to prevent the due exercise of its police power or to thwart the application of public policy.” Id. (quotation marks omitted).

Following the above precedents, the Court ultimately held that: “For reasons ... discussed [in the opinion], we believe the Court of Appeals erred in reversing the circuit court’s grant of summary judgment to County as to Quail Hill’s claim of equitable estoppel.” Id., 387 S.C. at 237, 692 S.E.2d at 506. In other words, the Supreme Court in Quail Hill affirmed that the government was not estopped from contesting erroneous statements made by its staff. See id., 387 S.C. at 238, 692 S.E.2d at 507 (“[W]e agree with County’s argument that the RU zoning classification was a mistaken statement of law and, thus, could not be used to estop County from enforcing it.”). That holding is entirely consistent with the holdings of Texaco, Heyward, and

TNS Mills and, in fact, relies on the same rationale stated by the Court in Heyward – that the government cannot be estopped from exercising its police power. Compare id., 387 S.C. at 236, 692 S.E.2d at 506 (discussing police power rationale for not applying estoppel to governmental entities) with Heyward, 240 S.C. at 351, 126 S.E.2d at 17 (holding that “estoppel will not be applied to deprive the government of the due exercise of its police power, or to effect public revenues or property rights”).

Thus, I conclude that the Department is not estopped from invoking the correct refund limitations period, even if Department employees believed they had the authority to allow the taxpayer to extend the time in which a claim for refund could be filed. This court clearly does not wish to shield a governmental agency from the doctrine of equitable estoppel where its agents act within the scope of their authority. Rather, this Court recognizes that however Duke Energy seeks to characterize the evidence presented in response to the Department’s summary judgment motion, the Department’s employees did not have the authority to create an unauthorized refund procedure. Moreover, execution of Forms FS-43 by Department employees can provide the taxpayer with no greater remedies than those provided by the governing statutes for refund claims and the like. It is upon these principles that the court in Phillips held that “[w]hile equitable principles may extend the time for commencing an action under statutes of limitation, nonclaim statutes impose a condition precedent to the enforcement of a right of action and are not subject to equitable exceptions.” Supra. (citing Estate of Decker, 684 N.E.2d at 1139) (emphasis added).

In fact, even if estoppel was applicable here, Duke Energy failed to set forth a genuine issue of material fact as to its meeting those requirements. “To prove estoppel against the government, the relying party must prove: (1) the lack of knowledge and of the means of knowledge of the truth of the facts in question; (2) justifiable reliance upon the government’s conduct; and (3) a prejudicial change in position.” S.C. Dep’t of Transp. v. Horry County, 391 S.C. 76, 83, 705 S.E.2d 21, 25 (2011). Furthermore, “[o]nce the party moving for summary judgment meets the initial burden of showing the absence of a genuine issue as to any material fact, the nonmoving party may not simply rest on the mere allegations contained in the pleadings.” Grant v. Mount Vernon Mills, Inc., 370 S.C. 138, 142, 634 S.E.2d 15, 17 (Ct. App. 2006). “Rather, the nonmoving party must come forward with specific facts showing there is a genuine issue for trial.” Id. (quoting Peterson v. W. Am. Ins. Co., 336 S.C. 89, 94, 518 S.E.2d

608, 610 (Ct.App.1999)). Here, there is no dispute that Duke Energy could have referenced the governing refund statutes and learned that Department employees cannot extend the time periods set forth in the applicable refund statutes. See Am. Legion Post 15, 381 S.C. at 583, 674 S.E.2d at 184. Moreover, I do not find that the Form FS-43 misinformed Duke Energy that it could file an amended tax return requesting a refund after the statutory timeframe.

Equitable Tolling

Duke Energy contends that the Department should be equitably tolled from requiring Duke Energy to comply with the statutory time frame within which to file a refund because the Department's employees induced Duke Energy to file belatedly. In support of this remedy, Duke Energy contends that it agreed to the waivers because the Department represented that the statute of limitations was extended for both tax assessments and tax refund claims.

"[T]he doctrine of equitable tolling may be applied to toll the running of the statute of limitations." Hooper v. Ebenezer Sr. Servs. & Rehab. Ctr., 386 S.C. 108, 115, 687 S.E.2d 29, 32 (2009) (quoting 54 C.J.S. Limitations of Actions § 115 (2005)). As explained above, however, the statute requiring that refunds be filed within specific timeframes creates a condition precedent to seeking that remedy and thus is not subject to the equitable remedies for statutes of limitations. See Phillips, supra. Thus, equitable tolling is not a proper remedy in this case. Cf. United States v. Brockamp, 519 U.S. 347 (1997) (holding that the statutory limitations period on tax refund claims under the applicable provision of the Internal Revenue Code does not authorize equitable tolling).

Even if, arguendo, equitable tolling could apply here, in Hooper, the South Carolina Supreme Court explained that "equitable tolling is a doctrine that should be used sparingly and only when the interests of justice compel its use." 386 S.C. at 117, 687 S.E.2d at 33. Here, however, in an attempt to invoke this extraordinary remedy, Duke Energy submitted affidavits and deposition testimony that reference the belief by Department employees that Duke Energy could seek a "refund" based upon extensions granted by the executed Forms FS-43. However, those affidavits do not contain an averment by any Department employee that he or she specifically stated to a Duke Energy representative that Duke Energy's time to seek a "refund" was extended by Form FS-43. More importantly, there is no reference that any Department employee stated that Duke Energy could file an amended tax return seeking a refund based upon

a new basis. Nor is there any sworn testimony by a Duke Energy representative that he or she was misdirected by a Department employee.

Therefore, I conclude that equitable tolling does not lie in this case.

Conclusion

Finally, the context of Duke Energy's request is important in recognizing the proper resolution of this issue. Duke Energy asserts that there are disputed facts regarding this issue because some of the Department's employees viewed Form FS-43 as extending the period during which a taxpayer could seek a refund. However, statements to that effect do not answer the issue in this case. This case is not simply about whether Duke Energy can seek a refund based upon a tax review that had been held open pending the Department's determination of the proper tax to assess. Rather, Duke Energy originally filed as a manufacturer using the three-factor formula. Now, it seeks a refund, not based upon the initial filing, but based upon an amended tax return using the single-factor gross-receipts apportionment formula – an entirely different basis. Duke Energy's amended return also now includes the gross receipts from the sale of its securities and other capital investments, which further includes the principal.

Duke Energy interprets Form FS-43 as not only allowing it to question its initial filing but as allowing it to file a new (amended) tax return and claim an entirely new basis for a refund. The plain reading of the tax statutes and review of the affidavits and deposition testimony submitted by Duke Energy fail to establish a genuine issue of material fact regarding the request of Duke Energy. In other words, though there are statements regarding the right of Duke Energy to seek a refund, no evidence was presented that any Department employees interpreted Form FS-43 as allowing a taxpayer to file an amended return on an entirely different basis than the original return and then seek a refund based on that amended return.¹⁵ Therefore, the Department's Motion for Summary Judgment as to the issue of the timeliness of Duke Energy's amended income tax return filings is granted.

II. Apportionment Method

The next issue is whether Duke Energy is a "manufacturer" and therefore required to use the multi-factor apportionment formula pursuant to S.C. Code Ann. § 12-6-2250 (****)

¹⁵ Review of the record does not even establish the validity of the Form FS-43 agreements for tax years 1978 through 1983. In fact, Duke Energy has even conceded that it has not located the executed Form FS-43 agreements for tax years 1978 through 1983.

(applicable to tax years after 1995)/ Section 12-7-1140 (applicable to tax years prior to 1996); or whether Duke Energy was required to use the single-factor gross-receipts formula pursuant to Section 12-6-2290 (****) (applicable to tax years after 1995)/ Section 12-7-1190 (applicable to tax years prior to 1996). Duke Energy argues that it is not a manufacturer, even though it filed its original corporate income tax returns under this status. Duke Energy contends that it is actually a seller of services, and therefore amended its tax return filing using the single-factor gross receipts formula.

During the tax periods at issue, taxpayers whose principal business in South Carolina was "(a) manufacturing . . . goods and materials within this State" had to apportion their income using a three-factor formula composed of property, payroll, and sales. S.C. Code Ann. § 12-6-2250 (applicable to tax years after 1995); S.C. Code Ann. § 12-7-1140 (applicable to tax years prior to 1996). All other taxpayers (except certain specific industries not relevant here) had to apportion their income using a single-factor gross-receipts apportionment formula. S.C. Code Ann. § 12-6-2290 (applicable to tax years after 1995); *Id.* § 12-7-1190 (applicable to tax years prior to 1996). "Manufacturing" is not, and was not during the tax periods at issue, statutorily defined for South Carolina apportionment law purposes.¹⁶

Based on the record, I find that genuine issues of material fact exist necessitating an evidentiary hearing as to whether Duke Energy, based on its activities within the State, falls under Section 12-6-2250 as a "manufactur[er]," or whether Duke Energy is a seller of services, or otherwise falls under none of the above-categories, and is therefore required to apportion its income to South Carolina based on the single-factor gross-receipts apportionment formula pursuant to Section 12-6-2290 (applicable to tax years after 1995)/ Section 12-7-1190 (applicable to tax years prior to 1996). Accordingly, the Court denies the Department's Motion for Summary Judgment with respect to this issue.

III. Gross Receipts

The final issue is whether Duke Energy was allowed, in its calculation of corporate income tax owed to South Carolina, to include in the apportionment formula the return of

¹⁶ "Manufacturing" is not statutorily defined, but it is discussed in *Columbia Ry., Gas & Elec. Co. v. S.C. Tax Comm'n*, 134 S. C. 319, 132 S.E. 611 (1926), a case in which the South Carolina Supreme Court held that a company engaged in the business of generating electricity was properly considered a "manufacturer" for purposes of a particular statute that imposed a corporate income tax on "a corporation engaged in the business of manufacturing."

principal from its sales of securities and other capital investments. Duke Energy argues that "gross receipts" in the gross receipts factor of the denominator of the single-factor gross-receipts apportionment formula and "sales" in the sales factor of the denominator of the three-factor apportionment formula include the entire amount of return capital from a sale of securities or other capital investments, **including the return of principal**. The Department, however, argues that gross receipts and sales include only the net proceeds from sales of securities or other capital investments.

South Carolina law provides that a taxpayer required to apply the single-factor gross-receipts apportionment formula must do so "using a fraction in which the numerator is gross receipts from within this State during the taxable year and the denominator is total gross receipts from everywhere during the taxable year." See S.C. Code Ann. § 12-6-2290 (****) (applicable for tax years beginning after 1995); see also *id.* § 12-7-1190 (****) (applicable for tax years prior to 1996).¹⁷ "Gross receipts" was not defined for South Carolina apportionment law purposes during the tax periods at issue.

For purposes of the multi-factor apportionment formula¹⁸ the sales factor consists of "[t]he ratio of sales made by such taxpayer during the income year which are attributable to this State to the total sales made by such taxpayer everywhere during the income year" S.C. Code Ann. § 12-7-1170 (****) (for tax years prior to 1996).¹⁹ The term "sales" includes: "(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." *Id.*²⁰

¹⁷ Even though the Court finds as a matter of law that Duke Energy's filings of tax refund claims for tax years ending 1978-1993 were untimely, and thus will not be considered here, the filing for tax year 1994 was timely, and thus statutes applicable to tax years prior to 1996 will be discussed.

¹⁸ Section 12-6-2250 (applicable to tax years after 1995) and Section 12-7-1140 (applicable to tax years prior to 1996).

¹⁹ For tax years after 1995, S.C. Code Ann. § 12-6-2280 (****) similarly provides that: "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."

²⁰ For tax years after 1995, S.C. Code Ann. § 12-6-2280 (B) (****) similarly provides that the term "sales in this State" includes sales of goods, merchandise, or property received by a purchaser in this State. The place where goods are received by the purchaser after all transportation is completed is considered the place at which the goods are

"The language of a tax statute must be given its plain ordinary meaning in the absence of an ambiguity therein. . . [I]f a legislative intent is clearly apparent from the language of the statute there is no occasion for resort to the rule of statutory construction." Beach v. Livingston, 248 S.C. 135, 139, 149 S.E.2d 328, 330 (1996) (internal citation omitted). "If the statute is ambiguous, however, courts must construe the terms of the statute." S.C. Energy Users Comm. v. S.C. Pub. Serv. Comm'n, 388 S.C. 486, 491, 697 S.E.2d 587, 590 (2010) (internal citation omitted). "A statutory provision should be given a reasonable and practical construction consistent with the purpose and policy expressed in the statute." Lockwood Greene Eng'rs, Inc. v. S.C. Tax Comm'n, 293 S.C. 447, 449, 361 S.E.2d 346, 347 (Ct. App. 1987). "When faced with an undefined statutory term, the term must be interpreted in accordance with its usual and customary meaning." Id. at 492, 697 S.E.2d at 590 (internal citation omitted). "Courts should not merely consider the language of the particular clause being construed, but the undefined word and its meaning in conjunction with the purpose of the whole statute and the policy of the law." Id. Finally, "[s]tatutes should not be construed so as to lead to an absurd result." Kennedy v. S.C. Ret. Sys., 345 S.C. 339, 351, 549 S.E.2d 243, 249 (2001) (internal citation omitted).

Here, there is no genuine issue of material fact with regard to the Gross Receipts Issue. The sole question of law is whether Duke Energy could include the return of principal from its sales of securities and other investment transactions as part of the sales or gross receipts factors in the apportionment formula. This is a novel question in South Carolina, but is not unprecedented in some of our sister States.

The first approach to this issue was taken by New Jersey in Am. Tel. and Tel. Co. v. Dir., Div. of Taxation, 194 N.J. Super. 168, 476 A.2d 800 (App. Div. 1984). In that case, the New Jersey Supreme Court concluded that the inclusion of gross or full revenues from the short-term sale or redemption of investment paper in the denominator of the receipts fraction of the apportionment formula would lead to "absurd results" in that such inclusion would greatly distort the amount of business the taxpayer did within and without New Jersey and would thus defeat the intent and purpose of the apportionment statute. Id. at 172, 476 A.2d at 802. Both Indiana and Arizona have adopted similar rationales to the one used by the New Jersey court. See

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."

Sherwin-Williams Co. v. Ind. Dept. of State Revenue, 673 N.E.2d 849 (Ind. Tax 1996) (holding that “‘gross receipts’ for the purpose of the sales factor includes only the interest income, and not the rolled over capital or return of principal, realized from the sale of investment securities”); Walgreen Ariz. Drug Co. v. Ariz. Dep’t of Revenue, 209 Ariz. 71, 97 P.3d 896 (App. 2004) (holding that the return of principal from the type of short-term investments at issue was not includable in the sales factor denominator).

The other approach to this issue was taken by Tennessee and California.²¹ In Sherwin-Williams Co. v. Johnson, 989 S.W.2d 710 (Tenn. App. 1998), the chancellor had followed the same reasoning employed by the New Jersey and Indiana courts (and later the Arizona court), holding that “to include the principal in the sales factor denominator would distort the extent of Sherwin-Williams’ business activities in Tennessee and other states in which it does business and defeat the intent and purpose of the [apportionment] statute. . .” and that “the amount of return of principal on the sale or redemption of interest bearing securities related to its, [sic] working capital investments should not be included in the denominator of the sales factor.” Id. at 714. The Tennessee Court of Appeals, though finding the chancellor’s holding “logical and appealing,” nevertheless decided not to follow the “absurd result standard.” The court instead concluded that:

An absurd result is not necessary, for in spite of the plain language of the [sales factor statute], the commissioner may opt for a different scheme of assessment whenever the resulting apportionment does not fairly represent the taxpayer’s business in this state. The very absurdity of the result sought . . . lays a sound basis for the implementation of [the alternative apportionment method statute].

Id. at 714-15.

The California Supreme Court, in Microsoft Corp. v. Franchise Tax Bd., quoted this passage with approval as it went on to hold that “gross receipts” is not limited to net proceeds. 39 Cal.4th 750, 763, 139 P.3d 1169, 1177 (2006). Referencing California’s alternative apportionment method, the court concluded that “[t]he UDITPA contains an equitable relief provision so that, in cases where application of the statutory sales definition results in excessive distortion, an ‘absurd result’ may be avoided.”

²¹ South Carolina’s apportionment provisions, like those in New Jersey, Indiana, Arizona, Tennessee, and California, are based on the Uniform Division of Income for Tax Purposes Act (UDITPA).

After considering the two lines of reasoning set forth by our sister States, I conclude that the law of South Carolina favors the view expressed by the courts in New Jersey, Indiana, and Arizona.

As the Tennessee Court of Appeals correctly noted, “[i]f the words of a statute plainly mean one thing they cannot be given another meaning by judicial construction.” Johnson, 989 S.W.2d at 714-15 (internal citation omitted); see also Denman v. City of Columbia, 387 S.C. 131, 138, 691 S.E.2d 465, 468 (2010) (“Under the plain meaning rule, it is not the Court’s place to change the meaning of a clear and unambiguous statute.”). However, to rearrange the order of the court’s sentences, “This sound rule . . . is met by the equally well settled rule that: . . . ‘It is presumed that the legislature enacting a statute did not intend an absurdity, and such a result will be avoided by this court if the terms of the statute admit of it by reasonable construction.’” Johnson, 989 S.W.2d at 714 (internal citations omitted).

Logical Definition of Gross Receipts

The term “gross receipts” does not plausibly include the return of principal from the sale of securities and other capital investments. In examining the meaning of “gross receipts it is helpful to start first with a consideration from a macro perspective of the known interpretation of the meaning of “gross income.” “Gross income”, at least in the context of self-employment or self-owned businesses, is defined as “gross receipts minus ordinary and necessary expenses required for self-employment or business operation. . . .” Spreeuw v. Barker, 385 S.C. 45, 65, 682 S.E.2d 843, 853 (Ct. App. 2009) (citing S.C. Code Ann. Regs. 114-4720(A)(4) (Supp. 2008)). This definition logically applies to other types of businesses, too. Based on the implication of this definition, it logically flows that gross receipts equal gross income plus ordinary and necessary expenses of business operations. The South Carolina Supreme Court in Roper v. S.C. Tax Comm’n, Title 65-Section 251 of the 1952 Code of Laws of South Carolina also defined “gross income” as: “the income of a taxpayer derived from . . . interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit” 231 S.C. 587, 598, 99 S.E.2d 377, 382 (1957) (emphasis added); see also S.C. Code Ann. § 12-7-415 (****) (adopting the Internal Revenue Code’s (I.R.C.) determination of gross income with modifications specified in Section 12-7-430 (which are not relevant here)); I.R.C. § 61(a) (****) (generally defining corporate gross income as “all income from whatever source derived” and

covering many of the same categories mentioned in Roper)²²; S.C. Code Ann. § 12-6-1110 (****). The Court went on to point out that “the word ‘income’ as used in a tax statute, is to be taken in its ordinary sense of gain or profit.” Id. (reaffirmed as “well-settled” in Scott v. S.C. Tax Comm’n, 262 S.C. 144, 148, 202 S.E.2d 854, 856 (1974)). Here, too, we find the same deductive reasoning that because gross income includes “all income,” and income, being gain or profit, excludes principal, then gross income necessarily excludes principal.

The U.S. Supreme Court also followed this reasoning in U.S. v. Forest Lumber Co., 429 U.S. 32 (1976). In that case, the Court found that the inclusion of “gains derived from dealing in property” as part of “all income from whatever source derived” in the definition of gross income under I.R.C. Section 61(a) (****) meant that taxable income, which includes gross income according to Section 63(a),²³ also therefore included capital gains as well as ordinary income, in the absence of a specific exclusion of capital gains. 429 U.S. at 37. The Court’s inclusion of capital gains impliedly excludes principal from gross income (and taxable income). Because, as mentioned earlier, gross receipts equal gross income plus the amount spent for ordinary and necessary business expenses, and gross income includes only the capital gains from sales of securities, then gross receipts can only include capital gains from sales of securities, which necessarily excludes principal. Therefore, the only remaining question is whether “ordinary and necessary expenses of business operations” includes principal.

Principal, by definition, cannot be an expense of a business operation. Since ordinary and necessary business expenses are subtracted from gross receipts to yield gross income, and neither business expenses nor gross income include principal, it is impossible for gross receipts to include principal. Put another way, because gross receipts are equivalent to gross income plus

²² Nowhere in South Carolina’s statutory law or in the federal statutory law adopted by South Carolina is principal from investments listed as part of gross income. In fact, principal would later be excluded in S.C. Code Ann. § 2295(B)(1) (2007), which became effective for tax years after 2006. Also, it is worth noting that even in the context of child support, gross income does not include principal in the return from the sale of investments. Indeed, the inclusion of “capital gains” in the list of items considered part of gross income for child support purposes necessarily implies the exclusion of principal from the return of investment sales. See S.C. Code Ann. Regs. 114-4720(A)(2) (2012).

²³ Generally, the taxable income of a business is its gross income minus any deductions that are allowed by state law. I.R.C. § 63(a) (****).

ordinary and necessary business expenses; and neither gross income nor business expenses include principal, gross receipts, being the sum of those two parts, cannot include principal.²⁴

Logical Definition of Sales

It is equally implausible to include principal from the sale of securities and other capital investments in the definition of “sales” for purposes of the standard apportionment formula. A major difference between the Tennessee case and the present case is that Tennessee’s standard apportionment statute defined “the term ‘sales’ to include all gross receipts of the taxpayer not otherwise allocated under the Excise Tax Law.” Johnson, 989 S.W.2d at 713 (emphasis in original). Likewise, the California standard apportionment statute included “all gross receipts” in the definition of “sales.” South Carolina’s standard apportionment statute defines the term “sales,” but this definition does not include “gross receipts.”²⁵ Instead, under its definition of “sales,” “[i]f the income-producing activity is performed partly within and partly without this State, sales are attributable to this State to the extent the income-producing activity is performed within this State.” S.C. Code Ann. § 12-6-2280(C)(2) (****) (formerly 12-7-1170 (****)) (emphasis added).²⁶ This phrase “income-producing” is used to modify “activity” several other times in the definition of “sales.” “Income” means “an actual gain or actual increase of wealth.”

²⁴ For examples in the I.R.C. of exclusion of principal from gross receipts, see I.R.C. § 165(g)(3)(B) (****) (in the context of determining whether a corporation is affiliated with a taxpayer, “in computing gross receipts for purposes of [calculating the percentage of gross receipts that have come from particular sources], gross receipts from sales or exchanges of stocks and securities shall be taken into account *only to the extent of gains* therefrom.”) (emphasis added); *id.* § 1362(d)(3) (in the context of a small business corporation’s termination of its election to be an S corporation, where its passive investment income exceeds twenty-five percent of gross receipts for three consecutive taxable years and the corporation has accumulated earnings and profits at the close of each of those years, when capital assets (other than stocks or securities) are disposed of, “gross receipts from such dispositions shall be taken into account *only to the extent of the capital gain net income* therefrom[;] and in the case of sales or exchanges of stock or securities, gross receipts shall be taken into account *only to the extent of the gains* therefrom.”) (emphasis added); and *id.* § 1244 (in the context of calculating the percentage of gross receipts from particular sources for determining whether “stock” means stock in a domestic corporation for determining losses on small business stocks, “gross receipts from the sales or exchanges of stock or securities shall be taken into account *only to the extent of gains* therefrom.”) (emphasis added).

²⁵ “Sales” and “gross receipts” were later further defined together by S.C. Code Ann. § 12-6-2295 (2007) (effective for tax years beginning after 2006). However, the years at issue here are 1978-2001. Further, because the Court finds as a matter of law that the refund claims filed for tax years ending 1978-1993 are untimely, the only years that will be considered for the gross receipts issue will be tax years ending 1994-2001.

²⁶ Duke Energy states in its Motion for Reconsideration that “[t]he concept of income-producing activity has no bearing on the definition of ‘total sales’ and whether the principal from sales of securities should be included in the sales factor denominator.” However, the Legislature clearly intended to specify what kind of activity would be used to measure “sales” for purposes of the apportionment formula, and did so by including the modifying phrase “income-producing.”

See Scott v. S.C. Tax Comm'n, 262 S.C. 144, 148-49, 202 S.E.2d 854, 856 (1974) (Bussey, J., dissenting) (citing 85 C.J.S. Taxation 1096, p. 730). This emphasis on income production suggests that principal is excluded from the definition of "sales."²⁷ Moreover, this limitation of "sales" to the net income derived therefrom is not a novel interpretation. Indeed, our own Supreme Court has approved of an apportionment formula "whereby [a business's] sales, payroll, and property in South Carolina were divided by its national net sales, payroll, and property." See Eastman Kodak Co. v. S.C. Tax Comm'n, 308 S.C. 415, 416, 419, 418 S.E.2d 542, 542, 544 (1992) (holding in part that safe harbor lease transactions that were part of a corporation's business "were properly included in the denominator of the apportionment formula in computing [that corporation's] national net income from payroll, property, and sales.") (emphasis added). Using this interpretation and limiting the sales factor in the denominator of the three-part apportionment formula to net income is the more sound application of the apportionment formula.

The conclusion in this case is further supported by the fact that in the context of consolidated returns filed by multiple corporations conducting business within and without the State, the returns included in the sales factor of the standard apportionment formula must "contain such other information necessary to compute the net income of each taxpayer properly attributable to the state so that South Carolina can impose a tax on the taxpayers concerned." Emerson Elec. Co. v. Wasson, 287 S.C. 394, 396-97, 339 S.E.2d 118, 120 (1986) (discussing S.C. Code Ann. § 12-7-1570 (****) (for tax years prior to 1996), the predecessor of § 12-6-5020 (****) (for tax years after 1996)) (emphasis altered). This infers that when a single corporation also conducts business within and without the State, its net income only, and not principal, is included in the sales factor for purposes of apportioning the amount of corporate income taxes the State could impose on that corporation. See, e.g., Eastman Kodak Co., 308 S.C. at 416, 418 S.E.2d at 542 (Kodak included only the net income in the sales factor in the denominator of the apportionment formula).²⁸

²⁷ Though Duke Energy is a nonresident corporation, it is worth noting that South Carolina taxable income for nonresident individuals, nonresident trusts, nonresident estates, and nonresident beneficiaries include only amounts attributable to, among other things, "income from intangible personal property, including annuities, dividends, interest, and gains that is derived from property employed in a trade, business, profession, or occupation carried on in this State." It is interesting that nowhere is "principal" mentioned as an inclusion in taxable income.

²⁸ In its Motion for Reconsideration, Duke Energy attempted to analogize this case with S.C. Dep't of Revenue v. Blue Moon of Newberry, Inc., 397 S.C. 256, 725 S.E.2d 480 (2012) to support its proposition that "the Court should

Alternative Apportionment Method

The Tennessee and California opinions rely upon the presupposition that “an absurd result is not necessary” because the Department “may opt for a different scheme of assessment whenever the resulting apportionment does not fairly represent the taxpayer’s business in this State.” Microsoft, 39 Cal.4th at 763, 139 P.3d at 1177 (quoting Johnson, 989 S.W.2d at 715). South Carolina indeed has a similar provision. S.C. Code Ann § 12-6-2320(A) (2002) provided that:

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.

(Emphasis added).

not restrict the meaning of ‘gross receipts’ and ‘total sales’ when the language of the statute does not contain or require any limitations.” In Blue Moon of Newberry, a case involving a regulation that restricted the sale of alcoholic beverages by nonprofit organizations to “bona fide members and bona fide guests of members of such organizations,” the South Carolina Supreme Court rejected the Department’s view that “bona fide implie[d] that the guest have some degree of familiarity or camaraderie with the member,” because “the plain language of the regulation contain[ed] no support of this, and the ordinary definition of bona fide d[id] not require it.” Id. at 258, 263-64, 725 S.E.2d at 482, 484-85. Rather, the regulation clearly defined “bona fide guests” as those “who accompany a member onto the premises or for whom the member has made prior arrangements with the management of the organization.” Id. at 258, 725 S.E.2d at 482. In the present case, however, the term “gross receipts,” unlike “bona fide guests” in Blue Moon of Newberry is not defined for South Carolina apportionment law purposes during the tax periods at issue. Therefore, this Court must determine whether principal was included in the components of gross receipts (gross income and ordinary and necessary expenses of business operations). For the reasons given above, state and federal law establishes that principal is excluded from the components of gross receipts. Indeed, it is the inclusion of principal that has no foundation whatsoever in South Carolina or federal tax law. Though “sales” is defined for South Carolina apportionment law purposes, the ordinary meaning of the terms comprising its definition do not support, let alone require, the inclusion of principal, for the reasons explained above. Also, this Court’s purpose in excluding the return of principal from the definitions of “gross receipts” and “sales” is the same as the Court’s in Blue Moon of Newberry – to preserve the purpose of the apportionment statutes and prevent the production of an absurd result. Contrary to Duke Energy’s assertion, the Court’s opposition to “artificially inflat[ing] the denominator of either the sales factor or gross receipt factor and thereby decreas[ing] the amount of income subject to tax in South Carolina” is not based upon a belief that taxpayers should be required to “pay the *most* taxes.” Rather, the Court’s opposition is based upon the belief that taxpayers are required to pay the correct amount of taxes owed to this State, which is the amount that “fairly represents the taxpayer’s business activity in this State.” Indeed, this is the whole purpose of the apportionment statutes.

I nevertheless find that the California and Tennessee cases, in relying upon this statutory option, miss an important distinction between the court's roles of statutory construction and application of the alternative apportionment provision. Though the alternative relief provision exists as a mechanism to correct problems caused by the application of the standard apportionment statutes (see Media Gen. Commc'ns v. S.C. Dep't of Revenue, 388 S.C. 138, 694 S.E.2d, 525 (2010)), the standard application statutes should not be so construed as to encourage excessive distortion simply because the alternative relief provision exists to remedy that distortion. In applying the principles of statutory construction, the court's function is, in part, to construe statutory law to avoid an absurd result. Ventures S.C., LLC v. S.C. Dep't of Revenue, 378 S.C. 5, 9, 661 S.E.2d 339, 341 (2008) ("[T]he Court will reject the plain meaning of the words used in a statute if it would lead to an absurd result. . ."). If, as here, the proposed construction of a statute reaches an absurd result, our courts should recognize that absurdity and end the inquiry.

On the other hand, the function of the alternative apportionment provision is quite different. The alternative apportionment provision should be utilized only when the standard apportionment statute does not operate sensibly in a given case. As the Florida Supreme Court pointed out in Roger Dean Enters, Inc. v. State, "[t]here is a very strong presumption in favor of normal three-factor apportionment and against the applicability of the relief provisions. . . Departures from the basic formula should be avoided except where reasonableness requires." 387 So.2d 358, 363 (internal citations omitted). Further, in St. Johnsbury Trucking Co. v. New Hampshire, the New Hampshire Supreme Court, in addressing very similar statutory language, held that:

The statutory provisions require that the three-factor formula will be used for apportioning business profits, and an alternative formula may be used if the statutory method of apportionment "does not fairly reflect the extent of the business activities of a business organization within this state." The legislature has, therefore, specified that an alternative formula is the exception, and the party who wants to use an alternative formula accordingly has the burden of showing that the alternative is appropriate.

118 N.H. 209, 212, 385 A.2d 215, 217 (1978) (emphasis added).²⁹

²⁹ The following states have followed the holding in St. Johnsbury Trucking: Idaho - Union Pac. Corp. v. Idaho State Tax Comm'n, 83 P.3d 116, 120 (Idaho 2004); and Kentucky - Ruby Const. Co., Inc. v. Dep't of Revenue, 578 S.W.2d 248, 253 (Ky. Ct. App. 1978).

In this case, to interpret the standard apportionment formula to include the return of principal in either the sales factor or gross-receipts factor of the denominator would engender an absurd application of the standard apportionment statute simply because another statute exists which allows for another means of accounting when the standard apportionment statute does not "fairly represent the extent of the taxpayer's business activity in this State." In other words, such an interpretation would create the very absurdity that courts are to avoid in their statutory construction. Rather than having Section 12-6-2320(A) available as a remedial back-up, a corporation would have nothing to lose and everything to gain by adding the return of principal to the denominator and thereby reducing the amount of taxes owed to South Carolina, regardless of whether the numbers accurately reflected the corporation's business activity within and without the State. As a result, the alternative apportionment statute, which was intended to be a remedy held in reserve for the relatively infrequent occasion that the standard formula did not result in a fair representation, would then become a standard follow-up to the application of the standard apportionment statute. Indeed, both statutes would become standard, because distortion of business activity representation would be fostered on the front end (through the principal-inclusive standard apportionment formula) so that it could, and necessarily would, be dealt with on the back end (through the alternative apportionment formula).³⁰

This potential for abuse by corporations and the futility of going through this extra-step process needlessly is reflected in a finding by the Arizona Court of Appeals that in most of the cases that the taxpayer cited to support the inclusion of the return of principal in the sales factor denominator of the standard apportionment formula, the courts "nonetheless approved exclusion of the principal from the sales factor denominator pursuant to their states' version of UDITPA's 'relief provision' [i.e., alternative apportionment method]." Walgreen, 209 Ariz. at 901-02, 97 P.3d 896 at 76-77 (citing Union Pac. Corp. v. Idaho State Tax Comm'n, 139 Idaho 572, 83 P.3d 116, 122 (2004); Am. Tel. & Tel. Co. v. State Tax Appeal Bd., 241 Mont. 440, 787 P.2d 754, 757-58 (1990); Johnson, 989 S.W.2d at 715). Microsoft, which was decided two years after Walgreen, can be added to this list, as it applied California's alternative apportionment method

³⁰ In its Memorandum in Opposition to the Department's Motion for Summary Judgment and in Support of its Cross-Motion for Partial Summary Judgment, Duke Energy argues that the definitions of "sales" and "gross receipts" set forth in S.C. Code Ann. § 12-6-2295 (2007) (effective for tax years beginning after 2006), shows the Legislature's intent to make a "drastic" change to the existing law based on its various inclusions in, and exclusions from, the definitions of "sales" and "gross receipts" that had previously not existed. This Court's response to that argument is set forth in its Order Denying Motion For Reconsideration in Part and Granting Reconsideration in Part.

statute to "fairly represent the extent of the taxpayer's business activity in this state" after the court included principal in the sales denominator of its standard apportionment formula.³¹

Criticism of the "Absurd Results Standard"

The California Supreme Court in Microsoft criticized the proponents of the "absurd results standard," in part, because "[i]n each case, the same language governs both sales of off-the-shelf products and sales of securities. *AT&T* [(the New Jersey case)] and its progeny offer no explanation why in one instance that language should require inclusion of gross proceeds and in the other require inclusion of only net proceeds." 39 Cal.4th at 763, 139 P.3d at 1177.³² Nevertheless, the resolution of this issue has been clarified in South Carolina by the Supreme Court's holding in Hay v. Leonard, 212 S.C. 81, 46 S.E.2d 653 (1948).

Hay involved a challenge to the validity of Charleston County's levying an annual license tax for the privilege of engaging in each and every business and occupation in Charleston County, except in the City of Charleston. In reaching its decision, the South Carolina Supreme Court explained the reason why merchandise, or "off-the-shelf products," includes gross proceeds in its taxation, and the Court's reasoning suggests why the sale of securities would not include gross proceeds. The Court explained: "the [license] tax is not on the property itself; it is on the **privilege of dealing with it**. The value of such privilege is measured by the gross receipts therefrom, and this is a familiar and valid method of ascertaining such value." *Id.* at 97, 46 S.E.2d at 660 (emphasis added). A merchant is required to possess a license in order to have the privilege of dealing in merchandise; and the tax is on this privilege, not on the merchandise. This is why "[t]he sale of all merchandise includes previous taxation" *Id.*; see also State ex rel. Roddey v. Byrnes, 219 S.C. 485, 514, 66 S.E.2d 33, 45 (1951) ("In general, the sales tax [,a form of excise tax], is [, like a license tax,] an imposition upon the privilege of the business of selling at retail and measured by the amount of business done"). The sale of securities is

³¹ Paradoxically, the court went on to justify this decision to apply the alternative method statute because it was "unable to accept, even for a moment, the notion that more than 11 percent of [taxpayer's] entire unitary business activities should be attributed to *any* single state solely because it is the center of working capital investment activities that are clearly only an incidental part of one of America's largest, and most widespread, businesses." This rationale highlights the precise reason why principal from the sale of securities and other capital investment activities should not be included in the standard apportionment formula in the first place: the inclusion of principal causes distortions as to the amount of business activity actually performed in a State, which, in turn, have to be remedied.

³² This is the first of the "two problems" that the California Supreme Court had with the "absurd results" cases. The second problem will be discussed in the immediately-following paragraph.

altogether different in that a license is not required to purchase or sell securities,³³ and no sales tax is imposed upon the sale of securities.³⁴ Therefore, here there exist no "privilege" grounds upon which to include principal in the gross receipts, as the value received from the sales of the securities for tax purposes would be measured by the capital gains, not by the principal. The principal would consist of the business's "idle cash" that would presumably have been taxed already.

Conclusion

This Court hereby follows New Jersey, Indiana, and Arizona in adopting the "absurd results" approach to interpreting South Carolina's standard apportionment statute and therefore rejects Duke Energy's attempt to include the return of principal in the denominator of the standard apportionment formula. In sum, the alternative apportionment formula exists to remediate any nonsensical application of the standard apportionment formula. However, that remediation should not be the result of a court's addition, through its failure to apply the rules of statutory interpretation, of a component to the standard apportionment formula that neither exists in the statute nor was intended by the Legislature. The absurdity that the alternative apportionment formula is intended to remediate is when a taxpayer follows the standard apportionment formula but the result is nevertheless an unfair representation of the extent of the taxpayer's business activity in the State. Construing the purpose of the alternative provision to avoid an absurd use of the standard apportionment statute clearly could open the door to the abuse of the standard apportionment statute and an excessive need to apply Section 12-6-2320(A). Furthermore, to use the alternative apportionment provision as a means to avoid absurdity resulting from an interpretation of the standard apportionment provision that is not envisioned by the tax laws places upon the State a burden of policing tax returns that simply should not exist.

Importantly, it is not the amount of distortion that determines absurdity here. If it was, then there would exist an issue of material fact in this case, and indeed in every such case, as to the amount of distortion that would result from the inclusion of principal, and a hearing would be necessary to obtain facts whereby the degree of distortion could be measured so as to determine

³³ This statement does not include securities brokering.

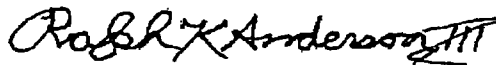
³⁴ Capital gains tax is imposed upon the sale of securities (assuming a profit is made from the sale). This tax is imposed on the profit, or "gains," made on the capital originally invested, not on the returned principal.

whether the results of principal inclusion would be absurd in this case. But such a case-by-case determination is not necessary where, as here, principal cannot, as a matter of law, be included in sales or gross receipts for purposes of the standard apportionment formula. Thus, no hearing is necessary on the gross receipts issue, and the Department's Motion for Summary Judgment as to this issue is therefore granted for the reasons set forth above.

ORDER

THEREFORE, IT IS HEREBY ORDERED that: (1) the Department's Motion for Summary Judgment with respect to the Timeliness Issue is **GRANTED**; (2) the Department's Motion for Summary Judgment with respect to the Apportionment Method Issue is **DENIED**; and (3) the Department's Motion for Summary Judgment with respect to the Gross Receipts Issue is **GRANTED**, and Duke Energy's Cross-Motion for Partial Summary Judgment as to this same issue is therefore **DENIED**.

IT IS SO ORDERED.



Ralph K. Anderson, III
Chief Administrative Law Judge

October 11, 2012
Columbia, South Carolina

CERTIFICATE OF SERVICE

I, E. Harvin Belser Fair, hereby certify that I have this date served this Order upon all parties to this cause by depositing a copy hereof, in the United States mail, postage paid, in the Interagency Mail Service, or by electronic mail to the address provided by the party(ies) and/or their attorney(s).

E. Harvin Belser Fair

E. Harvin Belser Fair
Judicial Law Clerk

October 11, 2012
Columbia, South Carolina

EXHIBIT D

**STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT**

Duke Energy Corporation,	)	
	)	Docket No. 10-ALJ-17-0270-CC
Petitioner,	)	
	)	ORDER DENYING MOTION FOR
vs.	)	RECONSIDERATION IN PART AND
	)	GRANTING RECONSIDERATION
South Carolina Department of Revenue,	)	IN PART
	)	
Respondent.	)	
	)	

Appearances:

For the Petitioners: Burnet R. Maybank, III, Esq.; Eric S. Tresh, Esq.; Jeffrey A. Friedman, Esq.; and Maria M. Todorova, Esq.

For the Respondent: Tracey C. Green, Esq.; John W. Roberts, Esq.; Harry Hancock, Esq.; and J. Abraham Gutting, Esq.

This matter was initially before the Administrative Law Court (ALC or Court) upon a Motion for Summary Judgment filed by Respondent Department of Revenue (Department) and a Cross-motion for Partial Summary Judgment filed by Petitioner Duke Energy Corporation (Duke Energy). The underlying case arises from the Department's denial of amended corporate income tax returns filed by Duke Energy in 2002 for income tax years 1978-2001. On August 9, 2012, the Court issued an Order in which it granted the Department's Motion for Summary Judgment as to the timeliness of Duke Energy's amended refund claims for tax years ending 1978-1993; denied the Department's Motion for Summary Judgment as to whether Duke Energy is considered a "manufacturer" under the applicable apportionment statute; and granted the Department's Motion for Summary Judgment as to Duke Energy's inclusion of the return of principal in its apportionment formula and denied Duke Energy's Cross-Motion for Partial Summary Judgment on this issue.

On August 20, 2012, Duke Energy filed a Motion for Reconsideration of the Court's Order Granting the South Carolina Department of Revenue's Motion for Summary Judgment as to the Waiver and Gross Receipts Issues. The Department filed its Memorandum in Opposition to Duke Energy's Motion for Reconsideration on September 14, 2012. Some of the arguments warrant reconsideration and clarification of the original Order. Accordingly, I am issuing an

FILED

October 11, 2012

SC ADMIN. LAW COURT

Amended Order Granting Summary Judgment in Part and Denying Summary Judgment in Part in this case addressing those issues. The remaining arguments will be addressed below.¹

DISCUSSION

In its Memorandum in Opposition to the Department's Motion for Summary Judgment and in Support of its Cross-Motion for Partial Summary Judgment, Duke Energy argues that in 2007, the South Carolina Legislature made a "drastic" change in the law when it specifically excluded from its definitions of "sales" and "gross receipts" the principal from bonds, loans, or similar marketable instruments. See 2007 S.C. Laws Act 110 § 51.A (enacted as S.C. Code Ann. § 12-6-2295(B)(1)) (Setting forth that "[t]he terms 'sales' as used in Section 12-6-2280 and 'gross receipts' as used in Section 12-6-2290 do not include: (1) repayment, maturity, or redemption of the principal of a loan, bond, or mutual fund or certificate of deposit or similar marketable instrument."). According to Duke Energy, the addition of that exclusion created a material change to the law, and thus "there is a presumption that the Legislature intended to change the existing law rather than to clarify its original intent." It is true that "[w]hen the Legislature adopts an amendment to a statute, th[e] Court recognizes a presumption that the Legislature intended to change the existing law. **Nonetheless, a subsequent statutory amendment may also be interpreted as clarifying original legislative intent.**" Duvall v. South Carolina Budget and Control Bd., 377 S.C. 36, 659 S.E.2d 125 (2008) (Internal citations omitted) (emphasis added).

In its Motion for Reconsideration, Duke Energy further explained that: "Presumably, the South Carolina Legislature was troubled by the inclusion of the principal in the sales factor, which led to its changing the statute to exclude receipts." (Emphasis added). I find no support for such a presumption. If the Legislature was so troubled by an interpretation that would allow inclusion of principal in the sales factor, it is just as likely, if not more so, that this troublesomeness would motivate the Legislature to clarify the existing law so as to avoid an application that it never intended. Duke Energy instead relies on an unsupported statutory

¹ The Court notes that Duke Energy filed an appeal of the Court's original decision granting partial summary judgment "out of an abundance of caution." Following Duke Energy's filing of a Motion to Reconsider, this Court issued an Order staying its decision granting partial summary judgment. Therefore, there was no valid decision regarding the issues addressed in the parties' cross motions for Summary Judgment until the issuance of the Amended Order Granting Summary Judgment In Part and Denying Summary Judgment in Part entered simultaneously with this Order on October 11, 2012.

interpretation premised on the notion that because principal is excluded in S.C. Code Ann. §12-6-2295 (2007) (effective for tax years beginning after 2006), then principal must necessarily have been included in the gross receipts/sales factor prior to the enactment of this statute. On the contrary, the Department asserts that it has had a longstanding interpretation that principal was not included in gross receipts, an assertion that Duke Energy did not dispute. In light of the reasons discussed in the Amended Order Granting Summary Judgment in Part and Denying Summary Judgment in Part as to why the return of principal was excluded from the apportionment formula prior to the enactment of Section 12-6-2295, as well as the Department's longstanding policy of excluding principal from the apportionment formula,² it is clear that the Legislature intended Section 12-6-2295 to clarify the existing law.

However, Duke Energy further contends in its Motion for Reconsideration that this Court, presumably to avoid inconsistency, must interpret Section 12-6-2295 as reflecting a change in the existing law, not clarification of it, since "the Department (and this Court) allowed the sales of Duke Energy securities to be included at net – not excluded all together [sic] as the statutory regime now requires." The problem with this argument is that it misinterprets Section 12-6-2295, the current "statutory regime," as excluding the sales of Duke Energy's securities altogether from the definitions of "sales" and "gross receipts." Though Duke Energy did not in its Motion for Reconsideration cite to a specific subsection to support its position, it clarified in a written response, dated September 21, 2012, to a question posed by this Court that it was

² Duke Energy asserts in its responses to the inquiries presented by the Court on September 19, 2012 that the Department "recently abandoned" its position that it had a long-standing policy "to require only the inclusion of the net gain or interest from short-term investment transactions in the calculation of the apportionment formula," citing the Department's Memorandum in Support of Its Motion for Summary Judgment at 33. The Court finds no such abandonment by the Department – indeed, quite the opposite. On page 33 of the Department's Memorandum in Support of Its Motion for Summary Judgment, the Department states in the heading for section 3, in bold-face type, the following:

Because the Department's long-standing administrative policy excluding the return of principal from short-term investment transactions in the calculation of a taxpayer's apportionment formula is a reasonable application of the legislative intent and the allocation and apportionment statutes, Duke Energy is prohibited from including the return of principal from short-term investment transactions in the calculation of its sales factor or gross receipts factor.

Moreover, the very first sentence of the discussion under this heading states the following: "It has been the long-standing administrative policy of the Department to require only the inclusion of the net gain or interest from short-term investment transactions in the calculation of the apportionment formula regardless of whether a taxpayer files using the three-factor formula or the single factor gross receipts formula." The remainder of the Department's discussion is consistent with this position.

referring to Section 12-6-2295(B)(1).³ Also in its written response, Duke Energy likened the inclusions and exclusions set forth in Section 12-6-2295 to the amended language of S.C. Code Ann. § 12-50-150 (2000), which the South Carolina Supreme Court, in Key Corporate Capital, Inc. v. County of Beaufort, considered to be a change in the law, rather than a clarification. 373 S.C. 55, 644 S.E.2d 675 (2007). As Duke Energy correctly points out, the Court in Key Corporate Capital held that the subsequent amendment of the statute at issue, which added “plus interest in the amount actually earned by the county on the amount refunded” to “the amount paid” in determining the total amount refunded to a successful bidder when a tax sale is voided, constituted a change in the statute, not a clarification. The Court reasoned that the plain meaning of the original statute included only “the amount paid” in the refund, and that the “plus interest” language that was added “materially changed the terminology of the statute, [and that] a departure from existing law [, therefore,] clearly was intended, rather than a clarification of original intent.”

Unlike the Court in Key Corporate Capital, which “s[aw] no reason not to apply the presumption[,]” this Court has set forth in its Amended Order reasons not to apply the presumption but instead finds that Section 12-6-2295(B)(1) was “a subsequent statutory amendment . . . clarifying original legislative intent.”⁴ Key Corporate Capital, 373 S.C. at 60, 644 S.E.2d at 678 n.3 (quoting Stuckey v. State Budget and Control Bd., 339 S.C. 397, 401, 529 S.E.2d 706, 708 (2000)). An amendment to the language of a law does not necessarily mean a change in the meaning of that law, for an amendment may also be interpreted as a clarification by the legislature of its original intent. See Duvall, 377 S.C. at 46, 659 S.E.2d at 130 (“[A] subsequent statutory amendment may also be interpreted as clarifying original legislative intent.”). Rather, the Court must look at whether an amendment to the language of a statute alters the meaning of the statute to determine whether a change, rather than a mere clarification, was intended by the Legislature.

³ In its Motion for Reconsideration, Duke Energy made the following statement: “This legislative change made clear that the sales of securities are excluded from the factor entirely.” In response to this statement, the Court posed two questions to the parties: “(1) To which subsection of 12-6-2295 is ‘legislative change’ referring? (2) How, specifically, does this subsection exclude Duke Energy’s sales of securities, e.g. municipal bonds and commercial paper?”

⁴ The Court quite agrees that parts of Section 12-6-2295(B) reflect changes made by the Legislature to prior law, such as subsections (7) and (9), which respectively exclude from “sales” and “gross receipts” pension reversions and income from forgiveness of indebtedness, both of which had not been so excluded before.

The amendment to the statute in Key Corporate Capital constituted a clear change in the meaning of the statute at issue in that case by adding interest to “the amount paid” in calculating the total amount refunded to a successful bidder when a tax sale is voided. As a result of the new statutory language, the successful bidder would be refunded a higher amount than he/she originally paid, and therefore would receive more under the new statute than under the old statute, which only refunded the amount paid and did not include interest. Thus, because the meaning of the statute was altered by the “material[] change[s] to] the terminology of the statute,” the Court held that “a departure from existing law clearly was intended, rather than a clarification of original intent. . . .” 373 S.C. at 61, 644 S.E.2d at 678. In the present case, however, Section 12-6-2295(B)(1) merely follows the existing law in South Carolina with regard to the treatment of principal, specifically that principal is excluded from “sales” and “gross receipts,” as has been previously discussed. Section 12-6-2295(B)(1) thus simply clarifies that exclusion of principal from “sales” and “gross receipts” for purposes of the apportionment formula applies to “repayment, maturity, or redemption of the principal of a loan, bond, or mutual fund or certificate of deposit or similar marketable instrument[.]” (Emphasis added).

Nevertheless, Duke Energy argues in its responses to the Court’s inquiries dated September 19, 2012 that the language of Section 12-6-2295(B)(1) “does not exclude the ‘sales’ of securities,” only “the repayment, maturity or redemption of a security,” and that the Department’s auditor, Joe Southard, created an ambiguity by stating in his deposition testimony that the exclusion did apply to the sales of securities. (Emphasis omitted). It must be noted from the outset that Duke Energy’s position that Section 12-6-2295(B)(1) does not exclude the sales of securities stands in complete contradiction to the position that Duke Energy took in its Memorandum in Support of Its Motion for Reconsideration, in which it stated: “This legislative change [set forth in S.C. Code Ann. § 12-6-2295(B)(1)] made clear that **the sales of securities are excluded from the factor entirely.**” (Emphasis added). Because Duke Energy’s initial argument was that the sales are excluded by the “change” Section 12-6-2295, and Duke Energy confirmed that it was relying on subsection (B)(1) when referencing that change, Duke Energy cannot now argue that sales of securities are **not** excluded by Section 12-6-2295(B)(1). See Cothran v. Brown, 357 S.C. 210, 215, 592 S.E.2d 629, 631 (2004) (citations omitted) (“Judicial estoppel is an equitable concept that prevents a litigant from asserting position inconsistent with, or in conflict with, one the litigant has previously asserted in the same or related proceeding. The

purpose of the doctrine is to ensure the integrity of the judicial process, not to protect the parties from allegedly dishonest conduct by their adversary.”).

In response to Duke Energy’s initial argument, this Court finds that “sales” of securities are not subject to the exclusion under 12-6-2295(B)(1), but only to the extent of the net gains from those sales; the principal from those sales is excluded. The Court also disagrees with Duke Energy’s statement that “th[e] exclusion is limited to the repayment, maturity or redemption of a security,” because this statement excludes a key phrase in the language of the statute: “the principal of.” The statutory exclusion under (B)(1) applies only to “repayment, maturity, or redemption of the principal of a loan, bond, or mutual fund or certificate of deposit or similar marketable instrument[.]” (Emphasis added).⁵ Hence, the exclusion only applies to the extent of the principal of the securities that have been repaid, have matured, or have been redeemed. Indeed, this was the understanding that the Department’s auditor had, as reflected in his response that only the net amount from the repayment, maturity, or redemption of the principal of a marketable instrument falling under (B)(1) would be included in the sales factor, not the principal. Thus, the auditor’s deposition testimony cited by Duke Energy in footnote 3 of its responses to the Court’s inquiries dated September 19, 2012 does not create an ambiguity, but rather echoes the Department’s long-standing policy of excluding principal from “sales” and “gross receipts” in the apportionment formula.

Finally, Duke Energy argues that “principal” in Section 12-6-2295(B)(1) modifies only “a loan, bond or mutual fund” and does not modify “certificate of deposit” and “similar marketable instrument.” Section 12-6-2295(B)(1) excludes from the definitions of “sales” and “gross receipts” “repayment, maturity, or redemption of the principal of a loan, bond, or mutual fund or certificate of deposit or similar marketable instrument.” Duke Energy maintains that “the word ‘or’ is a disjunctive particle [sic] and its use before ‘certificate of deposit’ and before ‘similar marketable instrument’ signifies an alternative.” Thus, “principal” modifies only “a loan, bond, or mutual fund.”

As an initial matter, because Duke Energy admits that “[t]he statute requires the exclusion of the ‘principal’ of ‘a loan, bond, or mutual fund,’” and admits that it “purchased and

⁵ According to Duke Energy’s letter dated July 17, 2012 in response to inquiries issued by the Court, the securities that Duke Energy purchased and sold as a part of its business included municipal bonds, loan repurchase agreements, and commercial paper.

sold securities[,] including municipal bonds . . .,” Duke Energy essentially concedes that the principal of at least some of the securities that it sold is excluded from “sales” and “gross receipts” in the apportionment formula under Section 12-6-2295(B)(1). However, as discussed in this Court’s Amended Order, the principal from the sales of securities was likewise excluded from the “sales” or “gross receipts” factor of the apportionment formula prior to the enactment of Section 12-6-2295(B)(1). Therefore, no change took place with respect to the exclusion of principal from the sales of securities under the “sales” or “gross receipts” factors of the apportionment formula. This stands in contradiction to Duke Energy’s contention that the apportionment formula was substantially changed based upon the language of Section 12-6-2295(B)(1) enacted by the Legislature in 2007.⁶

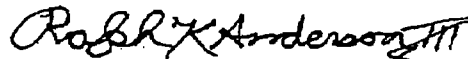
As to Duke Energy’s statutory interpretation of Section 12-6-2295(B)(1), the Court agrees that the “or” is a logical disjunction, coordinating conjunction, or disjunctive conjunction or disjunctive participle that signifies an alternative between the phrases “loan, bond, or mutual fund”; “certificate of deposit”; and similar marketable instrument.” See Garris v. Governing Bd. of the S.C. Reinsurance Facility, 333 S.C. 432, 440, 551 S.E.2d 48, 52 (1998) (recognizing “where a statute contains two clauses which prescribe its applicability and the clauses are connected by the disjunctive ‘or,’ application of the statute is not limited to cases falling within both clauses, but applies to cases falling within either”); Brewer v. Brewer, 242 S.C. 9, 14, 129 S.E.2d 736, 738 (1963) (holding the word “or” used in a statute or regulation is a disjunctive participle marking an alternative). However, the use of “or” here does not limit the application of “the principal of” to the first phrase – “loan, bond, or mutual fund.” Rather, “the principal of” modifies all three phrases in subsection (B)(1). The controlling language of this subsection is the first part of the subsection – “repayment, maturity, or redemption of the principal of.” “The principal” cannot be separated from “repayment, maturity, or redemption,” as the “repayment, maturity, or redemption” is “of the principal.” Likewise, the latter part of the subsection “a loan, bond, or mutual fund or certificate of deposit or similar marketable instrument” cannot be separated from the controlling, first half of the subsection – “repayment, maturity, or redemption

⁶ Duke Energy infers that a distinction there exist between the sale of securities, and the repayment, maturity, or redemption of securities. I find no such distinction evident from the language of Section 12-6-2295(B)(1). Moreover, as explained above, Duke Energy in both its Memorandum in Support of its Cross-Motion for Partial Summary Judgment and in its Motion for Reconsideration contends that the sales of securities are excluded from the apportionment formula of Section 12-2-2295 entirely.

of the principal of.” Had the Legislature intended “certificate of deposit” and “similar marketable instrument” to be interpreted as separate items that were not modified by “repayment, maturity, or redemption of the principal of,” then the Legislature would have listed “certificate of deposit” and “similar marketable instrument” as separate, enumerated items, as it did in subsections (B)(2)-(10). Rather, the Legislature clearly put these various terms under one subsection because they were “similar marketable instrument[s].” Hence, each of the terms, “loan,” “bond,” “mutual fund,” “certificate of deposit,” and “similar marketable instrument” are all singular, all being modified by the same indefinite article “a.” Furthermore, from a practical standpoint, to adopt Duke Energy’s interpretation would be to endorse the absurd notions that the net gain from certificates of deposit or similar marketable instruments is excluded from “sales” and “gross receipts” for purposes of tax apportionment, and that certificates of deposit should be treated differently from bonds. The Legislature could hardly have intended such an absurd application. Therefore, this Court rejects Duke Energy’s interpretation of Section 12-6-2295(B)(1).

IT IS THEREFORE ORDERED that that the Petitioners’ Motion for Reconsideration is denied, in part, and granted, in part, in keeping with this Order.

AND IT IS SO ORDERED.



Ralph King Anderson, III
Administrative Law Judge

October 11, 2012
Columbia, South Carolina

CERTIFICATE OF SERVICE

I, E. Harvin Belser Fair, hereby certify that I have this date served this Order upon all parties to this cause by depositing a copy hereof, in the United States mail, postage paid, in the Interagency Mail Service, or by electronic mail to the address provided by the party(ies) and/or their attorney(s).

E. Harvin Belser Fair

E. Harvin Belser Fair
Judicial Law Clerk

October 11, 2012
Columbia, South Carolina

EXHIBIT E

**STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT**

Duke Energy Corporation,	)	
	)	Docket No. 10-ALJ-17-0270-CC
Petitioner,	)	
	)	
	)	FINAL ORDER AND DECISION
vs.	)	
	)	
South Carolina Department of Revenue,	)	
	)	
Respondent.	)	
_____	)	

Appearances:

For the Petitioners: Burnet R. Maybank, III, Esq.; Eric S. Tresh, Esq.; Jeffrey A. Friedman, Esq.; and Maria M. Todorova, Esq.

For the Respondent: Tracey C. Green, Esq.; John W. Roberts, Esq.; Harry Hancock, Esq.; and J. Abraham Gutting, Esq.

STATEMENT OF THE CASE

This matter comes before the Administrative Law Court (ALC or Court) following Duke Energy Corporation's (Duke Energy) request for a contested case hearing under S.C. Code Ann. § 12-60-460 (Supp. 2006). Duke Energy is contesting the Determination of the South Carolina Department of Revenue (Department) denying Duke Energy's claim for a refund of South Carolina corporate income taxes for the tax years 1994 through 2001 (Tax Periods at Issue).¹ Duke Energy asserts that it is a service provider and thus is required to apportion its income to South Carolina on the basis of the single-factor gross-receipts apportionment formula. A hearing was held before this Court on September 5 and 6, 2012.

LEGAL ISSUES RAISED

The following issue is raised in this proceeding: Whether Duke Energy, based on its activities within the State of South Carolina, falls under Section 12-6-2250 as a "manufactur[er]" or some other category listed in 12-6-2250, or whether Duke Energy is required to apportion its

¹ Duke Energy originally sought refunds for the tax years 1978 through 2001. On October 11, 2012, this Court ruled that Duke Energy's refund claims for the tax years 1978 through 1993 are untimely. Thus, Duke Energy's refund claims for 1978-1993 are not before the Court at this time.

FILED

November 2, 2012

SC ADMIN. LAW COURT

income to South Carolina based on the single-factor gross-receipts apportionment formula pursuant to Section 12-6-2290.²

STIPULATIONS OF FACT

At the hearing into this matter and pursuant to ALC Rule 25(C), the parties entered the following written stipulations of fact into the Record:

Preliminary Definitions

1. "Gross-receipts apportionment formula" refers to South Carolina's method of income apportionment prescribed under S.C. Code Ann. § 12-6-2290 and former S.C. Code Ann. § 12-7-1190.
2. "Multi-factor apportionment formula" refers to South Carolina's method of income apportionment prescribed under S.C. Code Ann. § 12-6-2250 and former S.C. Code Ann. § 12-7-1140.
3. "Petitioner" means Duke Energy Corporation (formerly known as Duke Power Company) and any predecessor or successor and any other entity owned by Duke Energy Corporation.
4. "Respondent" means the South Carolina Department of Revenue.
5. "1978-2001 tax periods" means the Petitioner's tax years 1978 through 2001, all of which were reported on a calendar-year basis.

The Parties

6. Respondent is an administrative Cabinet-level agency of the State of South Carolina responsible for administering and enforcing the State's revenue laws.

² In my Amended Order Granting Summary Judgment in Part and Denying Summary Judgment in Part, I stated the issue presently before the Court as follows: "whether Duke Energy, based on its activities within the State, falls under Section 12-6-2250 as a "manufactur[er]," or whether Duke Energy is a seller of services, or otherwise falls under none of the above-categories, and is therefore required to apportion its income to South Carolina based on the single-factor gross-receipts apportionment formula" This statement of the issue contains the conclusory phrase "is a seller of services, or otherwise falls under none of the above categories." This phrase erroneously presupposes that a seller of services could not be included in Section 12-6-2250. However, as will be discussed in more detail later, sales of electricity, though considered a service for certain tax purposes, has also been considered "tangible personal property," for those same tax purposes. Therefore, electricity could be considered a service and still be tangible personal property under Section 12-6-2250. The error of excluding "seller of services" from Section 12-6-2250 in the statement of the issue, however, did not affect the need to have a hearing on the present issue because there is a genuine issue of material fact as to the nature of Duke Energy's status for purposes of Sections 12-6-2250, -2290 based on its business activities.

7. Petitioner is, and was during the 1978-2001 tax periods, engaged in the generation, transmission, distribution, and sale of electricity in portions of North Carolina and South Carolina.
8. The Parties stipulated to Petitioner's restated corporate charters filed with the North Carolina Secretary of State on July 26, 1977, October 6, 1993, and June 18, 1997.
9. The Parties stipulated to Petitioner's Form 10-Ks for the 1978-2001 tax periods.
10. During the 1978-2001 tax periods, Petitioner was regulated by the South Carolina Public Service Commission (Commission) as an "electric utility" pursuant to Title 58-27-10(7).

Procedural History

11. Petitioner timely filed its South Carolina corporate income tax returns (including license tax returns) for the 1978-2001 tax periods.
12. On its originally-filed South Carolina corporate income tax returns for the tax periods 1978-2001, Petitioner filed using the multi-factor apportionment formula.
13. On December 12, 2002, Petitioner filed South Carolina amended corporate income tax returns for the 1978-2001 tax periods seeking a refund of corporate income taxes plus applicable interest ("1978-2001 Refund Claims").
14. The Parties stipulated to Petitioner's South Carolina amended corporate income tax returns filed on December 12, 2002 for the 1978-2001 tax periods.
15. The 1978-2001 Refund Claims reflected use of the gross-receipts apportionment formula to apportion Petitioner's income to South Carolina.
16. On February 12, 2003, Respondent denied Petitioner's 1978-2001 Refund Claims.
17. On March 13, 2003, Petitioner timely appealed from the denial of its 1978-2001 Refund Claims.
18. On February 4, 2010, Respondent issued a Determination denying Petitioner's refund claims for tax periods 1978-2001.
19. On March 3, 2010, Petitioner timely filed a Request for Contested Case Hearing with the Clerk's Office of the South Carolina Administrative Law Court in Columbia, South Carolina contesting the Determination.
20. Petitioner and Respondent timely filed their Prehearing Statements and Amended Prehearing Statements.

FINDINGS OF FACT

Having observed the witnesses and exhibits presented at the hearing and taking into consideration the burden of persuasion and the credibility of the witnesses, I make the following additional findings of fact by a preponderance of the evidence:

Duke Energy Business Operations

Duke Energy is engaged in the business of generation, transmission, distribution, and sale of electricity in portions of both North Carolina and South Carolina. Clearly, providing electricity is Duke Energy's "primary business." Duke Energy also furthers its primary business by owning and operating transmission and distribution assets in South Carolina as well as in North Carolina.

Duke Energy sells electricity on both a metered and flat-fee basis. Under the flat-fee plan, Duke Energy provides electricity for outdoor lighting at a fixed price.³ The metered service plan is based on usage, i.e., the electricity provided by Duke Energy is read by a meter and billed to the customer on the basis of usage during the billing period. Regardless of the service plan, a portion of each Duke Energy customer's service charge recovers Duke Energy's costs associated with maintaining the infrastructure that Duke Energy uses to provide electric service. This charge is known as a capacity charge and is billed to the customer as part of the monthly service charge, even if the customer does not use electricity in a given month. Nevertheless, however the profits from the flat-rate or capacity charges are perceived, those charges were not a significant portion of Duke Energy's profit from the sale of electricity during the Tax Periods at Issue.⁴

Production of Electricity

Duke Energy operates plants in both South Carolina and North Carolina to produce electricity. In South Carolina, Duke Energy has two nuclear power plants, four coal power

³ Although Duke Energy introduced evidence regarding the fact that it charges a flat fee for outdoor lighting, that does not negate the fact that the vast majority of the electricity delivered by Duke Energy is sold based on quantity consumed. Moreover, the time period for which outdoor lighting operates is controlled by use of a photocell, and Duke Energy has information to make estimates regarding variables in the timing to determine a pricing for the outdoor lighting.

⁴ Mr. Dhiaa Jamil did testify that a portion of a customer's bill is a flat fee for a capacity charge, but he also testified that he did not know the rate or level at which that fee is imposed—other than that it is less than \$100—and, in fact, ultimately testified "that's really not my area." The Court concludes that this testimony does not assist Duke Energy in meeting its burden of proof.

plants, three hydroelectric power plants, and several oil or gas power plants.⁵ The electricity that is produced and consumed by its customers is created at Duke Energy generation facilities. A generator is a "mechanical device" that uses mechanical energy to produce electric energy or, as it is more commonly known, electricity. Generators have been used to produce electricity in substantially the same manner for over 100 years. Many, though not all, of Duke Energy's generation facilities use a turbine driven by steam power to turn the generator. Although the sources or inputs (e.g., coal, uranium, water) used at these different types of generation facilities may vary, all use a generator to produce electricity. The result, however, is the same: Duke Energy employs a mechanical device to produce and generate electricity using the same process employed since the early 20th century.

Duke Energy nonetheless offered evidence that the production of electricity does not create anything. Rather, Duke Energy avers it is doing nothing more than providing access to "the electromagnetic field." However, Duke Energy produces that electromagnetic field. Duke Energy's own witness testified that, "in layman's terms," electromagnetic field is electric current," and that any electromagnetic field results from the electric current created by the generator. No matter what moniker used to describe the product produced by Duke Energy, the electric current that generates that field, or even the field itself, is produced through a mechanical process run by Duke Energy.

Distribution and Sale of the Electricity

The process by which Duke Energy generates or produces electricity does not end at the generator. The generator is obviously connected to the transmission and distribution network. That network consists of transmission and distribution lines, which are conductors made of copper, towers and poles, and transformers. During the transmission and distribution process, the transformers process the electricity by "stepping up" and "stepping down" the voltage of the electricity. By "stepping up" the voltage, Duke Energy is able to transmit the electrical current at a low current. The "step up" process is done in order to efficiently deliver electricity by reducing line loss, which is the loss to Duke Energy of a quantity of electricity as heat during the transmission and distribution processes.

⁵ Duke Energy also produces electricity using natural gas, wind, and solar. Duke Energy also occasionally purchases electricity from other electric utilities. However, these methods of producing or acquiring electricity appear to be much less significant than the methods indicated above.

Ultimately, electricity must be delivered at the specified voltage so that it can be used by customers in their homes and businesses. Typically, electricity is not usable by a customer unless it is at 120 volts, although sometimes it is delivered at 220 volts. Whatever the required voltage, it is necessary to ensure that the electricity delivered to a customer is "stepped down" to the usable voltage, a process that is done close to where the electricity is eventually used by the customer.

Most customers of Duke Energy obtain the electricity after it passes through a meter. More specifically, by activating a switch, which creates a load and completes a circuit, the electricity passes through the customer's meter and operates the device. Duke Energy measures the amount of electricity consumed by each customer (usually in term of kilowatts) and then charges the consumer for the quantity used/consumed.⁶ Moreover, electricity is not a useable product unless it is delivered to customers at precise specifications. Prior to delivery of the electricity to the consumer through the meter, the electric utility owns the electricity, which is not delivered for sale until it is processed into a form usable by a consumer. This typically occurs closer to the customer's business or home.

Duke Energy compared the provision of electricity to the provision of telecommunication services—both cellular and landline. However, unlike Duke Energy, telecommunication companies do not generate electricity but, instead, only use electricity purchased from electric utilities. Furthermore, Duke Energy delivers to its customers a quantifiable product that is produced by Duke Energy. In contrast, telecommunications companies transmit communications or intelligence produced or created by one customer to another through a system operated by electricity purchased from utilities like Duke Energy. Additionally, cellular telephone providers use radio technology to transfer information between two locations. The frequencies and strengths of telecommunications waves are vastly different than the frequencies and strengths of electricity.

In sum, the generation, transmission, and distribution processes are interconnected. Duke Energy cannot produce or deliver electricity to consumers in the absence of any one of these parts, each of which provide an essential aspect of Duke Energy's process for producing,

⁶ Aside from the fact that electricity is measured by quantity, the nature of electricity, as a product, is further demonstrated by the fact that electric current is a flow of charges or charged particles, the rate of which is measured in amperes.

transmitting, and delivering electricity to customers. Moreover, Duke Energy presented no evidence that supports separating its electric transmission and distribution processes from its generation processes and, in fact, described the whole process as a "very elaborate system." Indeed, Mr. Jamil testified that each of the processes employed by Duke Energy is "used to produce electricity."⁷

Physical Nature of Electricity

Electricity is a physical product with physical characteristics. Regarding whether electricity may be sensed by humans, I do not find that the testimony presented by either party was probative as expert testimony. In other words, there was no evidence that the witnesses possessed "knowledge, skill, experience, training, or education" regarding the effect of electrical stimulation upon the human physiology justifying this Court to accept their opinion as expert testimony. Nevertheless, based upon the evidence, I find that it is possible to feel electricity, and thus electricity can be touched. Though Duke Energy presented valid instances in which a person may not feel electricity, that does not discount the instances when it can be felt.

Moreover, even if I were to find Duke Energy's evidence regarding this matter to be probative, I am unconvinced. Duke Energy's expert witness, Mr. Ioannis Papapolymerou, explained that a human cannot feel electricity but only the impact of the electricity. Though I find the proposed nuances between the feeling of an object itself and the feeling of the impact from the object to be the makings of an interesting theoretical debate, I find no considerable distinction between the two and therefore find that electricity can be felt by humans.

Electricity can also be stored. Concerning this issue, Duke Energy characterized an electric charge as the source of electricity and as the physical property that is stored. The electrical charge is nonetheless a component of what is produced by Duke Energy.

In sum, Duke Energy takes raw materials (e.g., coal, uranium, water), uses those materials to power mechanical devices to produce a form of electricity that is usable and consumed by the public. Although electricity is unique, it is a tangible product with identifiable physical characteristics that may be created, measured, felt, stored, and consumed, and an electric utility may exercise ownership rights over it.

⁷ Additionally, Duke Energy introduced an exhibit listing the "Functions" of Duke Energy as "Production," "Transmissions," and "Distribution."

Department's Policy History

The Department and the Commission have a longstanding interpretation that electric utilities should be characterized as manufacturers for purposes of corporate income tax apportionment. Though the Department's policy was never set forth in any public document, it was memorialized in the foreign corporation training manual used by the Department's auditors. Joseph Southard, a retired auditor for the Department with over 25 years of experience, who conducted audits of several electric utilities, including Duke Energy, explained that the Department's policy was that electric utilities were manufacturers for purposes of the apportionment statutes.

The Department also applied this policy consistently, and Duke Energy offered nothing to show otherwise. No other electric utilities challenged that position before Duke Energy filed its amended returns. In fact, Duke Energy filed its returns using the multi-factor apportionment formula for at least 23 years before filing the amended returns and challenging the policy in 2002.

CONCLUSIONS OF LAW

In determining the income tax due from Duke Energy, the Department apportioned Duke Energy's South Carolina income using the multi-factor apportionment formula of Section 12-6-2250. The Department argues that Duke Energy's principal business in South Carolina is manufacturing and that Section 12-6-2250 should therefore apply. Duke Energy, however, contends that its principal business in South Carolina is the provision of service to customers and that Section 12-6-2290 should thus apply.

Burden of Proof

Because Duke Energy is challenging a determination by the Department that it must apportion its income under section 12-6-2250, it has the burden of proof. See SCALCR 29(B); Ford v. Atl. Coast Line R. Co., 169 S.C. 41, 168 S.E. 143, 167 (1932) ("The general rule is, in the absence of valid statutory enactment to the contrary, that the burden of proof rests upon him who has the affirmative of the issue and does not shift to the defendant even when aided, in the first instance, by a rebuttable presumption."); see also Anonymous v. State Bd. of Med. Exam'rs, 329 S.C. 371, 496 S.E.2d 17 (1998). This burden requires Duke Energy to prove that the Department's determination is wrong by a preponderance of the evidence. See, e.g., Janasik v. Fairway Oaks Villas Horizontal Prop. Regime, 307 S.C. 339, 346, 415 S.E.2d 384, 388 (1992)

("Findings of fact based upon a 'preponderance' of the evidence are those supported by the greatest 'weight, amount, credibility or truth' as reflected by the whole of the evidence before the court, or 'evidence which convinces as to its truth.'").

Apportionment of Income

The method of apportionment that a taxpayer must use depends upon the nature of the taxpayer's business in this State. Section 12-6-2250⁸ requires a taxpayer to apportion its multi-state income using the property, payroll, and sales factors if the taxpayer falls within the following definition:

A taxpayer whose principal business in this 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

S.C. Code Ann. § 12-6-2250.⁹ On the other hand, "[i]f the principal profits or income of a taxpayer are derived from sources other than those described in Section 12-6-2250," the taxpayer is required to use the single-factor gross-receipts apportionment formula. S.C. Code Ann. § 12-6-2290.¹⁰ Consequently, the issue that must be resolved for the Tax Periods at Issue is whether the Department erroneously determined that Duke Energy must apportion its income pursuant to Section 12-6-2250. After considering the evidence in the record and the pertinent legal authorities, I conclude that Duke Energy has failed to establish by the preponderance of the evidence that its principal business in South Carolina is not manufacturing or some other activity falling under Section 12-6-2250.

Agency Deference

The Department contends that in determining this issue the ALC must give its construction of Section 12-6-2250 deference. "An agency's long-standing interpretation of a statute is usually entitled to be given deference and should not be overruled by a reviewing court

⁸ Because the Tax Periods at Issue cover multiple years (1994-2001), a parenthetical date will not be used for the statutory citations.

⁹ Section 12-6-2250 during the Tax Periods at Issue required that the sales factor be double-weighted in calculation of the apportionment formula. This section was previously designated as section 12-7-1140, which was repealed in 1995. Prior to June 12, 1995, section 12-7-1140 provided a three-factor formula without the double-weighted sales factor.

¹⁰ Like section 12-6-2250, the predecessor of section 12-6-2290, S.C. Code § 12-7-1190, was repealed in 1995, but the language remained substantially the same. Section 12-6-2290 also excludes sources described in section 12-6-2310, but that statute references income earned by railroad companies, motor carriers, telephone service companies, pipeline companies, airline companies, and shipping lines, none of which are applicable in this case.

in the absence of cogent reasons. . . .” Media Gen. Commc’ns, Inc., and Media Gen. Broad. of S.C. Holdings, Inc. v. S.C. Dep’t of Revenue, 388 S.C. 138, 149, 694 S.E.2d 525, 531 (2010) (citing Etiwan Fertilizer Co. v. S.C. Tax Comm’n, 217 S.C. 354, 360, 60 S.E.2d 682, 684 (1950)). In Etiwan, the Court further explained that: “[W]here the construction of the statute has been uniform for many years in administrative practice, and has been acquiesced in by the General Assembly for a long period of time, such construction is entitled to weight, and should not be overruled without cogent reasons.” Etiwan, 217 S.C. at 359, 60 S.E.2d at 684. If the Department is entitled to deference, it is Duke Energy’s burden to prove that the Department’s policy is “arbitrary, discriminatory or unreasonable.” Colonial Life & Acc. Ins. Co. v. S. Carolina Tax Comm’n, 248 S.C. 334, 339, 149 S.E.2d 777, 780 (1966) (“The Commission has the power and duty . . . to prescribe a method for arriving at a tax base which reasonably represents the proportion of the trade or business carried on within this State...and its determination thereabout will not be overthrown by the courts except upon a showing, absent here, that it is arbitrary, discriminatory or unreasonable”) (internal quotation marks omitted); see also Vulcan, 342 S.C. at 496, 536 S.E.2d at 900; Etiwan, 217 S.C. at 359, 60 S.E.2d at 684. For the reasons set forth below, Duke Energy did not meet its burden in this regard.

The record shows that the Department and the Commission consistently have characterized electric utilities as manufacturers for purposes of corporate income tax apportionment.¹¹ Duke Energy filed its returns using the multi-factor apportionment formula for at least 23 years before filing the amended returns and challenging the policy in 2002, which reflects that Duke Energy was aware of the policy. And although a Duke Energy witness, Cooper Monroe,¹² testified that the original returns were filed in error, he also acknowledged that Duke Energy and accounting firms “in [his] experience” apply a review process before a tax return is filed. This long period of time in which Duke Energy filed returns using the multi-factor apportionment formula leads to the conclusion that the returns were filed in

¹¹ Duke Energy asserts that there is an inconsistency in the Department’s audit manual in that service providers (those whose principal business is providing a service) have to apportion their income to South Carolina based on the single-factor gross-receipts apportionment method, while power companies must use the multi-factor apportionment formula. However, there is only an inconsistency if one adopts the premise that the generation, transmission, and distribution of electricity constitutes provision of service, or the premise that provision of service generates more profits or income than generation, transmission, and distribution of electricity, neither of which this Court adopts.

¹² Thomas Cooper Monroe, III is currently the Director of State and Local Tax for Duke Energy.

accordance with the policies and filing requirements promulgated by the Department and as understood by Duke Energy at the time the returns were originally filed.

Moreover, though the policy was not set forth in a publicly-issued advisory opinion, a decision of the Commission for property tax purposes supports the conclusion that the Department openly and consistently viewed electric utilities as manufacturers. In 1985, the Commission determined that "'X' Electric and Gas" was a manufacturer because the Supreme Court had held that its predecessor was a manufacturer in the Columbia Ry. decision. S.C. Tax Comm'n Decision P-D-532, 1985 WL 192777 (Apr. 11, 1985) (citing Columbia Ry., Gas & Elec. Co. v. Query, 134 S.C. 319, 132 S.E. 611, 612 (1926)). Although this ruling was rendered in the context of property taxes, it reflects a public position that the Department consistently applied the Columbia Ry., supra, and Duke Power, infra, decisions and consistently determined that electric utilities are manufacturers. The consistency of this policy is further evidenced by the fact that in P-D-532, the Department gave the electric utility the benefit of being a manufacturer by determining that its property-tax assessment ratio should be 6% as opposed to the 10.5% applicable to the personal property of non-manufacturing entities.¹³ More importantly, the South Carolina Supreme Court's decision in Columbia Ry., supra publicly reflects in the income-tax context the Department's position that those engaged sale of electricity are manufacturers. See also Duke Power Co. v. Bell, 156 S.C. 299, 152 S.E. 865 (1930) (recognizing the same position in the property-tax context). I find that though the notice to the General Assembly is traditionally given through a policy available to the public, the facts in this case meet the criteria envisioned in Etiwan. See also Whitner v. State, 328 S.C. 1, 6, 492 S.E.2d 777, 779 (1997) ("[T]here is a basic presumption that the legislature has knowledge of previous legislation as well as of judicial decisions construing that legislation when later statutes are enacted concerning related subjects.") (emphasis added). Nevertheless, whether or not the Department's position is given deference, I find that Duke Energy's principal business is manufacturing for the reasons given below.

¹³ Also, in 1970, the South Carolina Attorney General opined that the South Carolina Electric & Gas Company was a manufacturer and that any plant it used to produce electricity was a manufactory eligible for property tax exemptions. 1970 S.C. Op. Att'y Gen. 154, Op. No. 2909, 1970 WL 12192 (June 2, 1970). The basis for this ruling was the Columbia Ry. and Duke Power decisions.

Manufacturing

Duke Energy must apportion its multi-state income for the Periods at Issue pursuant to Section 12-6-2250 unless Duke Energy proves that its principal business within this State is not (1) “manufacturing”; or (2) “any form of collecting, buying, assembling, or processing goods and materials within this State”; or (3) “selling, distributing, or dealing in tangible personal property.” Though Duke Energy suggests a contrary reading of this statute, the Legislature’s use of the disjunction “or” following “manufacturing” in Section 12-6-2295(a)’s phrase “manufacturing or any form of collecting, buying, assembling, or processing goods and materials within this State” demonstrates that the term “manufacturing” is not dependent on, or modified by, the clause “any form of collecting, buying, assembling, or processing goods and materials within this State.” Michau v. Georgetown County ex rel. S.C. Counties Workers Comp. Trust, 396 S.C. 589, 595, 723 S.E.2d 805, 808 (2012) (“[T]he ‘use of the word ‘or’ in a statute ‘is a disjunctive particle [sic] that marks an alternative.’”) (citing K & A Acquisition Group, LLC v. Island Pointe, LLC, 383 S.C. 563, 580, 682 S.E.2d 252, 261 (2009)). This conclusion is supported by the statutory history, which reflects that the apportionment statute, when adopted, addressed only corporations “engaged in the business of manufacturing,” 1927 S.C. Acts 1, No. 1, § 15(1),¹⁴ and that the latter clause of subsection (a) was added in 1946, 1946 S.C. Acts 1491, No. 553, § 3 (amending apportionment statute, then found in section 2451 of the 1942 Code, to apply to taxpayers whose “principal business ... in this State is manufacturing, or if it is any form of collecting, buying, selling, assembling or processing goods and materials within this State.”) (emphasis added). Thus, inclusion of the phrase “or any form of collecting, buying, assembling, or processing goods and materials” after “manufacturing” in Section 12-6-2250(a) reflects that the Legislature intended to cover not just manufacturing but all activities that a business could perform in regards to a product prior to making that product available to its customers. See Charleston County Sch. Dist. v. State Budget and Control Bd., 313 S.C. 1, 5, 437 S.E.2d 6, 8 (1993) (“The cardinal rule of statutory construction is to ascertain and effectuate the intent of the legislature.”).

Here, there is no dispute regarding several of the elements of Section 12-6-2250. It is undisputed that Duke Energy is a taxpayer required to file corporate income tax returns in this

¹⁴ This language remained the same in the apportionment statute enacted as Section 2451 in both the 1932 South Carolina Code of Laws and the 1942 South Carolina Code of Laws.

State. Similarly, it is undisputed that Duke Energy has multi-state income that must be apportioned. See S.C. Code Ann. § 12-6-2210(b). There is also no disagreement that Duke Energy is engaged in the business of generation, transmission, distribution, and sale of electricity in portions of both North Carolina and South Carolina. Mr. Dhiaa Jamil¹⁵ testified that providing electricity is Duke Energy's "primary business." To conduct its primary business, Duke Energy operates generation plants in both South Carolina and North Carolina.

Because "manufacturing" is not defined in the apportionment statutes, this Court must interpret it in accord with its usual and customary meaning. E.g., Travelscape, LLC v. S.C. Dept. of Revenue, 391 S.C. 89, 99-100, 705 S.E.2d 28, 33-34 (2011). Merriam-Webster's Dictionary presently defines "manufacture" as "the process of making wares by hand or by machinery especially when carried on systematically with division of labor." It further defines the term to include "productive industry using mechanical power and machinery" and "the act or process of producing something." See <<http://www.merriam-webster.com/dictionary/manufacture>> (accessed October 18, 2012); see also Jennings v. Jennings, No. 27177 (Oct. 18, 2012) (Hearn, J.) (referencing online Merriam-Webster's Dictionary for definition of a word).¹⁶ And in 1939, in holding that the generation of electricity is manufacturing, the Iowa Supreme Court referenced Webster's definition of manufacturing, which was "to make by hand, by machinery, or by other agency; to work raw materials into forms for use; to produce mechanically." Winterfield, 285 N.W. at 224-25. Applying this definition, the court held that generating electricity is manufacturing. Id.

Our Supreme Court has also held on two different occasions that an electric utility that generates electricity is engaged in manufacturing. In Columbia Ry., the South Carolina Supreme Court held that a company engaged in the business of generating electricity was properly

¹⁵ Dhiaa M. Jamil, P.E., currently is the Executive Vice President of Nuclear Generation and the Chief Nuclear Officer for Duke Energy.

¹⁶ It is also worth noting that the current Merriam-Webster's definition of the term "ware," a term included in the definition of "manufacturing," includes manufactured goods. See <<http://www.merriam-webster.com/dictionary/ware>> (accessed October 18, 2012). Also, Merriam-Webster's current definition of "good" includes "something that has economic utility or satisfies an economic want" and "something manufactured or produced for sale." See <<http://www.merriam-webster.com/dictionary/good>> (accessed October 18, 2012). Thus, even if in Section 12-6-2250(a) "manufacturing" modified "goods," the electricity that Duke Energy generates, transmits, and distributes would be in accord with the common understanding of the term "manufactured good," and would therefore still satisfy Section 12-6-2250(a) under that alternative interpretation of the statute. Furthermore, Duke Energy has failed to prove by the preponderance of the evidence that the electricity it produces is not a good or that it is not manufactured.

considered a "manufacturer" for purposes of a statute that imposed a corporate income tax on "a corporation engaged in the business of manufacturing." 132 S.E. at 612 ("We do not think that there is any doubt that the appellant is engaged in the business of manufacturing gas and electricity"); see also State v. Broad River Power Co., 157 S.C. 1, 153 S.E. 537, 539 (1929) (noting that the Columbia Railway company built "a large plant for the manufacture of gas and electricity for sale to the public generally") (emphasis added).¹⁷ In a later case, reviewing a different statute, the Supreme Court held that Duke Power Co., a predecessor of Duke Energy, was entitled to claim a property tax exemption for manufactories—defined as a physical plant, or a place or building, where manufacturing is carried on—because it was a manufacturer. Duke Power, *supra*. The Court held that, based on Columbia Ry., Duke Power was engaged in manufacturing. *Id.*, 152 S.E. at 868 ("If a company engaged in the generation of electricity is a 'manufacturer' for the purposes of a Statute imposing a tax, the plan or structure wherein the process of generating such electricity is carried on is a manufactory for the purposes of a tax exempting statute."). Thus, although Columbia Ry. considered the 1926 Manufacturer's Tax Act, the Duke Power decision reflects that the Court's holding that Duke Power was engaged in manufacturing was not limited to that statute.¹⁸

The Supreme Court's determination that two different electric utilities were engaged in manufacturing for purposes of two different tax statutes certainly supports the conclusion that electric utilities are engaged in manufacturing for purposes of other tax statutes, including the apportionment statute. This is especially so given the Supreme Court's holding that "the legislative classification [of the apportionment statute] ... should be liberally construed in favor of the inclusion of business to which the formula is appropriate." Hertz Corp. v. S. C. Tax Comm'n, 246 S.C. 92, 96, 142 S.E.2d 445, 447 (1965) (holding that taxpayer involved in renting

¹⁷ Notably, the 1927 Century Dictionary defined manufacture as "the making of goods or wares by ... machinery, esp. on a large scale"

¹⁸ When the holding of Columbia Ry. is considered in light of the pertinent language from the Manufacturer's Tax Act at issue in that case, the application of that decision in this case becomes evident, especially in light of the absence of any distinction between Duke Energy's business in this State versus its business in North Carolina. Specifically, the Manufacturer's Tax Act provided that "every person, firm or corporation engaged in the business of manufacturing" was subject to the tax imposed on manufacturers. 1923 S.C. Acts 12, No. 21, §11-A. And although the tax at issue was a license tax on "the entire receipts," it was specifically imposed on "the business of manufacturing." Thus, the Columbia Ry. decision is based on a 1923 Act directed at manufacturers and uses the same language as the apportionment statute at issue in this case. Compare S.C. Code Ann. § 12-6-2250 (applying to "a taxpayer whose principal business in this State is ... manufacturing") with 1923 S.C. Acts 12, No. 21, §11-A (applying to a taxpayer "engaged in the business of manufacturing").

tangible personal property came within the predecessor to section 12-6-2250).¹⁹ The fact that the common definition of “manufacture” has remained constant from the time of the Columbia Railway and Duke Power decisions up to the present, and that definition is still applicable to Duke Energy’s operations, further validates that Duke Energy is engaged in manufacturing electricity. In addition, Duke Energy generates, transmits, and distributes electricity in South Carolina using the same methods and principles employed during the era in which these cases were decided. Furthermore, Duke Energy’s corporate charter for the Tax Periods at Issue retained the same language used in its original charter, which was considered pertinent by the Supreme Court. Compare Duke Power, 152 S.E. at 867 (referencing charter granting authorization to Duke Power Company to “manufacture, generate, buy, sell, accumulate, store, transmit, furnish, and distribute electric current for light, heat, and power”) with Restated Arts. Inc. Duke Power Co. (October 6, 1993) (authorizing company “[t]o manufacture, generate, buy, sell, accumulate, store, transmit, furnish and distribute electric current for light, heat and power”) and Restated Arts. Inc. Duke Energy Corp. (June 18, 1997) (same). If the processes of generating, transmitting, and distributing electricity are the same today as those employed in 1926 and 1930, and if those processes constituted manufacturing for purposes of a tax statute during those years, then the generation of electricity constitutes manufacturing for purposes of a tax statute during the Tax Periods at Issue. Duke Energy therefore is engaged in the business of manufacturing in this State for purposes of Section 12-6-2250.

¹⁹ Although not binding here, courts in other states have held that generating or producing electricity is manufacturing, reflecting that a position such as that taken by the Department is reasonable. Some of these cases have cited Columbia Ry. and Duke Power as support for that holding. Curry v. Ala. Power Co., 8 So.2d 521, 525 (Ala. 1942) (citing Columbia Ry. and Duke Power decisions in holding that generating electricity is manufacturing); State ex rel. Winterfield v. Hardin County Rural Elec. Co-op., 285 N.W. 219, 226 (Iowa 1939) (citing Columbia Ry. and Duke Power and stating: “The great preponderance of authority as evidenced by the decisions of the courts supports the proposition that one engaged in the generation of electricity is engaged in a manufacturing or mechanical business”). Other states simply have held that generating electricity is manufacturing. E.g., Pub. Serv. Co. v. Dep’t of Rev., 10CA1026, 2011 WL 4089971 (Colo. Ct. App. Sept. 15, 2011) (generating electricity is manufacturing); Davis v. Gulf Power Corp., 799 So. 2d 298, 301 (Fla. Dist. Ct. App. 2001) (generation of electricity is a manufacturing process and electricity is tangible personal property); Minn. Power & Light Co. v. Pers. Prop. Tax. Taxing Dist., City of Fraser, Sch. Dist. No. 695, 182 N.W.2d 685, 692 (Minn. 1970) (producing electricity is manufacturing); Bd. of Assessors of Holyoke v. State Tax Comm’n, 244 N.E.2d 287, 289 (Mass. 1969) (same); Morley v. Brown & Root, 239 S.W.2d 1012, 1015 (Ark. 1951); (same); City of Louisville ex rel. v. Howard, 208 S.W.2d 522, 526 (Ky. 1947) (“The generation of electricity is manufacturing.”); Chicago, M., St. P. & P.R. Co. v. Custer County, 32 P.2d 8, 9 (Mont. 1934) (holding that “the electricity which exists in nature is not subject to use; the current which will cause the wheels of industry to turn, or will light a city, must be produced by the employment of labor and machinery and is, therefore, generally said to be manufactured”); see also Comm’r of Revenue v. Houghton Mifflin Co., 666 N.E.2d 491, 495 (Mass. 1996) (rejecting contention that process does not involve manufacturing merely because its inputs are not tangible).

Moreover, the evidence in this case establishes that Duke Energy is a manufacturer. As explained above, "manufacturing" is defined as "the act or process of producing something." Duke Energy's witnesses repeatedly characterized its business as "producing" electricity. Duke Energy is thus engaged in the "act or process of producing [electricity]." Electricity that is produced by Duke Energy and consumed by its customers is created at a generation facility.²⁰ The process that occurs at a generation facility reflects that it is manufacturing. Each of these facilities contains at least one generator. A generator is a "fairly large machine" and "mechanical device" that uses mechanical energy to produce electric energy or, as it is more commonly known, electricity. The generator creates an electric current that is processed through the transmission and distribution systems. Generators have been used to produce electricity in substantially the same manner for over 100 years. Many, though not all, of Duke Energy's generation facilities use a turbine driven by steam power to turn the generator.²¹ The result, however, is the same: Duke Energy employs a mechanical device to produce and generate electricity using the same process employed since the early 20th century. Thus, Duke Energy's generation facilities are, as recognized by our Supreme Court, locations at which manufacturing occurs. See Duke Power, 152 S.E. at 868.

Furthermore, though they disagree as to the ultimate characterization of electricity production, Duke Energy and the Department seem to agree that Duke Energy's generation, transmission, and distribution processes are interconnected. In other words, Duke Energy cannot produce or deliver electricity to consumers in the absence of any one of these parts, each of which provide an essential aspect of Duke Energy's process for producing, transmitting, and delivering electricity to customers. The generator is connected to the transmission system, which

²⁰ Mr. Jamil testified that Duke Energy could provide electricity even without its generation assets. That is, Duke Energy apparently contends that it could sell electricity without producing it and, thus, that it is not a manufacturer for that reason. But the fact that an entity could resell a product to customers without actually manufacturing that product does not mean that the entity that did produce the product is not a manufacturer. And a determination of whether any entity that simply resells electricity is a manufacturer is beyond the scope of this proceeding.

In any event, the record does not support any characterization of Duke Energy as a mere reseller of electricity for the Periods at Issue. The evidence reflects that Duke Energy generated virtually all of the electricity it sold during the Periods at Issue. [Duke Energy 1994-2001 Forms 10-K (showing "Electric Energy Generated" as being nearly equal to "Electric Energy Sold" each year) [Pet'r Hr'g Exs. 49-B-17 through 49-B-24].] Mr. Monroe testified that Duke Energy generates most of the electricity that it sells. Thus, the fact that other utilities might simply resell electricity without generating it, and that Duke Energy **could** do the same thing, is immaterial because the record reflects that Duke Energy does generate electricity; and it is therefore a manufacturer.

²¹ The design of a turbine used in these generation facilities has not significantly changed since the early 20th century.

is connected to the distribution system. As noted above, Duke Energy requires all three processes to provide electricity to its customers. Prior to distribution of the electricity to the consumer through the meter, the electric utility owns and continues to process the electricity, which is not in a form usable by a consumer prior to its distribution through the electric meter. Cf. Priest v. Brown, 302 S.C. 405, 411, 396 S.E.2d 638, 641 (Ct. App. 1990) (in affirming a trial court decision that strict liability was not applicable against electric utility for a person who was electrocuted and died after touching a downed distribution line, the court noted an affidavit that stating that "the electricity through these lines was of such a high voltage that it was not in a form immediately usable by a consumer" and held that the facts of this case alone suggest the electricity had not been placed into the stream of commerce . . .").

In addition, though electricity is a unique product with unique characteristics required by consumers, it is clearly produced by Duke Energy and distributed in keeping the required needs of the customers. Although there was testimony in the record regarding other forms of energy, such as kinetic and mechanical energy, those other energy forms are different than electricity or electric energy and do not meet the vast majority of consumer needs in homes and businesses. And this conclusion is not changed by the fact that electricity may exist in nature (e.g., a lightning strike is the effect of an electromagnetic field on air molecules), because that electricity is not usable by electric utilities or consumers in that form. See, e.g., Chicago, M., St. P. & P.R. Co. v. Custer County, 32 P.2d 8, 9 (Mont. 1934) (holding that "the electricity which exists in nature is not subject to use; the current which will cause the wheels of industry to turn, or will light a city, must be produced by the employment of labor and machinery and is, therefore, generally said to be manufactured . . .") (internal citations omitted).

The nature of electricity as a product produced by Duke Energy is further evidenced by the fact that Duke Energy does not have access to unlimited quantities of electricity because its ability to generate electricity is limited by the capacity of its generators. The fact that Duke Energy charges for electricity based on quantity, and cannot provide unlimited electricity, further supports the conclusion that generating electricity is manufacturing. Measuring electricity by quantity is the same as measuring any product by quantity, and the limitation on the quantity of electricity that can be produced is analogous to the limitation imposed on any manufacturer by the capacity of the machines employed in the manufacturing process.

In sum, the electricity consumed by Duke Energy's customers is the product of Duke Energy's generation of that electricity. Duke Energy employs an interconnected process of producing and delivering electricity that is substantially the same as that used by any entity that creates and produces a product using an assembly line and then charges the customer based on the amount of the product sold. A generator is analogous to any machine used by a manufacturer to produce a product for sale; the transmission and distribution systems are like the assembly line process used by a manufacturer to further refine and develop the product; and the customer is charged by the quantity of the product consumed.²² The fact that Duke Energy charges for electricity based on quantity, and cannot provide unlimited electricity, further supports the conclusion that generating electricity is manufacturing. Measuring electricity by quantity is the same as measuring any product by quantity, and the limitation on the quantity of electricity that can be produced is analogous to the limitation imposed on any manufacturer by the capacity of the machines employed in the manufacturing process.

Characterization of the Provision of Electricity as a Service

Duke Energy contends that its "principal business in South Carolina is the provision of electric service to its customers." (Emphasis added). At the outset, Duke Energy cannot "provide" electric service without the existence of electricity, and the electricity that Duke Energy provides cannot exist without first being produced, or manufactured. As to "electric service," the South Carolina Income Tax Act does not define the word "service." And the usage of the word "service" in the South Carolina Income Tax Act does not provide any guidance as to the term's meaning, as it is used in a variety of connotations.²³ Looking then to Merriam-

²² The Court recognizes that the transmission and distribution processes could be interpreted as being separate from manufacturing. Transmission of electricity, for instance, could fall under "processing" in Section 12-6-2250(a), because the electricity must be "stepped up" and "stepped down" in order to regulate the voltage so that line loss can be minimized. Also, for the electricity to be usable by the customers, it must be further manipulated to meet the specifications of the devices used by the customers. Likewise, distribution could be interpreted as "distributing . . . tangible personal property within this State," under Section 12-6-2250(b). This interpretation would require a determination of electricity's tangibility and whether electricity is "personal property." The Court will explain in more detail later in the decision why electricity is tangible personal property. At any rate, because the generation, transmission, and distribution of electricity are equally-necessary components of the business of providing electric power, Duke Energy's business activities seemingly could fall under Section 12-6-2250(a), or (a) and (b); but under either scenario, Duke Energy's principal business involves activities that are covered in Section 12-6-2250, which is the issue here.

²³ See, e.g., S.C. Code Ann. §§ 12-6-550 ("service" in the context of providing of water supply and sewage disposal); 12-6-1120 ("service" in the context of the National Guard and Armed Forces reserve components); 12-6-1720(1)(b) ("service" in the context of apportionment of nonresident individuals, trusts, estates, or beneficiaries); 12-6-2850 ("services" in the context of foreign trading receipts); and 12-6-3450 ("services" in the context of an

Webster's Dictionary, "service" is defined as "useful labor that does not produce a tangible commodity" or "a facility supplying some public demand." Merriam-Webster Online Dictionary, www.merriam-webster.com (last visited October 18, 2012). Because this Court, for reasons that will be discussed more fully below, finds electricity to be a tangible commodity, Duke Energy has failed to demonstrate that its "provision" of electricity to customers is a service under the first definition. As to the second definition, Duke Energy is doubtless a service because it is "a facility supplying some public demand." However, there is nothing in this definition of service that includes or excludes manufacturing. In this case, though, Duke Energy supplies to its customers electricity that it has already manufactured, thus demonstrating that the two activities are separate. Furthermore, a company need not be a manufacturer to be a provider of electric service. Indeed, Section 12-6-2250 itself draws the distinction between manufacturing, et. al., of goods and materials in (a) and selling, distributing, or dealing of tangible personal property in (b).

Duke Energy nevertheless contends that it is not manufacturing because it is not creating anything and is doing nothing more than "provid[ing] access to the electromagnetic field." However, Duke Energy fails to recognize that it produces/manufactures the product for which any service is provided. Electricity is a product that moves and is processed through the transmission and distribution systems and is delivered to the customer at the specifications required by that customer. Services typically are not measured by the quantity of the product consumed and are not delivered to or measured by mathematical calculations regarding the nature of the services.²⁴ In fact, even Duke Energy recognizes that it is producing something. Not even Duke Energy's own representations to the public refer to "providing access to the electromagnetic field." Moreover, Duke Energy's own witness testified that, "in layman's

employee's services for an employer in determining qualification for an income tax credit for persons terminated from employment as a result of the closing or realignment of a federal military installation).

²⁴ Duke Energy further supported its services argument through testimony that it currently is classified as a utility, not a manufacturer, for purposes of the North American Industry Classification System (NAICS), and that it classifies itself as a utility when filing its federal income tax returns. However, the specific NAICS and federal income tax return instructions referenced by the witness pertained to years after the Periods at Issue and, thus, do not assist in determining Duke Energy's character for the Periods at Issue. In any event, neither the NAICS nor the federal classification for data purposes answers the question of whether Duke Energy is a manufacturer for purposes of Section 12-6-2250. Similarly, Duke Energy's references to itself as a provider of services in various publications do not resolve the question of whether it falls within Section 12-6-2250.

terms," electromagnetic field is electric current," and that any electromagnetic field results from the electric current created by the generator.

Duke Energy also offered evidence that it charges a flat fee for outdoor lighting. That evidence does not negate the fact that the vast majority of the electricity delivered by Duke Energy is sold based on quantity consumed. Moreover, as Mr. Jamil testified, the time period for which outdoor lighting operates is controlled by use of a photocell, and Duke Energy is able to estimate the variables in the timing to determine a pricing for the outdoor lighting. Rather, as Mr. Monroe testified, Duke Energy sells electricity on a metered basis involving electricity flowing through a meter and the company "read[ing] the meter periodically and send[ing] a bill to the customer." Thus, substantially all, if not all, of the electricity provided by Duke Energy is priced at some level based on quantity.

Duke Energy finally attempts to compare the above-described processes to the provision of telecommunication services—both cellular and landline—but that comparison is unconvincing. Unlike Duke Energy, telecommunication companies do not generate or produce electricity, but instead only use electricity purchased from electric utilities. Moreover, the evidence in the record demonstrates the differences between a telecommunication service and Duke Energy's production and sale of electricity. First, Duke Energy delivers to its customers a quantifiable product that is produced by Duke Energy. In contrast, telecommunication companies transmit communication or intelligence from one customer to another through a system operated by electricity purchased from utilities like Duke Energy. In essence, the telecommunications company simply transports intelligence produced or created by one of its customers. The purpose of Duke Energy's business is thus to generate and provide electric energy while the purpose of a telecommunication company's business is to convey information. Because Duke Energy produces electricity for use by its customers at an appropriate specification, and telecommunications companies transport intelligence produced by its customers using electricity produced by an electric utility, I find that the purported comparison to a telecommunications company does not undermine the reasonableness of the Department's policy that Duke Energy is a manufacturer.

Conclusion

In sum, to conclude that Duke Energy provides a service rather than manufactures electricity would require a determination that the term "manufacturing" in Section 12-6-2250

means something different than “producing” (or “generating,” for that matter), a term generally used synonymously with “manufacturing.” Moreover, a person or entity providing services is not commonly understood to be “producing” services, and it is not commonly said that a company which generates and sells electricity is merely providing a service by “provid[ing] access to the electromagnetic field.” This is especially so given that the electric current that generates that field, or even the field itself, is generated through an asset-intensive process maintained and operated by Duke Energy. Finally, though it is conceivable that the processes of transmitting and distributing are not part of manufacturing, Duke Energy presented no evidence that would support separation of its electric transmission and distribution processes from its generation process and, in fact, described the whole process as a “very elaborate system.” In short, as Mr. Jamil testified, “you need all three.” In any event, even if the Court were to draw such a distinction, it would prove inconsequential to the outcome here because all three activities – generation, transmission, and distribution – fall under Section 12-6-2250.²⁵

Processing Goods and Materials within this State

Alternatively, the evidence reflects that Duke Energy comes within Section 12-6-2250 because its generation, transmission, and distribution of electricity constitutes “any form of...processing goods and materials within this state.” S.C. Code Ann. § 12-6-2250(a) (emphasis added). The use of “any form” in the statute reflects a legislative intent that the language be applied as broadly as possible and, concomitantly, a legislative preference for using the three-factor formula whenever possible. Hertz Corp., 246 S.C. at 96, 142 S.E.2d at 447 (identifying “any form” in predecessor to section 12-6-2250 as “broad language”). The evidence introduced by both parties shows that generating electricity is a form of processing raw materials

²⁵ Duke Energy also contends that electricity is not manufacturing because it is not tangible. Duke Energy’s conclusion is based upon two premises: 1) electricity is an intangible material and 2) the term “manufacturing” in Section 12-6-2250 is limited solely to tangible goods or materials. As to the first premise, this Court, for reasons discussed later in the text, finds that electricity Duke Energy produces is tangible. The Court, therefore, need not address the remaining premise. However, even if this Court found that electricity was intangible, this would not necessarily prevent electricity from being a manufactured product. Merriam-Webster’s definition of “manufacture” includes “the process of making wares by machinery” See <<http://www.merriam-webster.com/dictionary/manufacture>> (accessed October 19, 2012). Merriam-Webster’s definition of “wares” includes “intangible items” that are “marketable commodit[ies].” See <<http://www.merriam-webster.com/dictionary/ware>> (accessed October 19, 2012). Adopting this view of electricity, the Massachusetts Supreme Court, in Westinghouse Broad. Co., Inc. v. Comm’r of Revenue, noted that the proposition that an electric power company “may not be denied manufacturing status merely because its end product is intangible” . . . “conformed to [its] view that the production of electricity may entail manufacture” 382 Mass. 354, 358, 416 N.E.2d 191, 193 (1981).

such as coal, water, or nuclear fuel. These items are goods and materials.²⁶ These goods are processed and used to create energy to turn a generator either directly or indirectly, which constitutes “any form” of processing of those inputs in the generation process and, thus, falls within the statute.

Selling, Distributing, or Dealing in Tangible Personal Property

Duke Energy also comes within Section 12-6-2250 because its business constitutes “selling, distributing, or dealing in tangible personal property.” Duke Energy, however, argues that it is a seller of services and therefore cannot be a seller, distributor, or dealer of tangible personal property. The premise of this argument is that electric service is not tangible personal property. Duke Energy also argues that the definition of “tangible personal property” should not be taken from S.C. Code Ann. § 12-36-60, which sets forth the definition of “tangible personal property” for sales and use tax purposes. Rather, Duke Energy urges the Court to adopt the definition of “tangible property” set forth in the Income Tax Act, specifically S.C. Code Ann. § 12-6-30(11).

I agree that because “tangible personal property” in Section 12-6-2250(b) is part of the Income Tax Act, the definition for “tangible property” under the Income Tax Act must be used. S.C. Code Ann. § 12-6-30(11) defines “tangible property” as “includ[ing] . . . corporeal personal property but does not include money, bank deposits, shares of stock, bonds, credits, evidence of debt, chose in action, or evidence of an interest in property.” (Emphasis added). However, the term “corporeal” is not defined in the statute. “Where the legislature elects not to define a term in a statute, the courts will interpret the term in accord with its usual and customary meaning. In construing a statute, a court may consider legislation which deals with the same subject matter.” Adoptive Parents v. Biological Parents, 315 S.C. 535, 543, 446 S.E.2d 404, 409 (1994).

Because Section 12-36-60(11) also addresses “tangible personal property” for tax purposes, this Court may therefore look to it for guidance and clarity as to the meaning of “corporeal” for tangibility purposes. See Floyd v. Nationwide Mut. Ins. Co., 367 S.C. 253, 626 S.E.2d 6 (2005) (“The true guide to statutory construction is not the phraseology of an isolated

²⁶ Merriam-Webster’s definition of a “good” is “something that has economic utility or satisfies an economic want.” See <<http://www.merriam-webster.com/dictionary/good>> (accessed October 19, 2012). It defines “material” as “the elements, constituents, or substances of which something is composed or can be made.” See <<http://www.merriam-webster.com/dictionary/material>> (accessed October 19, 2012).

section or provision, but the language of the statute as a whole considered in light of its manifest purpose.”); TNS Mills, Inc. v. S.C. Dept. of Revenue, 331 S.C. 611, 620, 503 S.E.2d 471, 476 (1998) (“In construing statutory language, the statute must be read as a whole, and sections which are part of the same general statutory law must be construed together and each one given effect.”). The Court recognizes that Sections 12-6-30(11) and 12-36-60 differ with respect to their treatment of intangible personal property. Specifically, Section 12-36-60 includes as tangible personal property services and intangibles, whereas Section 12-6-30(11) excludes intangibles altogether; indeed, “intangible property” is separately defined under Section 12-6-30(12). However, the specific exclusions from tangible personal property (which are not at issue here) are nearly identical in both definitions,²⁷ and Section 12-36-60 provides a more specific definition of tangible personal property that also coincides with the general understanding of the term “corporeal” used Section 12-6-30(11) – “personal property which may be seen, weighed, measured, felt, touched, or which is in any other manner perceptible to the senses.”²⁸

Applying to the facts of this case the definition of tangible property found in Section 12-6-30(11) together with the general definition of tangible personal property given in the first sentence of Section 12-36-60, I conclude that electricity is tangible personal property. Electricity is a product delivered to customers at certain precise specifications. The evidence also established that electricity is a physical product with physical characteristics; that the electric charge associated with electricity is a physical property of matter; that it certainly is possible to feel electricity’s impact in the body; that electricity can be moved, manipulated, and stored, characteristics further suggesting the tangible nature of electricity; that the electric charge, which Duke Energy witnesses testified is the source of electricity, can be stored; and that electricity is a fungible product that is sold in quantifiable amounts. Further, in South Carolina, it is something that can be stolen and, thus, is subject to ownership rights. See S.C. Code Ann. § 16-13-380

²⁷ Section 12-6-30(11) excludes from tangible property the following: “money, bank deposits, shares of stock, bonds, credits, evidences of debt, choses in action, or evidences of an interest in property.” Similarly, Section 12-36-60 excludes from tangible personal property the following: “stocks, notes, bonds, mortgages, or other evidences of debt . . . [, and] transmission of computer database information by a cooperative service when the database information has been assembled by and for the exclusive use of the members of the cooperative service.”

²⁸ The American Heritage College Dictionary 311 (3d ed. 1993) defines “corporeal” as “[o]f a material nature; tangible.” See also Black’s Law Dictionary 394, 1336, 1592 (9th ed. 2009) (defining “corporeal” as “tangible”; “tangible” as “corporeal”; and “corporeal personal property” as “tangible personal property”).

("Theft of electric current").²⁹ Also, because the electricity sold, distributed, or dealt by Duke Energy is used by its customers in amounts, duration, and purposes chosen by its customers, i.e., it is under the customers' control after it is distributed to them, the electricity becomes personal property of the customers.

On one hand, Duke Energy does not wish to apply the definition of "tangible personal property" under Section 12-36-60; but nonetheless, Duke Energy wishes to use Section 12-36-60 to establish its sales of electricity as a service. It argues that if Section 12-36-60 applied, "the Department's view on the characterization of electricity based on the sales and use tax definition was long ago rejected by this Court in [Consolidated Hyrdo S.E., Inc. v. S.C. Dep't of Revenue & Taxation, No. 95-ALJ-17-0634, 1996 WL 909155 (S.C. Admin. L.J. Div. May 13, 1996) (Lee, A.L.J.)].” In that case, the taxpayer owned and operated several hydro-electric power generation facilities in South Carolina and was engaged in the business of production and sale of electricity. Citing the definition of "tangible personal property" set forth in S.C. Code Ann. § 12-36-60, relating to sales and use taxes, the company argued that it did not provide or sell a "service" and was therefore not subject to additional license taxes. The court in that case disagreed, concluding that "while electricity is included in [12-36-60] discussing the application of sales tax on the sale of tangible personal property, the sale of electricity is specifically recognized and defined as a service."

First, that decision has **no precedential value** and is thus not binding on this Court. Secondly, that decision merely concluded that the taxpayer was providing a service and thus subject to a license fee under then-Section 12-19-110. However, Section 12-19-110 was imposed "[i]n addition to . . . all other license taxes and fees or taxes of whatever kind" Section 12-19-110 did not prevent the application to the taxpayer of any other tax laws, including those that implicated "tangible personal property." Thus, even if this Court were to adopt the position that the sale of electricity was merely a service, the sale of electricity would simply be a service that does not fall "within the meaning of the general definition" of "tangible personal property" set forth in the first sentence of Section 12-36-60, Consolidated Hydro *4. But that

²⁹ Interestingly, this statute references the theft of electricity by any "person who . . . has no contract, agreement, license, or permission with or from any person authorized to manufacture, sell, or use electricity for the purpose of light, heat, or power." S.C. Code Ann. § 16-13-380 (emphasis added); see also S.C. Code Ann. § 16-13-390 (prohibiting the wrongful use of electricity by a person who has a "contract, agreement, license or permission, oral or written, with or from any person authorized to manufacture, sell or use electricity for the purpose of light, heat or power.") (emphasis added).

service would still be considered tangible personal property, as set forth in the second sentence; and it would therefore be subject to tax laws imposed by other statutes upon tangible personal property, just as it was subject to license fees imposed by other statutes upon services. Thus, even under Duke Energy's theory, it would still be considered to be "selling, distributing, or dealing in tangible personal property within this State" for corporate income tax apportionment purposes under Section 12-6-2250.

Furthermore, as previously mentioned, Merriam-Webster's Dictionary defines "service" as "useful labor that does not produce a tangible commodity" or "a facility supplying some public demand." Merriam-Webster Online Dictionary, www.merriam-webster.com (last visited October 29, 2012). Because, for the reasons given above, I find that electricity is a tangible commodity manufactured by Duke Energy, Duke Energy has failed to demonstrate that its "provision" of electricity to customers is a service under the first definition. As to the second definition, Duke Energy is doubtless a service because it is "a facility supplying some public demand." However, there is nothing in this definition of service that is determinative of tangibility or intangibility. Indeed, the actual provision of a product may be intangible, while the product itself is tangible.³⁰ And, to reiterate, even if this Court were to look to the sales or use tax definition of "tangible personal property" under Section 12-36-60, sales of electricity, though considered services under that statute, are considered tangible personal property. See S.C. Code Ann. § 12-36-60 ("Tangible personal property' . . . also includes . . . sales of electricity . . ."). Thus, even looking to the sales or use tax definition, and considering the sale of electricity to be a service, the sale of electricity would still be tangible personal property for tax purposes.³¹

In sum, although it admittedly is unique, electricity is a tangible product with identifiable physical characteristics that may be created, measured, felt, stored, and consumed, and an electric utility may exercise ownership rights over it. And even if the Court were to consider the

³⁰ See, e.g., *Pub. Serv. Co. v. Dep't of Revenue*, __P.3d__, 2011 WL 4089971 (Colo. Ct. App. 2011) ("There is . . . Colorado authority that electricity is both a product and a service").

³¹ Duke Energy points out that several other states have treated the provision of electricity as something other than tangible personal property. These states would include: North Carolina, Oregon, California, and Massachusetts. However, this Court finds more persuasive the decisions of those states that hold that electricity is tangible personal property. See e.g., *Exelon Corp. v. Dep't of Revenue*, 234 Ill.2d 266, 917 N.E.2d 899 (2009); *Tucson Elec. Power Co. v. Ariz. Dep't of Revenue*, 170 Ariz. 145, 822 P.2d 498 (Ct. App. 1991). Moreover, Duke Energy acknowledges that other states, in contexts other than income tax, have ruled that the sale of electricity is the sale of tangible personal property. See, e.g., *Davis v. Gulf Power Corp.*, 799 So. 2d 298, 301 (Fla. Dist. Ct. App. 2001) (property tax); *Texas E. Transmission Corp. v. Benson*, 480 S.W.2d 905, 908 (Tenn. 1972) (sales tax); *S. Natural Gas Co. v. State*, 261 Ala. 222, 73 So. 2d 731 (1953) (use tax).

sale of electricity merely a service, it would still be considered tangible personal property for tax purposes. Therefore, Duke Energy also falls within Section 12-6-2250(b).

More-than-50-percent Test

Though Duke Energy, as the taxpayer, may engage in activities falling under Section 12-6-2250, Duke Energy may still apply the single-factor gross receipts apportionment method under Section 12-6-2290 if the principal amount of its profits or income is derived from activities other than those covered in Section 12-6-2250. However, Duke Energy, which was engaged in more than one line of business during the Tax Periods at Issue, has the burden of proving that its principal business in this State was not from manufacturing, or any form of collecting, buying, assembling, or processing goods and materials within this State, or from selling, distributing, or dealing in tangible personal property within this State. In making this "principal business" determination, South Carolina adopts a more-than-50-percent test. The Department's longstanding policy provides:

[W]hether a business is a service related industry can be made by comparing the gross receipts of the business derived from providing services to total gross receipts of the business. If over 50 percent of the gross receipts are from providing services, then the business would be service related. This method has been utilized by the [South Carolina Tax] [C]ommission in determining whether a multistate taxpayer is providing services and thus would utilize the gross receipts ratio to apportion its income.

Rev. Rul. No. RR-87-5 (S.C. Tax Comm'n Sept. 16, 1987). Thus, under the Department's policy, if more than 50 percent of a business's gross receipts are from providing services, then the business would be service-related and the taxpayer would be required to apportion its income to South Carolina using the single-factor gross-receipts apportionment method under S.C. Code Ann. § 12-6-2290. Otherwise, the business would have to apportion its income to South Carolina using the three-factor apportionment method under S.C. Code Ann. § 12-6-2250.

Here, Duke Energy presented testimony indicating that Duke Energy's principal business is the provision of electricity services because at all times during the Periods at Issue more than 50 percent Duke Energy's gross receipts were derived from the provision of electric services. However, in light of my findings that Duke Energy's generation, transmission, and distribution of electricity are activities falling within Section 12-6-2250, that electricity is tangible personal property, and that sales of electricity are sales of tangible personal property, I find Duke Energy's evidence insufficient to establish that more than 50 percent of Duke Energy's gross

receipts were derived from activities not covered in Section 12-6-2250. Indeed, Duke Energy introduced no evidence supporting any breakdown of its gross receipts from manufacturing, services, and/or any other activity.

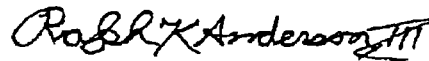
Conclusion

After considering the evidence in the record and the pertinent legal authorities, I conclude that Duke Energy failed to establish by the preponderance of the evidence that its principal business in South Carolina is not manufacturing. This Court thus rejects Duke Energy's attempt to use the single-factor apportionment formula for tax years 1994-2001 instead of the multi-factor apportionment formula it used in its original corporate income tax returns.

ORDER

THEREFORE, IT IS HEREBY ORDERED that Duke Energy's claims for refunds with respect to its attempt to use the single-factor apportionment formula for the corporate income tax periods 1994-2001 are DENIED and the Department's Determination is AFFIRMED.

IT IS SO ORDERED.

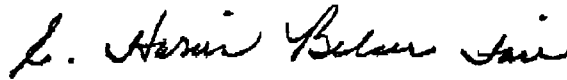


Ralph K. Anderson, III
Chief Administrative Law Judge

November 2, 2012
Columbia, South Carolina

CERTIFICATE OF SERVICE

I, E. Harvin Belser Fair, hereby certify that I have this date served this Order upon all parties to this cause by depositing a copy hereof, in the United States mail, postage paid, in the Interagency Mail Service, or by electronic mail to the address provided by the party(ies) and/or their attorney(s).



E. Harvin Belser Fair
Judicial Law Clerk

November 2, 2012
Columbia, South Carolina

EXHIBIT F

**STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT**

Duke Energy Corporation,	)	Docket No. 10-ALJ-17-0270-CC
	)	
Petitioner,	)	
	)	
	)	AMENDED FINAL ORDER
vs.	)	AND DECISION
	)	
South Carolina Department of Revenue,	)	
	)	
Respondent.	)	
	)	

Appearances:

For the Petitioner: Burnet R. Maybank, III, Esq.; Eric S. Tresh, Esq.; Jeffrey A. Friedman, Esq.; and Maria M. Todorova, Esq.

For the Respondent: Tracey C. Green, Esq.; John W. Roberts, Esq.; Harry Hancock, Esq.; and J. Abraham Gutting, Esq.

STATEMENT OF THE CASE

This matter comes before the Administrative Law Court (ALC or Court) following Duke Energy Corporation's (Duke Energy) request for a contested case hearing under S.C. Code Ann. § 12-60-460 (Supp. 2006). Duke Energy is contesting the Determination of the South Carolina Department of Revenue (Department) denying Duke Energy's claim for a refund of South Carolina corporate income taxes for the tax years 1994 through 2001 (Tax Periods at Issue).¹ Duke Energy asserts that it is a service provider and thus is required to apportion its income to South Carolina on the basis of the single-factor gross-receipts apportionment formula. A hearing was held before this Court on September 5 and 6, 2012.

On November 2, 2012, this Court entered its Final Order and Decision denying Duke Energy's claims for refund of corporate income taxes for the Tax Periods at Issue and affirming the Department's Determination that Duke Energy cannot apportion its income based on the single-factor gross-receipts apportionment method. Duke Energy filed its Motion for Reconsideration of the Court's Final Order and Decision on November 13. On November 15,

¹ Duke Energy originally sought refunds for the tax years 1978 through 2001. On October 11, 2012, this Court ruled that Duke Energy's refund claims for the tax years 1978 through 1993 are untimely. Thus, Duke Energy's refund claims for 1978-1993 are not before the Court at this time.

FILED

December 4, 2012

SC ADMIN. LAW COURT

2012, the Department informed the Court that it was not going to file a response to Duke Energy's Motion for Reconsideration. After careful consideration of the arguments made by Duke Energy, the Court has amended its November 2, 2012 Final Order and Decision accordingly below.

LEGAL ISSUES RAISED

The following issue is raised in this proceeding: Whether Duke Energy, based on its activities within the State of South Carolina, falls under Section 12-6-2250 as a "manufactur[er]" or some other category listed in 12-6-2250, or whether Duke Energy is required to apportion its income to South Carolina based on the single-factor gross-receipts apportionment formula pursuant to Section 12-6-2290.²

STIPULATIONS OF FACT

At the hearing into this matter and pursuant to ALC Rule 25(C), the parties entered the following written stipulations of fact into the Record:

Preliminary Definitions

1. "Gross-receipts apportionment formula" refers to South Carolina's method of income apportionment prescribed under S.C. Code Ann. § 12-6-2290 and former S.C. Code Ann. § 12-7-1190.
2. "Multi-factor apportionment formula" refers to South Carolina's method of income apportionment prescribed under S.C. Code Ann. § 12-6-2250 and former S.C. Code Ann. § 12-7-1140.

² In my Amended Order Granting Summary Judgment in Part and Denying Summary Judgment in Part, I stated the issue presently before the Court as follows: "whether Duke Energy, based on its activities within the State, falls under Section 12-6-2250 as a "manufactur[er]," or whether Duke Energy is a seller of services, or otherwise falls under none of the above-categories, and is therefore required to apportion its income to South Carolina based on the single-factor gross-receipts apportionment formula" This statement of the issue contains the conclusory phrase "is a seller of services, or otherwise falls under none of the above categories." This phrase erroneously presupposes that a seller of services could not be included in Section 12-6-2250. However, as will be discussed in more detail later, sales of electricity, though considered a service for certain tax purposes, has also been considered "tangible personal property," for those same tax purposes. Therefore, electricity could be considered a service and still be tangible personal property under Section 12-6-2250. The error of excluding "seller of services" from Section 12-6-2250 in the statement of the issue, however, did not affect the need to have a hearing on the present issue because there is a genuine issue of material fact as to the nature of Duke Energy's status for purposes of Sections 12-6-2250, -2290 based on its business activities.

3. "Petitioner" means Duke Energy Corporation (formerly known as Duke Power Company) and any predecessor or successor and any other entity owned by Duke Energy Corporation.
4. "Respondent" means the South Carolina Department of Revenue.
5. "1978-2001 tax periods" means the Petitioner's tax years 1978 through 2001, all of which were reported on a calendar-year basis.

The Parties

6. Respondent is an administrative Cabinet-level agency of the State of South Carolina responsible for administering and enforcing the State's revenue laws.
7. Petitioner is, and was during the 1978-2001 tax periods, engaged in the generation, transmission, distribution, and sale of electricity in portions of North Carolina and South Carolina.
8. The Parties stipulated to Petitioner's restated corporate charters filed with the North Carolina Secretary of State on July 26, 1977, October 6, 1993, and June 18, 1997.
9. The Parties stipulated to Petitioner's Form 10-Ks for the 1978-2001 tax periods.
10. During the 1978-2001 tax periods, Petitioner was regulated by the South Carolina Public Service Commission (Commission) as an "electric utility" pursuant to Title 58-27-10(7).

Procedural History

11. Petitioner timely filed its South Carolina corporate income tax returns (including license tax returns) for the 1978-2001 tax periods.
12. On its originally-filed South Carolina corporate income tax returns for the tax periods 1978-2001, Petitioner filed using the multi-factor apportionment formula.
13. On December 12, 2002, Petitioner filed South Carolina amended corporate income tax returns for the 1978-2001 tax periods seeking a refund of corporate income taxes plus applicable interest ("1978-2001 Refund Claims").
14. The Parties stipulated to Petitioner's South Carolina amended corporate income tax returns filed on December 12, 2002 for the 1978-2001 tax periods.
15. The 1978-2001 Refund Claims reflected use of the gross-receipts apportionment formula to apportion Petitioner's income to South Carolina.
16. On February 12, 2003, Respondent denied Petitioner's 1978-2001 Refund Claims.

17. On March 13, 2003, Petitioner timely appealed from the denial of its 1978-2001 Refund Claims.
18. On February 4, 2010, Respondent issued a Determination denying Petitioner's refund claims for tax periods 1978-2001.
19. On March 3, 2010, Petitioner timely filed a Request for Contested Case Hearing with the Clerk's Office of the South Carolina Administrative Law Court in Columbia, South Carolina contesting the Determination.
20. Petitioner and Respondent timely filed their Prehearing Statements and Amended Prehearing Statements.

FINDINGS OF FACT

Having observed the witnesses and exhibits presented at the hearing and taking into consideration the burden of persuasion and the credibility of the witnesses, I make the following additional findings of fact by a preponderance of the evidence:

Duke Energy Business Operations

Duke Energy is engaged in the business of generation, transmission, distribution, and sale of electricity in portions of both North Carolina and South Carolina. Duke Energy owns and operates generation, transmission, and distribution assets in South Carolina and North Carolina. Clearly, providing electricity is Duke Energy's "primary business."

Duke Energy sells electricity on both a metered and flat-fee basis. Under the flat-fee plan, Duke Energy provides electricity for outdoor lighting at a fixed price.³ The metered service plan is based on usage, i.e., the electricity provided by Duke Energy is read by a meter and billed to the customer on the basis of usage during the billing period. Regardless of the service plan, a portion of each Duke Energy customer's service charge recovers Duke Energy's costs associated with maintaining the infrastructure that Duke Energy uses to provide electric service. This charge is known as a capacity charge and is billed to the customer as part of the monthly service charge, even if the customer does not use electricity in a given month. Nevertheless, however the profits from the flat-rate or capacity charges are perceived, those

³ Although Duke Energy introduced evidence regarding the fact that it charges a flat fee for outdoor lighting, that does not negate the fact that the vast majority of the electricity delivered by Duke Energy is sold based on quantity consumed. Moreover, the time period for which outdoor lighting operates is controlled by use of a photocell, and Duke Energy has information to make estimates regarding variables in the timing to determine a pricing for the outdoor lighting.

charges were not a significant portion of Duke Energy's profit from the sale of electricity during the Tax Periods at Issue.⁴

Production of Electricity

Duke Energy operates plants in both South Carolina and North Carolina to produce electricity. In South Carolina, Duke Energy has two nuclear power plants, four coal power plants, three hydroelectric power plants, and several oil or gas power plants.⁵ The electricity that is produced and consumed by its customers is created at Duke Energy generation facilities. A generator is a "mechanical device" that uses mechanical energy to produce electric energy or, as it is more commonly known, electricity. Generators have been used to produce electricity in substantially the same manner for over 100 years. Many, though not all, of Duke Energy's generation facilities use a turbine driven by steam power to turn the generator. Although the sources or inputs (e.g., coal, uranium, water) used at these different types of generation facilities may vary, all use a generator to produce electricity. The result, however, is the same: Duke Energy employs a mechanical device to produce and generate electricity using a process that has not changed significantly since the early 20th century.

Duke Energy nonetheless offered evidence that the production of electricity does not create anything. Rather, Duke Energy avers it is doing nothing more than providing access to "the electromagnetic field." However, Duke Energy produces that electromagnetic field. Duke Energy's own witness testified that, "in layman's terms," electromagnetic field is electric current," and that any electromagnetic field results from the electric current created by the generator. No matter what moniker used to describe the product produced by Duke Energy, the electric current that generates that field, or even the field itself, is produced through a mechanical process run by Duke Energy.

Distribution and Sale of the Electricity

The process by which Duke Energy generates or produces electricity does not end at the generator. The generator is obviously connected to the transmission and distribution network.

⁴ Mr. Dhiaa Jamil did testify that a portion of a customer's bill is a flat fee for a capacity charge, but he also testified that he did not know the rate or level at which that fee is imposed—other than that it is less than \$100—and, in fact, ultimately testified "that's really not my area." The Court concludes that this testimony does not assist Duke Energy in meeting its burden of proof.

⁵ Duke Energy also produces electricity using natural gas, wind, and solar. Duke Energy also occasionally purchases electricity from other electric utilities. However, these methods of producing or acquiring electricity appear to be less significant than the methods indicated above.

That network consists of transmission and distribution lines, which are conductors made of copper, towers and poles, and transformers. During the transmission and distribution process, the transformers process the electricity by "stepping up" and "stepping down" the voltage of the electricity. By "stepping up" the voltage, Duke Energy is able to transmit the electrical current at a low current. The "step up" process is done in order to efficiently deliver electricity by reducing line loss, which is the loss to Duke Energy of a quantity of electricity as heat during the transmission and distribution processes.

Ultimately, electricity must be delivered at the specified voltage so that it can be used by customers in their homes and businesses. Typically, electricity is not usable by a customer unless it is at 120 volts, although sometimes it is delivered at 220 volts. Whatever the required voltage, it is necessary to ensure that the electricity delivered to a customer is "stepped down" to the usable voltage, a process that is done close to where the electricity is eventually used by the customer.

Most customers of Duke Energy obtain the electricity after it passes through a meter. More specifically, by activating a switch, which creates a load and completes a circuit, the electricity passes through the customer's meter and operates the device. Duke Energy measures the amount of electricity consumed by each customer (usually in term of kilowatts) and then charges the consumer for the quantity used/consumed.⁶ Moreover, electricity is not a useable product unless it is delivered to customers at precise specifications. Prior to delivery of the electricity to the consumer through the meter, the electric utility owns the electricity, which is not delivered for sale until it is processed into a form usable by a consumer. This typically occurs closer to the customer's business or home.

Duke Energy compared the provision of electricity to the provision of telecommunication services—both cellular and landline. However, unlike Duke Energy, telecommunication companies do not generate electricity but, instead, only use electricity purchased from electric utilities. Furthermore, Duke Energy delivers to its customers a quantifiable product that is produced by Duke Energy. In contrast, telecommunications companies transmit communications or intelligence produced or created by one customer to another through a system operated by

⁶ Aside from the fact that electricity is measured by quantity, the nature of electricity, as a product, is further demonstrated by the fact that electric current is a flow of charges or charged particles, the rate of which is measured in amperes.

electricity purchased from utilities like Duke Energy. Additionally, cellular telephone providers use radio technology to transfer information between two locations. The frequencies and strengths of telecommunications waves are vastly different than the frequencies and strengths of electricity.

In sum, the generation, transmission, and distribution processes are interconnected. Duke Energy cannot produce or deliver electricity to consumers in the absence of any one of these parts, each of which provide an essential aspect of Duke Energy's process for producing, transmitting, and delivering electricity to customers. Moreover, Duke Energy presented no evidence that supports separating its electric transmission and distribution processes from its generation processes and, in fact, described the whole process as a "very elaborate system." Indeed, Mr. Jamil testified that each of the processes employed by Duke Energy is "used to produce electricity."⁷

Physical Nature of Electricity

Electricity is a physical product with physical characteristics. Regarding whether electricity may be sensed by humans, I do not find that the testimony presented by either party was probative as expert testimony. In other words, there was no evidence that the witnesses possessed "knowledge, skill, experience, training, or education" regarding the effect of electrical stimulation upon the human physiology justifying this Court to accept their opinion as expert testimony. Nevertheless, based upon the evidence, I find that it is possible to feel electricity, and thus electricity can be touched. Though Duke Energy presented valid instances in which a person may not feel electricity, that does not discount the instances when it can be felt.

Moreover, even if I were to find Duke Energy's evidence regarding this matter to be probative, I am unconvinced. Duke Energy's expert witness, Mr. Ioannis Papapolymerou, explained that a human cannot feel electricity but only the impact of the electricity. Though I find the proposed nuances between the feeling of an object itself and the feeling of the impact from the object to be the makings of an interesting theoretical debate, I find no considerable distinction between the two and therefore find that electricity can be felt by humans.

⁷ Additionally, Duke Energy introduced an exhibit listing the "Functions" of Duke Energy as "Production," "Transmissions," and "Distribution."

Electricity can also be stored. Concerning this issue, Duke Energy characterized an electric charge as the source of electricity and as the physical property that is stored. The electrical charge is nonetheless a component of what is produced by Duke Energy.

In sum, Duke Energy takes raw materials (e.g., coal, uranium, water), uses those materials to power mechanical devices to produce a form of electricity that is usable and consumed by the public. Although electricity is unique, it is a tangible product with identifiable physical characteristics that may be created, measured, felt, stored, and consumed, and an electric utility may exercise ownership rights over it.

Department's Policy History

The Department and the Commission have a longstanding interpretation that electric utilities should be characterized as manufacturers for purposes of corporate income tax apportionment. Though the Department's policy was never set forth in any public document, it was memorialized in the foreign corporation training manual used by the Department's auditors. Joseph Southard, a retired auditor for the Department with over 25 years of experience, who conducted audits of several electric utilities, including Duke Energy, explained that the Department's policy was that electric utilities were manufacturers for purposes of the apportionment statutes.

The Department also applied this policy consistently, and Duke Energy offered nothing to show otherwise. No other electric utilities challenged that position before Duke Energy filed its amended returns. In fact, Duke Energy filed its returns using the multi-factor apportionment formula for at least 23 years before filing the amended returns and challenging the policy in 2002.

CONCLUSIONS OF LAW

In determining the income tax due from Duke Energy, the Department apportioned Duke Energy's South Carolina income using the multi-factor apportionment formula of Section 12-6-2250. The Department argues that Duke Energy's principal business in South Carolina is manufacturing and that Section 12-6-2250 should therefore apply. Duke Energy, however, contends that its principal business in South Carolina is the provision of service to customers and that Section 12-6-2290 should thus apply.

Burden of Proof

Because Duke Energy is challenging a determination by the Department that it must apportion its income under section 12-6-2250, it has the burden of proof. See SCALCR 29(B); Ford v. Atl. Coast Line R. Co., 169 S.C. 41, 168 S.E. 143, 167 (1932) ("The general rule is, in the absence of valid statutory enactment to the contrary, that the burden of proof rests upon him who has the affirmative of the issue and does not shift to the defendant even when aided, in the first instance, by a rebuttable presumption."); see also Anonymous v. State Bd. of Med. Exam'rs, 329 S.C. 371, 496 S.E.2d 17 (1998). This burden requires Duke Energy to prove that the Department's determination is wrong by a preponderance of the evidence. See, e.g., Janasik v. Fairway Oaks Villas Horizontal Prop. Regime, 307 S.C. 339, 346, 415 S.E.2d 384, 388 (1992) ("Findings of fact based upon a 'preponderance' of the evidence are those supported by the greatest 'weight, amount, credibility or truth' as reflected by the whole of the evidence before the court, or 'evidence which convinces as to its truth.'").

Apportionment of Income

The method of apportionment that a taxpayer must use depends upon the nature of the taxpayer's business in this State. Section 12-6-2250⁸ requires a taxpayer to apportion its multi-state income using the property, payroll, and sales factors if the taxpayer falls within the following definition:

A taxpayer whose principal business in this 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

S.C. Code Ann. § 12-6-2250.⁹ On the other hand, "[i]f the principal profits or income of a taxpayer are derived from sources other than those described in Section 12-6-2250," the taxpayer is required to use the single-factor gross-receipts apportionment formula. S.C. Code Ann. § 12-6-2290.¹⁰ Consequently, the issue that must be resolved for the Tax Periods at Issue is

⁸ Because the Tax Periods at Issue cover multiple years (1994-2001), a parenthetical date will not be used for the statutory citations.

⁹ Section 12-6-2250 during the Tax Periods at Issue required that the sales factor be double-weighted in calculation of the apportionment formula. This section was previously designated as section 12-7-1140, which was repealed in 1995. Prior to June 12, 1995, section 12-7-1140 provided a three-factor formula without the double-weighted sales factor.

¹⁰ Like section 12-6-2250, the predecessor of section 12-6-2290, S.C. Code § 12-7-1190, was repealed in 1995, but the language remained substantially the same. Section 12-6-2290 also excludes sources described in section

whether the Department erroneously determined that Duke Energy must apportion its income pursuant to Section 12-6-2250. After considering the evidence in the record and the pertinent legal authorities, I conclude that Duke Energy has failed to establish by the preponderance of the evidence that its principal business in South Carolina is not manufacturing or some other activity falling under Section 12-6-2250.

Agency Deference

The Department contends that in determining this issue the ALC must give its construction of Section 12-6-2250 deference. "An agency's long-standing interpretation of a statute is usually entitled to be given deference and should not be overruled by a reviewing court in the absence of cogent reasons. . . ." Media Gen. Commc'ns, Inc., and Media Gen. Broad. of S.C. Holdings, Inc. v. S.C. Dep't of Revenue, 388 S.C. 138, 149, 694 S.E.2d 525, 531 (2010) (citing Etiwan Fertilizer Co. v. S.C. Tax Comm'n, 217 S.C. 354, 360, 60 S.E.2d 682, 684 (1950)). In Etiwan, the Court further explained that: "[W]here the construction of the statute has been uniform for many years in administrative practice, and has been acquiesced in by the General Assembly for a long period of time, such construction is entitled to weight, and should not be overruled without cogent reasons." Etiwan, 217 S.C. at 359, 60 S.E.2d at 684. If the Department is entitled to deference, it is Duke Energy's burden to prove that the Department's policy is "arbitrary, discriminatory or unreasonable." Colonial Life & Acc. Ins. Co. v. S. Carolina Tax Comm'n, 248 S.C. 334, 339, 149 S.E.2d 777, 780 (1966) ("The Commission has the power and duty . . . to prescribe a method for arriving at a tax base which reasonably represents the proportion of the trade or business carried on within this State...and its determination thereabout will not be overthrown by the courts except upon a showing, absent here, that it is arbitrary, discriminatory or unreasonable") (internal quotation marks omitted); see also Vulcan, 342 S.C. at 496, 536 S.E.2d at 900; Etiwan, 217 S.C. at 359, 60 S.E.2d at 684. For the reasons set forth below, Duke Energy did not meet its burden in this regard.

The record shows that the Department and the Commission consistently have characterized electric utilities as manufacturers for purposes of corporate income tax apportionment.¹¹ Duke Energy filed its returns using the multi-factor apportionment formula for

12-6-2310, but that statute references income earned by railroad companies, motor carriers, telephone service companies, pipeline companies, airline companies, and shipping lines, none of which are applicable in this case.

¹¹ Duke Energy asserts that there is an inconsistency in the Department's audit manual in that service providers (those whose principal business is providing a service) have to apportion their income to South Carolina based on

at least 23 years before filing the amended returns and challenging the policy in 2002, which reflects that Duke Energy was aware of the policy. And although a Duke Energy witness, Cooper Monroe,¹² testified that the original returns were filed in error, he also acknowledged that Duke Energy and accounting firms "in [his] experience" apply a review process before a tax return is filed. This long period of time in which Duke Energy filed returns using the multi-factor apportionment formula leads to the conclusion that the returns were filed in accordance with the policies and filing requirements promulgated by the Department as understood by Duke Energy at the time the returns were originally filed.

Moreover, though the policy was not set forth in a publicly-issued advisory opinion, a decision of the Commission for property tax purposes supports the conclusion that the Department openly and consistently viewed electric utilities as manufacturers. In 1985, the Commission determined that "'X' Electric and Gas" was a manufacturer because the Supreme Court had held that its predecessor was a manufacturer in the Columbia Ry. decision. S.C. Tax Comm'n Decision P-D-532, 1985 WL 192777 (Apr. 11, 1985) (citing Columbia Ry., Gas & Elec. Co. v. Query, 134 S.C. 319, 132 S.E. 611, 612 (1926)). Although this ruling was rendered in the context of property taxes, it reflects a public position that the Department consistently applied the Columbia Ry., *supra*, and Duke Power, *infra*, decisions and consistently determined that electric utilities are manufacturers. The consistency of this policy is further evidenced by the fact that in P-D-532, the Department gave the electric utility the benefit of being a manufacturer by determining that its property-tax assessment ratio should be 6% as opposed to the 10.5% applicable to the personal property of non-manufacturing entities.¹³ More importantly, the South Carolina Supreme Court's decision in Columbia Ry., *supra* publicly reflects, in the context of a license tax imposed upon manufacturers' gross receipts, the Department's position that those engaged in the sale of electricity are manufacturers. See also

the single-factor gross-receipts apportionment method, while power companies must use the multi-factor apportionment formula. However, there is only an inconsistency if one adopts the premise that the generation, transmission, and distribution of electricity constitutes provision of service, or the premise that provision of service generates more profits or income than generation, transmission, and distribution of electricity, neither of which this Court adopts.

¹² Thomas Cooper Monroe, III is currently the Director of State and Local Tax for Duke Energy.

¹³ Also, in 1970, the South Carolina Attorney General opined that the South Carolina Electric & Gas Company was a manufacturer and that any plant it used to produce electricity was a manufactory eligible for property tax exemptions. 1970 S.C. Op. Att'y Gen. 154, Op. No. 2909, 1970 WL 12192 (June 2, 1970). The basis for this ruling was the Columbia Ry. and Duke Power decisions.

Duke Power Co. v. Bell, 156 S.C. 299, 152 S.E. 865 (1930) (recognizing the same position in the property-tax context). I find that though the notice to the General Assembly is traditionally given through a policy available to the public, the facts in this case meet the criteria envisioned in Etiwan. See also Whitner v. State, 328 S.C. 1, 6, 492 S.E.2d 777, 779 (1997) (“[T]here is a basic presumption that the legislature has knowledge of previous legislation as well as of judicial decisions construing that legislation when later statutes are enacted concerning related subjects.”) (emphasis added). Nevertheless, whether or not the Department’s position is given deference, I find that Duke Energy’s principal business is manufacturing for the reasons given below.

Manufacturing

Duke Energy must apportion its multi-state income for the Periods at Issue pursuant to Section 12-6-2250 unless Duke Energy proves that its principal business within this State is not (1) “manufacturing”; or (2) “any form of collecting, buying, assembling, or processing goods and materials within this State”; or (3) “selling, distributing, or dealing in tangible personal property.” Though Duke Energy suggests a contrary reading of this statute, the Legislature’s use of the disjunction “or” following “manufacturing” in Section 12-6-2295(a)’s phrase “manufacturing or any form of collecting, buying, assembling, or processing goods and materials within this State” demonstrates that the term “manufacturing” is not dependent on, or modified by, the clause “any form of collecting, buying, assembling, or processing goods and materials within this State.” Michau v. Georgetown County ex rel. S.C. Counties Workers Comp. Trust, 396 S.C. 589, 595, 723 S.E.2d 805, 808 (2012) (“[T]he ‘use of the word ‘or’ in a statute ‘is a disjunctive particle [sic] that marks an alternative.’”) (citing K & A Acquisition Group, LLC v. Island Pointe, LLC, 383 S.C. 563, 580, 682 S.E.2d 252, 261 (2009)). This conclusion is supported by the statutory history, which reflects that the apportionment statute, when adopted, addressed only corporations “engaged in the business of manufacturing,” 1927 S.C. Acts 1, No. 1, § 15(1),¹⁴ and that the latter clause of subsection (a) was added in 1946, 1946 S.C. Acts 1491, No. 553, § 3 (amending apportionment statute, then found in section 2451 of the 1942 Code, to apply to taxpayers whose “principal business ... in this State is manufacturing, or if it is any form of collecting, buying, selling, assembling or processing goods and materials within this

¹⁴ This language remained the same in the apportionment statute enacted as Section 2451 in both the 1932 South Carolina Code of Laws and the 1942 South Carolina Code of Laws.

State.”) (emphasis added). Thus, inclusion of the phrase “or any form of collecting, buying, assembling, or processing goods and materials” after “manufacturing” in Section 12-6-2250(a) reflects that the Legislature intended to cover not just manufacturing but all activities that a business could perform in regards to goods or materials prior to making those goods or materials available to its customers. See Charleston County Sch. Dist. v. State Budget and Control Bd., 313 S.C. 1, 5, 437 S.E.2d 6, 8 (1993) (“The cardinal rule of statutory construction is to ascertain and effectuate the intent of the legislature.”).

Here, there is no dispute regarding several of the elements of Section 12-6-2250. It is undisputed that Duke Energy is a taxpayer required to file corporate income tax returns in this State. Similarly, it is undisputed that Duke Energy has multi-state income that must be apportioned. See S.C. Code Ann. § 12-6-2210(b). There is also no disagreement that Duke Energy is engaged in the business of generation, transmission, distribution, and sale of electricity in portions of both North Carolina and South Carolina. Mr. Dhiaa Jamil¹⁵ testified that providing electricity is Duke Energy’s “primary business.” To conduct its primary business, Duke Energy operates generation plants in both South Carolina and North Carolina.

Because “manufacturing” is not defined in the apportionment statutes, this Court must interpret it in accord with its usual and customary meaning. E.g., Travelscape, LLC v. S.C. Dept. of Revenue, 391 S.C. 89, 99-100, 705 S.E.2d 28, 33-34 (2011). Merriam-Webster’s Dictionary presently defines “manufacture” as “the process of making wares by hand or by machinery especially when carried on systematically with division of labor.” It further defines the term to include “productive industry using mechanical power and machinery” and “the act or process of producing something.” See <<http://www.merriam-webster.com/dictionary/manufacture>> (accessed October 18, 2012); see also Jennings v. Jennings, No. 27177 (Oct. 18, 2012) (Hearn, J.) (referencing online Merriam-Webster’s Dictionary for definition of a word).¹⁶ And in 1939, in holding that the generation of

¹⁵ Dhiaa M. Jamil, P.E., currently is the Executive Vice President of Nuclear Generation and the Chief Nuclear Officer for Duke Energy.

¹⁶ It is also worth noting that the current Merriam-Webster’s definition of the term “ware,” a term included in the definition of “manufacturing,” includes manufactured goods. See <<http://www.merriam-webster.com/dictionary/ware>> (accessed October 18, 2012). Also, Merriam-Webster’s current definition of “good” includes “something that has economic utility or satisfies an economic want” and “something manufactured or produced for sale.” See <<http://www.merriam-webster.com/dictionary/good>> (accessed October 18, 2012). Thus, even if in Section 12-6-2250(a) “manufacturing” modified “goods,” the electricity that Duke Energy generates, transmits, and distributes would be in accord with the common understanding of the term

electricity is manufacturing, the Iowa Supreme Court referenced Webster's definition of manufacturing, which was "'to make by hand, by machinery, or by other agency; to work raw materials into forms for use; to produce mechanically.'" Winterfield, 285 N.W. at 224-25. Applying this definition, the court held that generating electricity is manufacturing. Id.

Our Supreme Court has also held on two different occasions that an electric utility that generates electricity is engaged in manufacturing. In Columbia Ry., the South Carolina Supreme Court held that a company engaged in the business of generating electricity was properly considered a "manufacturer" for purposes of a statute that imposed a corporate license tax on the gross receipts of "a corporation engaged in the business of manufacturing." 132 S.E. at 612 ("We do not think that there is any doubt that the appellant is engaged in the business of manufacturing gas and electricity"); see also State v. Broad River Power Co., 157 S.C. 1, 153 S.E. 537, 539 (1929) (noting that the Columbia Railway company built "a large plant for the manufacture of gas and electricity for sale to the public generally") (emphasis added).¹⁷ In a later case, reviewing a different statute, the Supreme Court held that Duke Power Co., a predecessor of Duke Energy, was entitled to claim a property tax exemption for manufactories—defined as a physical plant, or a place or building, where manufacturing is carried on—because it was a manufacturer. Duke Power, supra. The Court held that, based on Columbia Ry., Duke Power was engaged in manufacturing. Id., 152 S.E. at 868 ("If a company engaged in the generation of electricity is a 'manufacturer' for the purposes of a Statute imposing a tax, the plan or structure wherein the process of generating such electricity is carried on is a manufactory for the purposes of a tax exempting statute."). Thus, although Columbia Ry. considered the 1926 Manufacturer's Tax Act, the Duke Power decision reflects that the Court's holding that Duke Power was engaged in manufacturing was not limited to that statute.¹⁸

"manufactured good," and would therefore still satisfy Section 12-6-2250(a) under that alternative interpretation of the statute. Furthermore, Duke Energy has failed to prove by the preponderance of the evidence that the electricity it produces is not a good or that it is not manufactured.

¹⁷ Notably, the 1927 Century Dictionary defined manufacture as "the making of goods or wares by ... machinery, esp. on a large scale"

¹⁸ When the holding of Columbia Ry. is considered in light of the pertinent language from the Manufacturer's Tax Act at issue in that case, the application of that decision in this case becomes evident, especially in light of the absence of any distinction between Duke Energy's business in this State versus its business in North Carolina. Specifically, the Manufacturer's Tax Act provided that "every person, firm or corporation engaged in the business of manufacturing" was subject to the tax imposed on manufacturers. 1923 S.C. Acts 12, No. 21, §11-A. And although the tax at issue was a license tax on "the entire receipts," it was specifically imposed on "the business of manufacturing." Thus, the Columbia Ry. decision is based on a 1923 Act directed at manufacturers and uses the

The Supreme Court's determination that two different electric utilities were engaged in manufacturing for purposes of two different tax statutes certainly supports the conclusion that electric utilities are engaged in manufacturing for purposes of other tax statutes, including the apportionment statute. This is especially so given the Supreme Court's holding that "the legislative classification [of the apportionment statute] ... should be liberally construed in favor of the inclusion of business to which the formula is appropriate." Hertz Corp. v. S. C. Tax Comm'n, 246 S.C. 92, 96, 142 S.E.2d 445, 447 (1965) (holding that taxpayer involved in renting tangible personal property came within the predecessor to section 12-6-2250).¹⁹ The fact that the common definition of "manufacture" has remained constant from the time of the Columbia Railway and Duke Power decisions up to the present, and that definition is still applicable to Duke Energy's operations, further validates that Duke Energy is engaged in manufacturing electricity. In addition, Duke Energy generates, transmits, and distributes electricity in South Carolina using the same methods and principles employed during the era in which these cases were decided. Furthermore, Duke Energy's corporate charter for the Tax Periods at Issue retained the same language used in its original charter, which was considered pertinent by the Supreme Court. Compare Duke Power, 152 S.E. at 867 (referencing charter granting authorization to Duke Power Company to "manufacture, generate, buy, sell, accumulate, store,

same language as the apportionment statute at issue in this case. Compare S.C. Code Ann. § 12-6-2250 (applying to "a taxpayer whose principal business in this State is ... manufacturing") with 1923 S.C. Acts 12, No. 21, §11-A (applying to a taxpayer "engaged in the business of manufacturing").

¹⁹ Although not binding here, courts in other states have held that generating or producing electricity is manufacturing, reflecting that a position such as that taken by the Department is reasonable. Some of these cases have cited Columbia Ry. and Duke Power as support for that holding. Curry v. Ala. Power Co., 8 So.2d 521, 525 (Ala. 1942) (citing Columbia Ry. and Duke Power decisions in holding that generating electricity is manufacturing); State ex rel. Winterfield v. Hardin County Rural Elec. Co-op., 285 N.W. 219, 226 (Iowa 1939) (citing Columbia Ry. and Duke Power and stating: "The great preponderance of authority as evidenced by the decisions of the courts supports the proposition that one engaged in the generation of electricity is engaged in a manufacturing or mechanical business"). Other states simply have held that generating electricity is manufacturing. E.g., Pub. Serv. Co. v. Dep't of Rev., 10CA1026, 2011 WL 4089971 (Colo. Ct. App. Sept. 15, 2011) (generating electricity is manufacturing); Davis v. Gulf Power Corp., 799 So. 2d 298, 301 (Fla. Dist. Ct. App. 2001) (generation of electricity is a manufacturing process and electricity is tangible personal property); Minn. Power & Light Co. v. Pers. Prop. Tax. Taxing Dist., City of Fraser, Sch. Dist. No. 695, 182 N.W.2d 685, 692 (Minn. 1970) (producing electricity is manufacturing); Bd. of Assessors of Holyoke v. State Tax Comm'n, 244 N.E.2d 287, 289 (Mass. 1969) (same); Morley v. Brown & Root, 239 S.W.2d 1012, 1015 (Ark. 1951); (same); City of Louisville ex rel. v. Howard, 208 S.W.2d 522, 526 (Ky. 1947) ("The generation of electricity is manufacturing."); Chicago, M., St. P. & P.R. Co. v. Custer County, 32 P.2d 8, 9 (Mont. 1934) (holding that "the electricity which exists in nature is not subject to use; the current which will cause the wheels of industry to turn, or will light a city, must be produced by the employment of labor and machinery and is, therefore, generally said to be manufactured"); see also Comm'r of Revenue v. Houghton Mifflin Co., 666 N.E.2d 491, 495 (Mass. 1996) (rejecting contention that process does not involve manufacturing merely because its inputs are not tangible).

transmit, furnish, and distribute electric current for light, heat, and power”) with Restated Arts. Inc. Duke Power Co. (October 6, 1993) (authorizing company “[t]o manufacture, generate, buy, sell, accumulate, store, transmit, furnish and distribute electric current for light, heat and power”) and Restated Arts. Inc. Duke Energy Corp. (June 18, 1997) (same). If the processes of generating, transmitting, and distributing electricity are, for the most part, the same today as those employed in 1926 and 1930, and if those processes constituted manufacturing for purposes of a tax statute during those years, then the generation of electricity constitutes manufacturing for purposes of a tax statute during the Tax Periods at Issue.²⁰ Duke Energy therefore is engaged in the business of manufacturing in this State for purposes of Section 12-6-2250.

Moreover, the evidence in this case establishes that Duke Energy is a manufacturer. As explained above, “manufacturing” is defined in Merriam-Webster’s online dictionary as “the process of making wares by hand or by machinery especially when carried on systematically with division of labor.” It further defines the term to include “productive industry using mechanical power and machinery” A “ware” is defined as “an “article of commerce.” The American Heritage College Dictionary 1521 (3d ed. 1993). Duke Energy’s witnesses repeatedly characterized its business as “producing” electricity.²¹ Electricity that is produced by Duke Energy and consumed by its customers is created at a generation facility.²² The process that

²⁰ Mr. Papapolymerou testified that although for the most part the process of generating electricity has not changed in the last one hundred years ago, Duke Energy has added renewable energies, developed solar panels, and developed more efficient wind generators. However, there is no evidence that these developments were implemented during the Tax Periods at Issue (1994-2001); and even had they been implemented during those periods, electricity was still being generated for the most part by the same processes that the Supreme Court has considered to be manufacturing. Mr. Jamil also testified that the basic generation process is the same today as it was in the early 20th century.

²¹ “Manufacturing,” as discussed previously, also includes “the act or process of producing something.” However, this definition, though accurate and applicable, describes manufacturing in its most general sense. The Court will use the other two definitions, as they are more specific.

²² Mr. Jamil testified that Duke Energy could provide electricity even without its generation assets. That is, Duke Energy apparently contends that it could sell electricity without producing it and, thus, that it is not a manufacturer for that reason. But the fact that an entity could resell a product to customers without actually manufacturing that product does not mean that the entity that did produce the product is not a manufacturer. And a determination of whether any entity that simply resells electricity is a manufacturer is beyond the scope of this proceeding.

In any event, the record does not support any characterization of Duke Energy as a mere reseller of electricity for the Tax Periods at Issue. The evidence reflects that Duke Energy generated virtually all of the electricity it sold during the Tax Periods at Issue. [Duke Energy 1994-2001 Forms 10-K (showing “Electric Energy Generated” as being nearly equal to “Electric Energy Sold” each year) [Pet’r Hr’g Exs. 49-B-17 through 49-B-24].] Mr. Monroe testified that Duke Energy generates most of the electricity that it sells. Thus, the fact that other utilities might simply resell electricity without generating it, and that Duke Energy could do the same thing, is immaterial because the record reflects that Duke Energy does generate electricity; and it is therefore a manufacturer.

occurs at a generation facility reflects that it is manufacturing. Each of these facilities contains at least one generator. A generator is a "fairly large machine" and "mechanical device" that uses mechanical energy to produce electric energy or, as it is more commonly known, electricity. The generator creates an electric current that is processed through the transmission and distribution systems. Generators have been used to produce electricity in substantially the same manner for over 100 years. Many, though not all, of Duke Energy's generation facilities use a turbine driven by steam power to turn the generator.²³ The result, however, is the same: Duke Energy employs a mechanical device to produce and generate electricity using the same process employed since the early 20th century. Thus, Duke Energy's generation facilities are, as recognized by our Supreme Court, locations at which manufacturing occurs. See Duke Power, 152 S.E. at 868.

Furthermore, though they disagree as to the ultimate characterization of electricity production, Duke Energy and the Department seem to agree that Duke Energy's generation, transmission, and distribution processes are interconnected. In other words, Duke Energy cannot generate electricity to deliver to consumers in the absence of any one of these parts.²⁴ The generator is connected to the transmission system, which is connected to the distribution system. As noted above, Duke Energy requires all three processes to provide electricity to its customers. Prior to distribution of the electricity to the consumer through the meter, the electric utility owns and continues to process the electricity, which is not in a form usable by a consumer prior to its distribution through the electric meter. Cf. Priest v. Brown, 302 S.C. 405, 411, 396 S.E.2d 638, 641 (Ct. App. 1990) (in affirming a trial court decision that strict liability was not applicable against electric utility for a person who was electrocuted and died after touching a downed distribution line, the court noted an affidavit that stating that "the electricity through these lines was of such a high voltage that it was not in a form immediately usable by a consumer" and held that the facts of this case alone suggest the electricity had not been placed into the stream of commerce . . .").

In addition, though electricity is a unique product with unique characteristics required by consumers, it is clearly produced by Duke Energy and distributed in keeping the required needs

²³ The design of a turbine used in these generation facilities has not significantly changed since the early 20th century.

²⁴ Duke Energy sometimes provides to its customers electricity that it has purchased from other utilities. But most of the electricity that Duke Energy provides to its customers is generated by Duke Energy.

of the customers. Although there was testimony in the record regarding other forms of energy, such as kinetic and mechanical energy, those other energy forms are different than electricity or electric energy and do not meet the vast majority of consumer needs in homes and businesses. And this conclusion is not changed by the fact that electricity may exist in nature (e.g., a lightning strike is the effect of an electromagnetic field on air molecules), because that electricity is not usable by electric utilities or consumers in that form. See, e.g., Chicago, M., St. P. & P.R. Co. v. Custer County, 32 P.2d 8, 9 (Mont. 1934) (holding that "the electricity which exists in nature is not subject to use; the current which will cause the wheels of industry to turn, or will light a city, must be produced by the employment of labor and machinery and is, therefore, generally said to be manufactured . . .") (internal citations omitted).

The nature of electricity as a product produced by Duke Energy is further evidenced by the fact that Duke Energy does not have access to unlimited quantities of electricity because its ability to generate electricity is limited by the capacity of its generators. The fact that Duke Energy charges for electricity based on quantity, and cannot provide unlimited electricity, further supports the conclusion that generating electricity is manufacturing. Measuring electricity by quantity is the same as measuring any product by quantity, and the limitation on the quantity of electricity that can be produced is analogous to the limitation imposed on any manufacturer by the capacity of the machines employed in the manufacturing process.²⁵

In sum, the electricity consumed by Duke Energy's customers is the product of Duke Energy's generation of that electricity. Duke Energy employs an interconnected process of producing and delivering electricity that is substantially the same as that used by any entity that creates and produces a product using an assembly line and then charges the customer based on the amount of the product sold. A generator is analogous to any machine used by a manufacturer to produce a product for sale; the transmission and distribution systems are like the assembly line process used by a manufacturer to further refine and develop the product; and the customer is

²⁵ Interestingly, S.C. Code Ann. § 16-13-380 references the theft of electricity by any "person who ... has no contract, agreement, license, or permission with or from any person authorized to manufacture, sell, or use electricity for the purpose of light, heat, or power." S.C. Code Ann. § 16-13-380 (emphasis added); see also S.C. Code Ann. § 16-13-390 (prohibiting the wrongful use of electricity by a person who has a "contract, agreement, license or permission, oral or written, with or from any person authorized to manufacture, sell or use electricity for the purpose of light, heat or power.") (emphasis added). Therefore, it is clear that the General Assembly understands that electricity can be manufactured.

charged by the quantity of the product consumed.²⁶ The fact that Duke Energy charges for electricity based on quantity, and cannot provide unlimited electricity, further supports the conclusion that generating electricity is manufacturing. Measuring electricity by quantity is the same as measuring any product by quantity, and the limitation on the quantity of electricity that can be produced is analogous to the limitation imposed on any manufacturer by the capacity of the machines employed in the manufacturing process.

Characterization of the Provision of Electricity as a Service

Duke Energy contends that its “principal business in South Carolina is the provision of electric service to its customers.” (Emphasis added). At the outset, Duke Energy cannot “provide” electric service without the existence of electricity, and the electricity that Duke Energy provides cannot exist without first being produced, or manufactured. As to “electric service,” the South Carolina Income Tax Act does not define the word “service.” And the usage of the word “service” in the South Carolina Income Tax Act does not provide any guidance as to the term’s meaning, as it is used in a variety of connotations.²⁷ Looking then to Merriam-Webster’s Dictionary, “service” is defined as “useful labor that does not produce a tangible commodity” or “a facility supplying some public demand.” Merriam-Webster Online Dictionary, www.merriam-webster.com (last visited October 18, 2012). Because this Court, for reasons that will be discussed more fully below, finds electricity to be a tangible commodity, Duke Energy has failed to demonstrate that its “provision” of electricity to customers is a service under the first definition. As to the second definition, Duke Energy is doubtless a service

²⁶ The Court recognizes that the transmission and distribution processes could be interpreted as being separate from manufacturing. Transmission of electricity, for instance, could fall under “processing” in Section 12-6-2250(a), because the electricity must be “stepped up” and “stepped down” in order to regulate the voltage so that line loss can be minimized. Also, for the electricity to be usable by the customers, it must be further manipulated to meet the specifications of the devices used by the customers. Likewise, distribution could be interpreted as “distributing . . . tangible personal property within this State,” under Section 12-6-2250(b). This interpretation would require a determination of electricity’s tangibility and whether electricity is “personal property.” The Court will explain in more detail later in the decision why electricity is tangible personal property. At any rate, because the generation, transmission, and distribution of electricity are equally-necessary components of the business of providing electric power, Duke Energy’s business activities seemingly could fall under Section 12-6-2250(a), or (a) and (b); but under either scenario, Duke Energy’s principal business involves activities that are covered in Section 12-6-2250, which is the issue here.

²⁷ See, e.g., S.C. Code Ann. §§ 12-6-550 (“service” in the context of providing of water supply and sewage disposal); 12-6-1120 (“service” in the context of the National Guard and Armed Forces reserve components); 12-6-1720(1)(b) (“service” in the context of apportionment of nonresident individuals, trusts, estates, or beneficiaries); 12-6-2850 (“services” in the context of foreign trading receipts); and 12-6-3450 (“services” in the context of an employee’s services for an employer in determining qualification for an income tax credit for persons terminated from employment as a result of the closing or realignment of a federal military installation).

because it is "a facility supplying some public demand." However, there is nothing in this definition of service that includes or excludes manufacturing. In this case, though, Duke Energy supplies to its customers electricity that it has already manufactured, thus demonstrating that the two activities are separate.

Duke Energy nevertheless contends that it is not manufacturing because it is not creating anything and is doing nothing more than "provid[ing] access to the electromagnetic field." However, Duke Energy fails to recognize that it produces/manufactures the product for which any service is provided. Electricity is a product that moves and is processed through the transmission and distribution systems and is delivered to the customer at the specifications required by that customer. Services are typically measured by the quantity of time provided, not by the quantity of the product consumed.²⁸ In fact, even Duke Energy recognizes that it is producing something. Not even Duke Energy's own representations to the public refer to "providing access to the electromagnetic field." Moreover, Duke Energy's own witness testified that, "in layman's terms," electromagnetic field is electric current," and that any electromagnetic field results from the oscillation of electrons caused by the electric charge created by the generator which moves in the form of a current.

Duke Energy also offered evidence that it charges a flat fee for outdoor lighting. That evidence does not negate the fact that the majority of the electricity delivered by Duke Energy is sold based on quantity consumed. Moreover, as Mr. Jamil testified, the time period for which outdoor lighting operates is controlled by use of a photocell, and Duke Energy is able to estimate the variables in the timing to determine a pricing for the outdoor lighting. Rather, as Mr. Monroe testified, Duke Energy sells electricity on a metered basis involving electricity flowing through a meter and the company "read[ing] the meter periodically and send[ing] a bill to the customer." Thus, the majority of the electricity provided by Duke Energy is priced at some level based on quantity.

²⁸ Duke Energy further supported its services argument through testimony that it currently is classified as a utility, not a manufacturer, for purposes of the North American Industry Classification System (NAICS), and that it classifies itself as a utility when filing its federal income tax returns. However, the specific NAICS and federal income tax return instructions referenced by the witness pertained to years after the Tax Periods at Issue and, thus, do not assist in determining Duke Energy's character for the Tax Periods at Issue. In any event, neither the NAICS nor the federal classification for data purposes answers the question of whether Duke Energy is a manufacturer for purposes of Section 12-6-2250. Similarly, Duke Energy's references to itself as a provider of services in various publications do not resolve the question of whether it falls within Section 12-6-2250.

Duke Energy finally attempts to compare the above-described processes to the provision of telecommunication services—both cellular and landline—but that comparison is unconvincing. Unlike Duke Energy, telecommunication companies do not generate or produce electricity, but instead only use electricity purchased from electric utilities. Moreover, the evidence in the record demonstrates the differences between a telecommunication service and Duke Energy's production and sale of electricity. First, Duke Energy delivers to its customers a quantifiable product that is produced by Duke Energy. In contrast, telecommunication companies transmit communication or intelligence from one customer to another through a system operated by electricity purchased from utilities like Duke Energy. In essence, the telecommunications company simply transports intelligence produced or created by one of its customers. The purpose of Duke Energy's business is thus to generate and provide electric energy while the purpose of a telecommunication company's business is to convey information. Because Duke Energy produces electricity for use by its customers at an appropriate specification, and telecommunications companies transport intelligence produced by its customers using electricity produced by an electric utility, I find that the purported comparison to a telecommunications company does not undermine the reasonableness of the Department's policy that Duke Energy is a manufacturer.

Conclusion

In sum, to conclude that Duke Energy provides a service rather than manufactures electricity would require a determination that the term "manufacturing" in Section 12-6-2250 means something different than "producing" (or "generating," for that matter), a term generally used synonymously with "manufacturing." Moreover, a person or entity providing services is not commonly understood to be "producing" services, and it is not commonly said that a company which generates and sells electricity is merely providing a service by "provid[ing] access to the electromagnetic field." This is especially so given that the electric current that generates that field, or even the field itself, is generated through an asset-intensive process maintained and operated by Duke Energy. Finally, though it is conceivable that the processes of transmitting and distributing are not part of manufacturing, Duke Energy presented no evidence that would support separation of its electric transmission and distribution processes from its generation process and, in fact, described the whole process as a "very elaborate system." In short, as Mr. Jamil testified, "you need all three." In any event, even if the Court were to draw

such a distinction, it would prove inconsequential to the outcome here because all three activities – generation, transmission, and distribution – fall under Section 12-6-2250.²⁹

Processing Goods and Materials within this State

Alternatively, the evidence reflects that Duke Energy comes within Section 12-6-2250 because its generation, transmission, and distribution of electricity constitutes “any form of...processing goods and materials within this state.” S.C. Code Ann. § 12-6-2250(a) (emphasis added). The use of “any form” in the statute reflects a legislative intent that the language be applied as broadly as possible and, concomitantly, a legislative preference for using the three-factor formula whenever possible. Hertz Corp., 246 S.C. at 96, 142 S.E.2d at 447 (identifying “any form” in predecessor to section 12-6-2250 as “broad language”). The evidence introduced by both parties shows that generating electricity is a form of processing raw materials such as coal, water, or nuclear fuel. These items are goods and materials.³⁰ These goods are processed and used to create energy to turn a generator either directly or indirectly, which constitutes “any form” of processing of those inputs in the generation process and, thus, falls within the statute.

Selling, Distributing, or Dealing in Tangible Personal Property

Duke Energy also comes within Section 12-6-2250 because its business constitutes “selling, distributing, or dealing in tangible personal property.” Duke Energy, however, argues that it is a seller of services and therefore cannot be a seller, distributor, or dealer of tangible personal property. The premise of this argument is that electric service is not tangible personal

²⁹ Duke Energy also contends that electricity is not manufacturing because it is not tangible. Duke Energy’s conclusion is based upon two premises: 1) electricity is an intangible material and 2) the term “manufacturing” in Section 12-6-2250 is limited solely to tangible goods or materials. As to the first premise, this Court, for reasons discussed later in the text, finds that the electricity Duke Energy produces is tangible. The Court, therefore, need not address the remaining premise. However, even if this Court found that electricity was intangible, this would not necessarily prevent electricity from being a manufactured product. Merriam-Webster’s definition of “manufacture” includes “the process of making wares by machinery” See <<http://www.merriam-webster.com/dictionary/manufacture>> (accessed October 19, 2012). Merriam-Webster’s definition of “wares” includes “intangible items” that are “marketable commodit[ies].” See <<http://www.merriam-webster.com/dictionary/ware>> (accessed October 19, 2012). Adopting this view of electricity, the Massachusetts Supreme Court, in Westinghouse Broad. Co., Inc. v. Comm’r of Revenue, noted that the proposition that an electric power company “may not be denied manufacturing status merely because its end product is intangible” . . . “conformed to [its] view that the production of electricity may entail manufacture” 382 Mass. 354, 358, 416 N.E.2d 191, 193 (1981).

³⁰ Merriam-Webster’s definition of a “good” is “something that has economic utility or satisfies an economic want.” See <<http://www.merriam-webster.com/dictionary/good>> (accessed October 19, 2012). It defines “material” as “the elements, constituents, or substances of which something is composed or can be made.” See <<http://www.merriam-webster.com/dictionary/material>> (accessed October 19, 2012).

property. Duke Energy also argues that the definition of “tangible personal property” should not be taken from S.C. Code Ann. § 12-36-60, which sets forth the definition of “tangible personal property” for sales and use tax purposes. Rather, Duke Energy urges the Court to adopt the definition of “tangible property” set forth in the Income Tax Act, specifically S.C. Code Ann. § 12-6-30(11).

I agree that because “tangible personal property” in Section 12-6-2250(b) is part of the Income Tax Act, the definition for “tangible property” under the Income Tax Act must be used. S.C. Code Ann. § 12-6-30(11) defines “tangible property” as “includ[ing] . . . corporeal personal property but does not include money, bank deposits, shares of stock, bonds, credits, evidence of debt, chose in action, or evidence of an interest in property.” (Emphasis added). The primary purpose in interpreting statutes is to ascertain the intent of the Legislature. Hodges v. Rainey, 341 S.C. 79, 85, 533 S.E.2d 578, 581 (2000). “[This Court] cannot construe a statute without regard to its plain and ordinary meaning, and this Court may not resort to subtle or forced construction in an attempt to limit or expand a statute's scope.” Cain v. Nationwide Prop. And Cas. Ins. Co., 378 S.C. 25, 29, 661 S.E.2d 349, 352 (2008) (internal citation omitted). “Where the statute's language is plain and unambiguous, and conveys a clear and definite meaning, the rules of statutory interpretation are not needed and the court has no right to impose another meaning.” Id. at 30, 661 S.E.2d at 352 (internal citation omitted).

In this case, it is clear that tangible personal property includes “corporeal personal property.” “Corporeal” is not a legal term of art in this case, and it is generally understood to mean “[o]f a material nature; tangible.”³¹ In further support of this plain understanding of the definition of “tangible property,” Section 12-36-60, which addresses “tangible personal property” for sales and use tax purposes, defines this term as “personal property which may be seen, weighed, measured, felt, touched, or which is in any other manner perceptible to the senses.” This definition coincides with the general understanding of the term “corporeal” included in the definition of “tangible property” under Section 12-6-30(11).³²

³¹ The American Heritage College Dictionary 311 (3d ed. 1993). See also Black's Law Dictionary 394, 1336, 1592 (9th ed. 2009) (defining “corporeal” as “tangible”; “tangible” as “corporeal”; and “corporeal personal property” as “tangible personal property”).

³² The Court recognizes that Sections 12-6-30(11) and 12-36-60 differ with respect to their treatment of intangible personal property. Specifically, Section 12-36-60 includes as tangible personal property services and intangibles, whereas Section 12-6-30(11) excludes intangibles altogether; indeed, “intangible property” is separately defined under Section 12-6-30(12). However, the specific exclusions from tangible personal property (which are not at issue

Applying to the facts of this case the definition of tangible property found in Section 12-6-30(11), according to its plain and ordinary meaning which is supported by the general definition of tangible personal property given in the first sentence of Section 12-36-60, I conclude that electricity is tangible personal property. Electricity is a product delivered to customers at certain precise specifications. The evidence also established that electricity is a physical product with physical characteristics; that the electric charge associated with electricity is a physical property of matter; that it certainly is possible to feel electricity's impact in the body; that electricity can be moved, manipulated, and stored, characteristics further suggesting the tangible nature of electricity; that the electric charge, which Duke Energy witnesses testified is the source of electricity, can be stored; and that electricity is a fungible product that is sold in quantifiable amounts. Also, because the electricity sold, distributed, or dealt by Duke Energy is used by its customers in amounts, duration, and purposes chosen by its customers, i.e., it is under the customers' control after it is distributed to them, the electricity becomes personal property of the customers.

On one hand, Duke Energy does not wish to apply the definition of "tangible personal property" under Section 12-36-60; but nonetheless, Duke Energy wishes to use Section 12-36-60 to establish its sales of electricity as a service. It argues that if Section 12-36-60 applied, "the Department's view on the characterization of electricity based on the sales and use tax definition was long ago rejected by this Court in [Consolidated Hydro S.E., Inc. v. S.C. Dep't of Revenue & Taxation], No. 95-ALJ-17-0634, 1996 WL 909155 (S.C. Admin. L.J. Div. May 13, 1996) (Lee, A.L.J.)." In that case, the taxpayer owned and operated several hydro-electric power generation facilities in South Carolina and was engaged in the business of production and sale of electricity. Citing the definition of "tangible personal property" set forth in S.C. Code Ann. § 12-36-60, relating to sales and use taxes, the company argued that it did not provide or sell a "service" and was therefore not subject to additional license taxes. The court in that case disagreed, concluding that "while electricity is included in [12-36-60] discussing the application of sales tax

here) are nearly identical in both definitions. Section 12-6-30(11) excludes from tangible property the following: "money, bank deposits, shares of stock, bonds, credits, evidences of debt, choses in action, or evidences of an interest in property." Similarly, Section 12-36-60 excludes from tangible personal property the following: "stocks, notes, bonds, mortgages, or other evidences of debt . . . [and] transmission of computer database information by a cooperative service when the database information has been assembled by and for the exclusive use of the members of the cooperative service." Also, as discussed above, Section 12-36-60 provides a specific definition of "tangible personal property" that coincides with the general understanding of "corporeal personal property" included in the definition of "tangible property" under Section 12-6-30(11).

on the sale of tangible personal property, the sale of electricity is specifically recognized and defined as a service.”

First, that decision has **no precedential value** and is thus not binding on this Court.

Secondly, that decision merely concluded that the taxpayer was providing a service and was thus subject to a license fee under then-Section 12-19-110. However, Section 12-19-110 was imposed “[i]n addition to . . . all other license taxes and fees or taxes of whatever kind” Section 12-19-110 did not prevent the application to the taxpayer of any other tax laws, including those that implicated “tangible personal property.” Thus, even if this Court were to adopt the position that the sale of electricity was merely a service under the Sales and Use Tax Act, the sale of electricity would simply be a service that does not fall “within the meaning of the general definition” of “tangible personal property” set forth in the first sentence of Section 12-36-60, Consolidated Hydro *4. But the inquiry does not end there in this case. The sale of electricity, though a service, would still be considered tangible personal property, as set forth in the second sentence. As such, it would be subject to tax laws imposed by other statutes upon tangible personal property, just as it was subject to license fees imposed by other statutes upon services. Thus, even under Duke Energy’s theory, it would still be considered to be “selling, distributing, or dealing in tangible personal property within this State” for corporate income tax apportionment purposes under Section 12-6-2250.

Furthermore, as previously mentioned, Merriam-Webster’s Dictionary defines “service” as “useful labor that does not produce a tangible commodity” or “a facility supplying some public demand.” Merriam-Webster Online Dictionary, www.merriam-webster.com (last visited October 29, 2012). Because, for the reasons given above, I find that electricity is a tangible commodity manufactured by Duke Energy, Duke Energy has failed to demonstrate that its “provision” of electricity to customers is a service under the first definition. As to the second definition, Duke Energy is doubtless a service because it is “a facility supplying some public demand.” However, there is nothing in this definition of service that is determinative of tangibility or intangibility. Indeed, the actual provision of a product may be intangible, while the product itself is tangible.³³ This is evident with the sales or use tax definition of “tangible personal property” under Section 12-36-60, in which sales of electricity, though considered

³³ See, e.g., *Pub. Serv. Co. v. Dep’t of Revenue*, ___P.3d___, 2011 WL 4089971 (Colo. Ct. App. 2011) (“There is . . . Colorado authority that electricity is both a product and a service”).

services under that statute, are considered tangible personal property. See S.C. Code Ann. § 12-36-60 (“‘Tangible personal property’ . . . also includes . . . sales of electricity . . .”). Thus, even looking to the sales or use tax definition, and considering the sale of electricity to be a service, the sale of electricity would still be tangible personal property for tax purposes.³⁴

In sum, although it admittedly is unique, electricity is a tangible product with identifiable physical characteristics that may be created, measured, felt, stored, and consumed, and an electric utility may exercise ownership rights over it. And even if the Court were to consider the sale of electricity merely a service, it would still be considered tangible personal property for tax purposes. Therefore, Duke Energy also falls within Section 12-6-2250(b).

More-than-50-percent Test

Though Duke Energy, as the taxpayer, may engage in activities falling under Section 12-6-2250, Duke Energy may still apply the single-factor gross receipts apportionment method under Section 12-6-2290 if the principal amount of its profits or income is derived from activities other than those covered in Section 12-6-2250. However, Duke Energy, which was engaged in more than one line of business during the Tax Periods at Issue, has the burden of proving that its principal business in this State was not from manufacturing, or any form of collecting, buying, assembling, or processing goods and materials within this State, or from selling, distributing, or dealing in tangible personal property within this State. In making this “principal business” determination, South Carolina adopts a more-than-50-percent test. The Department’s longstanding policy provides:

[W]hether a business is a service related industry can be made by comparing the gross receipts of the business derived from providing services to total gross receipts of the business. If over 50 percent of the gross receipts are from providing services, then the business would be service related. This method has been utilized by the [South Carolina Tax] [C]ommission in determining whether a multistate taxpayer is providing services and thus would utilize the gross receipts ratio to apportion its income.

³⁴ Duke Energy points out that several other states have treated the provision of electricity as something other than tangible person property. These states would include: North Carolina, Oregon, California, and Massachusetts. However, this Court finds more persuasive the decisions of those states that hold that electricity is tangible personal property. See e.g., Exelon Corp. v. Dept’t of Revenue, 234 Ill.2d 266, 917 N.E.2d 899 (2009); Tucson Elec. Power Co. v. Ariz. Dep’t of Revenue, 170 Ariz. 145, 822 P.2d 498 (Ct. App. 1991). Moreover, Duke Energy acknowledges that other states, in contexts other than income tax, have ruled that the sale of electricity is the sale of tangible personal property. See e.g., Davis v. Gulf Power Corp., 799 So. 2d 298, 301 (Fla. Dist. Ct. App. 2001) (property tax); Texas E. Transmission Corp. v. Benson, 480 S.W.2d 905, 908 (Tenn. 1972) (sales tax); S. Natural Gas Co. v. State, 261 Ala. 222, 73 So. 2d 731 (1953) (use tax).

Rev. Rul. No. RR-87-5 (S.C. Tax Comm'n Sept. 16, 1987). Thus, under the Department's policy, if more than 50 percent of a business's gross receipts are from providing services, then the business would be service-related and the taxpayer would be required to apportion its income to South Carolina using the single-factor gross-receipts apportionment method under S.C. Code Ann. § 12-6-2290. Otherwise, the business would have to apportion its income to South Carolina using the three-factor apportionment method under S.C. Code Ann. § 12-6-2250.

Here, Duke Energy presented testimony indicating that Duke Energy's principal business is the provision of electricity services because at all times during the Periods at Issue more than 50 percent Duke Energy's gross receipts were derived from the provision of electric services. However, in light of my findings that Duke Energy's generation, transmission, and distribution of electricity are activities falling within Section 12-6-2250, that electricity is tangible personal property, and that sales of electricity are sales of tangible personal property, I find Duke Energy's evidence insufficient to establish that more than 50 percent of Duke Energy's gross receipts were derived from activities not covered in Section 12-6-2250. Indeed, Duke Energy introduced no evidence supporting any breakdown of its gross receipts from manufacturing, services, and/or any other activity.

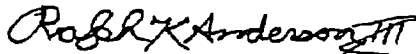
Conclusion

After considering the evidence in the record and the pertinent legal authorities, I conclude that Duke Energy failed to establish by the preponderance of the evidence that its principal business in South Carolina is not manufacturing. This Court thus rejects Duke Energy's attempt to use the single-factor apportionment formula for tax years 1994-2001 instead of the multi-factor apportionment formula it used in its original corporate income tax returns.

ORDER

THEREFORE, IT IS HEREBY ORDERED that Duke Energy's claims for refunds with respect to its attempt to use the single-factor apportionment formula for the corporate income tax periods 1994-2001 are **DENIED** and the Department's Determination is **AFFIRMED**.

IT IS SO ORDERED.



Ralph K. Anderson, III
Chief Administrative Law Judge

December 4, 2012
Columbia, South Carolina

CERTIFICATE OF SERVICE

I, E. Harvin Belser Fair, hereby certify that I have this date served this Order upon all parties to this cause by depositing a copy hereof, in the United States mail, postage paid, in the Interagency Mail Service, or by electronic mail to the address provided by the party(ies) and/or their attorney(s).

E. Harvin Belser Fair

E. Harvin Belser Fair
Judicial Law Clerk

December 4, 2012
Columbia, South Carolina

EXHIBIT G

**STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT**

Duke Energy Corporation,	)	
	)	Docket No. 10-ALJ-17-0270-CC
Petitioner,	)	
	)	
vs.	)	RECONSIDERATION ORDER
	)	
South Carolina Department of Revenue,	)	
	)	
Respondent.	)	
_____	)	

Appearances:

For the Petitioner: Burnet R. Maybank, III, Esq.; Eric S. Tresh, Esq.; Jeffrey A. Friedman, Esq.; and Maria M. Todorova, Esq.

For the Respondent: Tracey C. Green, Esq.; John W. Roberts, Esq.; Harry Hancock, Esq.; and J. Abraham Gutting, Esq.

This matter came before the Administrative Law Court (ALC or Court) following Duke Energy Corporation's (Duke Energy) request for a contested case hearing under S.C. Code Ann. § 12-60-460 (Supp. 2006). Duke Energy is contesting the Determination of the South Carolina Department of Revenue (Department) denying Duke Energy's claim for a refund of South Carolina corporate income taxes for the tax years 1994 through 2001 (Tax Periods at Issue).¹ A hearing was held before this Court on September 5 and 6, 2012. On November 2, 2012, this Court entered its Final Order and Decision (Final Decision) denying Duke Energy's claims for refund of corporate income taxes for the Tax Periods at Issue and affirming the Department's Determination that Duke Energy cannot apportion its income based on the single-factor gross-receipts apportionment method. Afterwards, Duke Energy filed a Motion for Reconsideration of the Court's Final Decision on November 13.

Some of Duke Energy's arguments warrant clarification or amendment of the original Final Decision. Accordingly, I am issuing an Amended Final Decision in this case addressing

¹ Duke Energy originally sought refunds for the tax years 1978 through 2001. On October 11, 2012, this Court ruled that Duke Energy's refund claims for the tax years 1978 through 1993 are untimely. Thus, Duke Energy's refund claims for 1978-1993 were not before the Court.

FILED

December 4, 2012

SC ADMIN. LAW COURT

those issues of whether Duke Energy can apportion its income based on the single-factor gross-receipts apportionment method. The remaining arguments will be addressed below.

DISCUSSION

Duke Energy's Motion for Reconsideration presented fifty instances in which they contend that this Court erred in the issuance of its Final Decision. Those arguments are addressed below in the numerical sequence in which they were presented.

1. Duke Energy contends that Court erred in finding that Duke Energy "further its primary business by owning and operating transmission and distribution assets in South Carolina and North Carolina." The Final Decision has been amended to address this issue.

2-4. Duke Energy contends that the Court improperly disregarded factual evidence that Duke Energy was subject to the regulation of its "rates and services" by the South Carolina Public Services Commission and the Federal Energy Regulatory Commission and its operations were characterized as a "franchise electric service business." The Court clearly acknowledged in the Stipulations of Fact (stipulation 10, p. 3) that Petitioner was regulated by the South Carolina Public Service Commission (Commission) as an "electric utility" pursuant to S.C. Code Ann. § 58-27-10 (7). Though Section 58-27-10(7) does not refer to an "electric utility" as providing a "service, Section 58-27-10 (8) does set forth that:

The term "rate" means and includes every compensation, charge, toll, rental, and classification, or any of them, demanded, observed, charged, or collected by any electrical utility for any electric current or service offered by it to the public and any rules, regulations, practices, or contracts affecting any such compensation, charge, toll, rental, or classification.

The Court further recognizes that Duke Energy "services" are subject to the regulation of the Federal Energy Regulatory Commission. Nevertheless, as explained in the Court's Decision, this "service" is that of "a facility supplying some public demand." See e.g., Black River Elec. Co-op., Inc. v. Pub. Serv. Comm'n, 39 P.U.R.3d 232, 120 S.E.2d 6 (S.C. 1961) ("The purpose underlying Section 24-63 was to prevent competition between utilities rendering service of the same kind so as to eliminate waste incident to a duplication of facilities."). Therefore, citation to the regulation of those bodies did not support Duke Energy's contentions. It thus was not probative as to the nature of Duke Energy's primary activities and thus its classification for corporation income tax purposes under either Section 12-6-2250 or -2290.

5. Duke Energy contends that the Court erred in finding that the profits from the flat-rate and capacity charges were not a significant portion of Duke Energy's profit from the sale of electricity. As the finder of fact, the Court simply does not find that the evidence established that these charges were a significant portion of Duke Energy's business. In fact, I find the evidence established otherwise. For instance, Mr. Robinson testified that a majority of an electric utility's, and thus Duke Energy's, product is not provided on a flat-fee basis. Tr. p. 393, lines 5-18. And Duke Energy's expert witness, Mr. Jamil, testified that though not always, Duke Energy typically provides electric service on a metered basis. Id. at 106, lines 22-23. He testified that he could not testify as to whether a flat fee for lighting generated a significant amount of Duke Energy's revenues. Id. at 175, lines 10-21.

As to the capacity charge, Mr. Jamil did testify that the capacity charge was a significant part of a customer's bill. However, he also testified that the amount of the charge depends on the customer's usage. Id. at 178, lines 18-19. He also testified that the amount of the charge would depend on the customer class. Id. at 179, lines 20-25 to p. 180, line 1. When asked about the capacity charge for a residence per month, Mr. Jamil testified that he did not have that information. Id. at 180, lines 8-12. Duke Energy has the burden of proving its case by a preponderance, or greater weight of the evidence, and merely stating that a capacity charge is a significant portion of a customer's bill (he did not testify that this charge was a significant portion of Duke Energy's receipts), is insufficient, especially in light of the fact that the witness admitted that the charge in relation to the bill was variable.

6. Duke Energy contends that the Court erred in finding that the process of generating electricity is the same process employed since the early 20th century. Duke Energy failed to set forth facts in the record to support this claim. See e.g., Campbell v. Carr, 361 S.C. 258, 603 S.E.2d 625 (Ct. App. 2004). Moreover, Duke Energy failed to explain the implication of the purported error upon the decision in this case. Furthermore, there is no evidence that the introduction of renewable energies, the use of solar panels, and the development of more efficient wind generators occurred during the Periods at Issue (1994-2001). Nevertheless, the following facts are cited as supporting the amended finding regarding this issue:

- Q: Now, a lot of your generation facilities use a turbine; is that correct?
A: (Nods head affirmatively.)
Q: Not all of them.

A: Many of them do.

Q: Many of them.

A: Yeah.

Q: And the design of a turbine used in one of these plants hasn't really changed since the early 20th century, has it?

A: Not significantly.

Q: And the generation process that we're discussing here today that Duke Energy makes available, that's not really changed much since the early 20th century, has it?

A: I mean, we've made it significantly more efficient, but

Q: Used technology --

A: Yeah.

Q: -- and things like that?

A: Different material --

Q: Is that correct?

A: Yeah.

Q: But the basic process is the same.

A: Basic process is the same

Tr. p. 169 line 25 to p. 170, line 24.

Q: And the process of generating electricity hasn't changed in the last hundred years.

A: For most of the part, no. However, we have added renewable energies. So in consideration of the environment, we have developed solar panels. We have also developed more efficient wind generators. Again, mainly to mitigate any environmental effects that we may have from traditional techniques.

Tr. p. 289 lines 11-19.

7-8. Duke Energy contends that the Court erred in finding that Duke Energy's generation and purchase of electricity using natural gas, wind and solar, "appear to be much less significant" than other methods. Duke Energy failed to explain the implication of the purported error upon the decision in this case. Furthermore, as the finder of fact, the Court is entitled to attribute as much or as little weight to evidence as it wishes. See MRI at Belfair, LLC v. S.C. Dep't of Health and Env'tl. Control, 392 S.C. 314, 324, 709 S.E.2d 626, 631 (2011) ("[A]s the fact-finder, the ALC was free to make factual findings based on its view of the credibility and weight of the evidence"). Here, as the finder of fact, the Court simply does not find that the

evidence established that Duke Energy's generation of electricity based upon natural gas, wind, and solar was significant during the Tax Periods at Issue. See e.g., Tr. p. 117, line 10 to p. 118, line 1. Duke Energy also argues that the Court erred in finding that Duke Energy's purchase of electricity from other electric utilities "appear[s] to be much less significant." Duke Energy instead asserts that it presented evidence that purchasing electricity from other utilities is an integral and necessary part of its primary business. However, Duke Energy's own witness, Mr. Monroe, testified as follows:

Q: But Duke Energy generates most of its own electricity that it sells, doesn't it?

A: Yes.

Tr. p. 88, lines 9 -11.

9. Duke Energy contends that the Court improperly ignored that the Department had conceded, in its Determination denying Duke Energy's refund claims and in its Pre-Hearing Statement, that Duke Energy provides a service. The Administrative Law Court hears this case as the de novo finder of fact. Young v. S.C. Dept. of Health and Envtl. Control, 383 S.C. 452, 680 S.E.2d 784 (Ct. App. 2009); Risher v. S.C. Dept. of Health and Envtl. Control, 393 S.C. 198, 207, 712 S.E.2d 428, 433 (2011), reh'g denied (July 21, 2011) ("The ALC, as the ultimate finder of fact in this action, was free to visit the Lot and draw its own conclusions therefrom."). The Court therefore makes its determination based upon its reasonable view of the facts. Furthermore, the Court is free to reach its own conclusions of law. As such, the Court in this case found, as set forth in its Final Decision, that Duke Energy's primary business is manufacturing and not providing a "service."

10. Duke Energy contends that the Court failed to consider the legislative history of Sections 12-6-2250 (and its predecessor Section 12-7-1120) and 12-6-2290 (and its predecessor Section 12-7-1190), as well as guidance issued by the Department on the same topic that the multi-factor apportionment formula is designed for taxpayers dealing in tangible personal property (such as manufacturers) whereas the single-factor gross-receipts formula is designed for taxpayers who do not deal in tangible personal property, such as service businesses. The Court simply disagrees with that assertion. The Court certainly made clear, as finder of fact and in its conclusions of law, that electricity is tangible personal property. Furthermore, there is evidence in the record that electricity is tangible. See e.g., Tr. p. 335, lines 19-21; p. 363, lines 3-7; p. 376, lines 12-23.

11. Duke Energy contends that the Court erred in disregarding the testimony of Duke Energy's expert witness, Dr. Papapolymerou, regarding whether one can feel electricity. First, Duke Energy carries the burden of proving that a person can not feel electricity, and as the finder of fact, the Court can choose to accept in part or in whole the testimony of expert witnesses. MRI at Belfair, LLC, 392 S.C. at 324, 709 S.E. at 631 ("[A]s the fact-finder, the ALC was free to make factual findings based on its view of the credibility and weight of the evidence"). Second, there is evidence in the record that electricity can be touched and sensed. See e.g., Tr. p. 332, lines 19 - 25; p. 376, lines 12 - 23. Here, the Court did not find any of the witnesses credible as to the physiology of the human body with respect to the nervous system, but did determine that electricity can be sensed, touched, and therefore felt.

12-13. Duke Energy contends that the Court erred in finding that Duke Energy produces electrical charge. Duke Energy also contends that the Court failed to consider the parties' expert witnesses' testimony that Duke Energy does not create the electrons residing in the power lines, and that the provision of electricity is not the transfer of electrons to the customers. As the finder of fact, the Court can choose to accept in part or in whole the testimony of expert witnesses. See MRI at Belfair, LLC, 392 S.C. at 324, 709 S.E. at 631 ("[A]s the fact-finder, the ALC was free to make factual findings based on its view of the credibility and weight of the evidence"). Moreover, the Court found that an electrical charge is a component of what is produced by Duke Energy. Dr. Papapolymerou testified that Duke Energy generates the electromagnetic field that causes the electrons to oscillate and thus the charges to flow, providing energy. See e.g., Tr. p. 285, lines 13 - 23; p. 288, line 13 to p. 289, line 3. Thus, electrical charge is a component of the energy generated by Duke Energy because the charges are manipulated by the magnetic field that is created and controlled by Duke Energy, which creates the energy that Duke Energy provides.

14. Duke Energy contends that the Court erred in making a factual finding that electricity can be created, felt, stored, or consumed and is a tangible product with identifiable physical characteristics. Duke Energy carries the burden of proving that a person can not feel electricity, and as the finder of fact, the Court is entitled to attribute as much or as little weight to evidence as it wishes. See MRI at Belfair, LLC, 392 S.C. at 324, 709 S.E. at 631 ("[A]s the fact-finder, the ALC was free to make factual findings based on its view of the credibility and weight of the evidence"). Here, the answers above, and the Amended Final Decision on pp. 23-24, address the issues of whether electricity can be created, felt, or is tangible. Moreover,

"consumed," as utilized in the Final Decision and Amended Final Decision, refers to the utilization of electricity as a customer. See Merriam-Webster Online Dictionary, www.merriam-webster.com (defining "consumed" as "to utilize as a customer") (last visited November 20, 2012). The evidence also established that the source of electricity, an electrical charge, can be stored. See e.g., Tr. p. 121 line 24 to p. 122, line 10; p. 259 lines 19-25; p. 277, line 17 to p. 278, line 4; p. 299 lines 4-5.

15. Duke Energy contends that the Court erred in disregarding Duke Energy's expert witness's testimony regarding the nature of electricity. Duke Energy carries the burden of proof and as the finder of fact, the Court is entitled to attribute as much or as little weight to evidence as it wishes. See MRI at Belfair, LLC, 392 S.C. at 324, 709 S.E. at 631 ("[A]s the fact-finder, the ALC was free to make factual findings based on its view of the credibility and weight of the evidence"). Moreover, this overly-broad issue fails to sufficiently specify an error.

16. Duke Energy contends that the Court erred in disregarding the Department's expert witness's testimony that Duke Energy provides a service. Duke Energy carries the burden of proof and as the finder of fact, the Court is entitled to attribute as much or as little weight to evidence as it wishes. MRI at Belfair, LLC, 392 S.C. at 324, 709 S.E. at 631 ("[A]s the fact-finder, the ALC was free to make factual findings based on its view of the credibility and weight of the evidence"). In reaching my factual determinations, I gave this evidence little, if any, weight and therefore chose not to reference it, being unpersuasive. Nevertheless, I now specifically find this evidence was not persuasive.²

17. Duke Energy contends that the Court erred in holding that "No other electrical utilities challenged that position [that electric utilities were manufacturers]" Duke Energy carries the burden of proof and as the finder of fact, the Court is entitled to attribute as much or as little weight to evidence as it wishes. See MRI at Belfair, LLC, 392 S.C. at 324, 709 S.E. at 631 ("[A]s the fact-finder, the ALC was free to make factual findings based on its view of the credibility and weight of the evidence"). Here, the evidence reflected that Mr. Southard was not aware of any challenges to the Department's position, other than that posed by Duke Energy. See Tr. p. 203, lines 1-2. And Duke Energy presented no evidence to the contrary. Moreover,

² I further note that it is the Court's responsibility to make "findings of fact." However, I am not aware of any responsibility to make "non-findings of fact."

since Duke Energy did not challenge the legal implications of this determination, the Court will not address that issue.

18. Duke Energy contends that the Court erroneously concluded that the Department has a longstanding policy of treating electric utilities as manufacturers for purposes of corporate income tax apportionment. I find the law cited in the Court's Final Decision supports the conclusion reached by the Court. The Court did not give deference to the Department based on its audit manual. Rather, the Court relied on a 1985 S.C. Tax Commission determination and on earlier S.C. Supreme Court decisions in Columbia Ry. and Duke Power Co. v. Bell in concluding that the public, including the General Assembly, was given notice of the Department's policy of treating electric utilities as manufacturers for purposes of corporate income tax apportionment.

19-20. Duke Energy contends that the Court gave improper deference to the Department's alleged long-standing policy of treating electric utilities as manufacturers for South Carolina income tax purposes. As set forth above, the law cited in the Court's Final Decision supports the conclusion reached by the Court. Here, there were prior known interpretations regarding the Department's policy of treating electric utilities as manufacturers for South Carolina corporate income tax purposes, and those interpretations were not contrary to any statute or regulation. The Court's rejection of Duke Energy's position is not a failure to consider that position. Moreover, Duke Energy cited no law in its Motion for Reconsideration to support its reasoning regarding these issues. See e.g., Campbell v. Carr, 361 S.C. 258, 603 S.E.2d 625 (S.C. App. 2004).

21. Duke Energy contends that the Court erroneously concluded that because Duke Energy filed its tax returns using the multi-factor apportionment formula over the course of 23 years, "the returns were filed in accordance with the policies and filing requirements promulgated by the Department." The Court found that Duke's filing according to the multi-factor apportionment formula over the course of 23 years "leads to the conclusion that "the returns were filed in accordance with the policies and filing requirements promulgated by the Department and as understood by Duke Energy at the time the returns were originally filed." (Emphasis added). The Final Decision has been amended to remove "and" from before "as understood" because it is unnecessary. Furthermore, Duke Energy failed to explain the implication of the purported error upon the decision in this case. Moreover, as the finder of fact, the Court is entitled to attribute as much or as little weight to evidence as it wishes. See MRI at

Belfair, LLC, 392 S.C. at 324, 709 S.E. at 631 (“[A]s the fact-finder, the ALC was free to make factual findings based on its view of the credibility and weight of the evidence”). Here, there was sufficient evidence from which the Court as the finder of fact could reasonably conclude that the Department had a longstanding policy of which Duke Energy should have been aware.

22. Duke Energy contends that the Court erroneously concluded that Columbia Ry., Gas & Elec. Co. v. Query, 134 S.C. 319, 132 S.E. 611 (1926), was decided in the income tax context. The Court’s Final Decision has been amended to address this issue.

23. Duke Energy contends that the Court erred in holding that the Department, in S.C. Tax Comm’n Decision P-D-532, 1985 WL 192777 (Apr. 11, 1985), ruled that the property tax assessment ratio for electric utilities should be 6% (as opposed to 10.5% applicable to the personal property of non-manufacturing entities).” However, as the Tax Commission pointed out in S.C. Tax Comm’n Decision P-D-532, 1985 WL 192777 (Apr. 11, 1985), South Carolina, in Columbia Ry., “has recognized that certain utilities may also be manufacturers,” and that utilities that generate electricity or any other power that they supply to their customers are such utilities and therefore manufacturers. The Commission also cited 17 A.L.R.3d, Taxes, “Manufacturing,” § 44, 102. The Tax Commission thus concluded that “X” Electric and Gas was a manufacturer and that the tax assessment ratio that applied to it was only 6% - the rate that a manufacturer paid on real property owned by or leased to the manufacturer and used primarily as an office building that is not located on the premises of or contiguous to the plant site of the manufacturer, which was the situation in that case. As the Tax Commission also properly pointed out, the reference to “utilities” in 12-43-220(a)(1) is limited to utilities that merely supply light, water, power, heat, transportation or means of communication, but do not generate the power that they supply to their customers. Those that generate the power they supply, such as Duke Energy, are considered manufacturers, not mere utilities.

24. Duke Energy contends that the Court erred in concluding that the terms “goods and materials” contained in Section 12-6-2250(a) “reflect[] that the Legislature intended to cover not just manufacturing but all activities that a business could perform in regards to a *product* prior to making that *product* available to its customers.” (Emphasis in original). The Final Decision has been amended to address this contention.

Duke Energy also asserts that both parties’ experts agree that electricity is not a material. The Court never found that electricity is a material. Rather, the Court noted that raw materials,

such as coal, water, or nuclear fuel, are processed to generate or produce the electricity. Under the facts of this case, the Court considers "generation," "manufacturing," and "production," from which the term "product" is derived, to be synonymous. Duke Energy then argues that Duke Energy presented ample evidence showing that electricity is not tangible personal property or a good. First, as reflected in the Final Decision, tangible personal property is a separate consideration, under subsection (b), from the "goods and materials" discussed in subsection (a). Nevertheless, the evidence established that electricity is tangible. See, e.g., Tr. p. 335, lines 19-21; p. 363, lines 3-7; p. 376, lines 12-23; p. 378, lines 13-15. Finally, Duke Energy maintains that the Department has not presented any evidence to show that electricity is a good or material. On the contrary, there is more than sufficient evidence that the electricity that Duke Energy generated during the Tax Periods at Issue satisfied an economic want, which causes that electricity to fall under the definition of "good."³

25. Duke Energy contends that the Court improperly applied the Webster's definitions of "manufacturing" and erroneously concluded that Duke Energy "makes" or "produces" "something." Duke Energy has cited no law explaining what was improper about applying Webster's definitions of "manufacturing." "Manufacturing" is not defined in the applicable statutes, and it is not a legal term of art. Therefore, it is perfectly proper to refer to a dictionary to understand the common usage of a statutorily-undefined term, as our Supreme Court has often done. Again, this Court finds "make," "produce," and "manufacture" to be synonymous. As finder of fact recognizing the burden of proof, this Court finds that there was more than sufficient evidence to support its finding that Duke Energy generates, or manufactures, electricity. In fact, Duke Energy's own witness, Mr. Jamil, testified that Duke Energy generates electricity, and also affirmed that Duke Energy uses various generation processes to produce electricity. See, e.g., Tr. p. 101, line 13 to p. 102, line 48. Therefore, Duke Energy's own witness testified not only that electric energy is generated or produced by Duke Energy, but also, based on his responses, clearly viewed generation and production as synonymous, and naturally so.

26. Duke Energy contends that the Court erred in finding that "the evidence in this case establishes that Duke Energy is a manufacturer" based on the Court's definition of

³ The sum of money involved in this case, being just income taxes alone, reflects that Duke Energy's electricity satisfied a vast quantity of economic want.

“manufacturing” as “the act or process of producing something” when Duke Energy presented evidence that it does not produce anything because electricity cannot be created or destroyed. The Court adopts the conclusions stated in response (25) above and further notes that Duke Energy carries the burden of proof, and as the finder of fact, the Court is entitled to attribute as much or as little weight to evidence as it wishes. See MRI at Belfair, LLC, 392 S.C. at 324, 709 S.E. at 631 (“[A]s the fact-finder, the ALC was free to make factual findings based on its view of the credibility and weight of the evidence”).

27. Duke Energy contends that the Court improperly considered cases from other states decided in tax contexts *other than income tax* holding that the generation of electricity is manufacturing, while, at the same time, the Court failed to consider *more recent* decisions from other jurisdictions decided in the *corporate income tax context* which hold that the provision of electricity is a service and not manufacturing. First, this Court finds that the cases cited properly supports the legal conclusions reached by the Court. Interestingly, one of the cases cited by the Court is dated September 15, 2011, which appears to this Court to be “recent.” In addition, Duke Energy has not explained why the ages of cases discredit the legal holding of those courts. It is simply a reflection that in those states, as in South Carolina, the law on this issue was settled long ago. Moreover, the Court found cases cited in Footnote 19 to be more akin to South Carolina law and therefore more convincing.

28. Duke Energy contends that the Court erred in making a factual finding that Duke Energy “cannot produce or deliver electricity to consumers in the absence of any one of these parts [- generation, transmission, and distribution,].” At the outset, Duke Energy carries the burden of proof, and as the finder of fact, the Court is entitled to attribute as much or as little weight to evidence as it wishes. See MRI at Belfair, LLC, 392 S.C. at 324, 709 S.E. at 631 (“[A]s the fact-finder, the ALC was free to make factual findings based on its view of the credibility and weight of the evidence”). Nevertheless, in light of Duke Energy assertion, the disputed language has been modified in the Amended Final Decision.

As to the remaining language, there was evidence that Duke Energy sometimes purchases electricity from other electric utilities. See e.g., Tr. p. 117, line 10 to 119, line 8; Tr. p. 181, lines 8-11. However, the evidence did not establish that Duke Energy’s purchasing of electricity from other electric utilities is a significant or necessary part of its business, or is “routinely” done. Mr. Jamil testified that it was “possible” to provide all of its electric service to

South Carolina without generating the electricity. *Id.* at 118, line 25 to 19, line 5. But he also admitted that he understands this would not be the most cost efficient. *Id.* at 119, line 6-8. More importantly, what Duke Energy could possibly do and what it actually did during the Taxable Periods at Issue are two different things. Duke Energy may sometimes purchase electricity from other electric utilities, but most of the electricity that Duke Energy provides to its customers is generated by Duke Energy. In addition, the evidence also clearly established that Duke Energy needs three components – generation, transmission and distribution – to provide electricity to its customers. See e.g., *Id.* at 104, lines 11-24.

29. Duke Energy contends that the Court erroneously reasoned that because electricity can be measured, generating electricity is manufacturing, when in fact, Duke Energy presented evidence that it also provides electricity on a fixed-fee basis. As to Duke Energy's provision of electricity on a fixed-fee basis, this was addressed in Footnote 3 and on p. 20 of the Final Decision, and need not be repeated here. As to measurability, this Court quite agrees that measurability alone is not an indication of manufacturing, which is why the Court noted measurability as "further evidence[]" and "further support[]" that generating electricity is manufacturing. All of the other reasons why generation is manufacturing were discussed prior to the paragraph on measurability. Together, all of these reasons led the Court to the conclusion that the generation of electricity was manufacturing.

30. Duke Energy contends that the Court erroneously concluded that Duke Energy cannot "provide" electric service "without the existence of electricity, and the electricity that Duke Energy provides cannot exist without first being produced, or manufactured." Quizzically, Duke Energy questions whether Duke Energy can provide electricity without its existence (it argues that electricity cannot be created or destroyed). The error of that objection is so obvious the Court need not comment further. Furthermore, as reflected in the record, electricity must be sold at a regulated voltage to be usable by the public. Duke Energy's expert testified that "[w]e drop the voltage down to a level that is usable to the customer – typically 120 volts; sometimes 220 volts. . . ." Tr. p. 115, lines 21-24. Since there was no evidence that electricity naturally exist at 120 volts, this Court found that "the electricity that Duke Energy provides cannot exist without first being produced, or manufactured." Additionally, see responses (25) and (26) above for additional explanation.

31. Duke Energy contends that the Court failed to consider testimony by Duke Energy's witness that the Standard Industry Classification System, which was in effect during the Periods at Issue, classified electric utilities and manufacturers in two separate categories, having two different codes, and that as an electric utility, Duke Energy was required to use the code applicable to the electric utilities classification. Footnote 24 in the Final Decision (Footnote 28 in the Amended Final Decision) adequately addresses this issue.

32. Duke Energy contends that the Court made an erroneous finding that "services typically are not measured by the quantity of the product consumed and are not delivered to or measured by mathematical calculations regarding the nature of the services." The Final Decision has been amended to address this issue.

33. Duke Energy contends that the Court made an erroneous finding when it concluded that "any electromagnetic field results from the electric current created by the generator." The Final Decision has been amended to clarify the Court's findings. However, Duke Energy's expert witness (Mr. Jamil), explained that in layman's terms the "electromagnetic field" is "current" or an "electric field." Tr. p. 153, lines 1-3; 17-23. Nevertheless, it is a "charge." *Id.* Mr. Jamil also explained that an electromagnetic field does not exist unless there is a current. Tr. p. 154, lines 21-25. He further testified as follows:

Q: And you have generation facilities in South Carolina and North Carolina.

A: Yes, we do.

Q: And the generator turns by -- it's the -- I assume it's a fairly large machine; is that correct?

A: Oh, yes.

Q: A mechanical device?

A: Yes.

Q: And then it creates a varying magnetic field?

A: Yes, it does.

Q: And then that generates the electricity?

A: That -- yes, that generates --

Tr. p. 157, lines 14-16; p. 159, lines 7-16. Therefore, ultimately, the electromagnetic field that is created by Duke Energy's generators results in the production of electricity that is sold by Duke Energy.

34. Duke Energy contends that the Court made an erroneous finding and failed to consider evidence presented by Duke Energy when it concluded that “substantially all, if not all, of the electricity provided by Duke Energy is priced at some level based on quantity.” I agree. Therefore, the Final Decision has been amended to reflect the change. “Substantially all, if not all,” will be replaced by “the majority.”

35. Duke Energy contends that the Court improperly discounted the similarities between the electricity provided by a telecommunications company and the electricity provided by Duke Energy. Again, Duke Energy carries the burden of proof, and as the finder of fact, the Court is entitled to attribute as much or as little weight to evidence as it wishes. See MRI at Belfair, LLC, 392 S.C. at 324, 709 S.E. at 631 (“[A]s the fact-finder, the ALC was free to make factual findings based on its view of the credibility and weight of the evidence”). Here, telecommunications companies use electricity, but they are providers or conveyors of communications or intelligence produced or created by one customer to another. This finding is more thoroughly addressed on pp. 20-21 of the Amended Final Decision.

36. Duke Energy contends that the Court failed to consider the definition of “manufacturing” in other contexts of the South Carolina Income Tax, as brought to the Court’s attention in Duke Energy’s Pre-Trial Brief. To the contrary, the Court considered Duke Energy’s definition as set forth on p. 16 of its pretrial brief in the other contexts of the South Carolina Income Tax Act. The first context cited by Duke Energy was the Renewable Tax Incentive Program under S.C. Code Ann. § 12-6-3588(B)(2). However, the Court rejected the definition of “manufacturing” under that statute because it became effective January 1, 2011, well after the Tax Periods at Issue in this case. As to the other provision cited by Duke Energy in its pretrial brief, Section 12-6-2260(M)(5), (6), the Court could not consider what it could not find. There was no subsection (M)(5) or (6) for Section 12-6-2260 during the Tax Periods at Issue. “Manufacture” is mentioned in (D)(5), the last provision of this statute, but this relates to unmanufactured tobacco stored in warehouses in this State for subsequent shipment to a manufacturer in another state. It provides no guidance as to the meaning of “manufacture” and is unrelated to the case at hand.

As to the definition of tangible personal property, in the Final Decision the Court agreed with Duke Energy that the “tangible property” definition under 12-6-30(11) should be used and did apply that definition. That definition included the term “corporeal,” which is not a legal term

of art in this case, and which is generally understood to mean "of a material nature; tangible." The Final Decision has nonetheless been amended to clarify that the Court only looked to the other statutory definition of "tangible property" to further support the plain meaning of the definition under 12-6-30(11). Section 12-6-60's definition was perfectly consistent with the plain ordinary meaning of "tangible" as something corporeal (material/physical).

37. Duke Energy contends that the Court improperly ignored the definition of "manufacturing" contained in the Income Tax Act, Jobs Tax Credit provisions. Duke Energy avers that the Court should have applied Section 12-6-3360(M)(8), which defines a "manufacturing facility" as "an establishment where *tangible* personal property is produced or assembled." However, during the Periods at Issue, the term "manufacturing facility" was defined in Section 12-6-3360(M)(5), not (8). Nevertheless, the Court agrees with the definition of "manufacturing" contained therein; and because the Court finds that the electricity generated by Duke Energy is tangible personal property, this definition is consistent with the Court's definitions of "manufacturing" and thus there is no ambiguity as to the definition of the term "manufacturing."

38. Duke Energy contends that the Court erred in holding that "manufacturing" is defined as "the act of processing or producing something." In light of this allegation, the Final Decision has been amended to include the more specific definitions for "manufacturing." Additionally, as to Duke Energy's arguments concerning the nature of the product produced by law firms, that is not at issue in this case. The Court notes, however, that law firms, like telecommunications, are in the business of conveying information, intelligence, and communications, and therefore do not appear to be manufacturers.

39. Duke Energy contends that the Court erred in holding that Duke Energy is a manufacturer because it charges its customers based on quantity and cannot produce unlimited quantities. To the contrary, all tangible items must be quantifiable, but not all quantifiable items are tangible.⁴ Hours, though quantifiable, are not tangible.⁵ And again, as mentioned in

⁴ Duke Energy argument is an example of the fallacy of denying the antecedent. See, Ruggero J. Aldisert, Logic for Lawyers: A Guide to Clear Legal Thinking 160 (National Institute for Trial Advocacy 3d ed. 1997); see also Irving M. Copi, Introduction to Logic 295 (5th ed. 1978).

⁵ It is nonetheless notable that the computation of hours is not based upon a physical quantification, but a formulaic quantification. As explained above, electrical current is measured based upon the movement or charge of an electrons, which have mass. Tr. 285, line 21 to p. 283, line 2; p. 330, line 1 to 331, line 2.

response (29) above, the finding that Duke Energy is a manufacturer was not based solely on the fact that it charges customers based on quantity and cannot produce unlimited quantities.⁶ Because tangible items must be quantifiable, showing that an item is quantifiable, though not itself conclusive, is a further indication that an item is tangible. At any rate, Duke Energy carries the burden of proving that electricity is not tangible, which it has failed to meet.

40. Duke Energy contends that the Court's construction of "manufacturer" was erroneous because "the statute's language is plain, unambiguous, and conveys a clear, definite meaning," and even if any ambiguities exist, "the taxpayer should receive the benefit in case of doubt." The soundness of the Court's decision regarding this issue is set forth in the Amended Final Decision and in responses (36) and (37) of this Order.

41. Duke Energy contends that the Court erred in finding that the generation of electricity is a form of processing raw materials used to create energy when Duke Energy presented uncontroverted evidence that electricity (or energy) cannot be created. That contention was controverted by Duke Energy's own witness. Mr. Jamil testified that Duke Energy's generators, which are turned by energy released by Duke Energy's processing of raw materials such as water, coal, or nuclear fuel, create an electric charge that travels in the form of a current and that oscillates electrons to produce an electromagnetic field, and that electromagnetic field generates electricity. Indeed, he testified that all of the generation processes that Duke Energy uses produce electricity. See response (33) above; Tr. p. 101, line 23 to p. 102, lines 1-24; p. 154, lines 11-18; p. 159, lines 7-16.

42. Duke Energy contends that the Court erred in considering Section 12-36-60 to interpret the term "corporeal" used in the definition of "tangible property" codified in Section 12-6-30(11). Though Section 12-36-60 does not mention the term "corporeal," at least in name, it does provide a specific definition of "tangible personal property" – "personal property which may be seen, weighed, measured, felt, touched, or which is in any manner perceptible to the sense" – which coincides with the general understanding of the term "corporeal," which is included as "tangible property under Section 12-6-30(11). The Final Decision has been amended to clarify this point.

⁶ This conclusion is reflected by the Court's finding in the Final Decision that Duke Energy is engaging in manufacturing uses the terms "further evidenced" and "further supports." See Page. 18 of Amended Final Decision.

43. Duke Energy contends that the Court erred in relying on the sales tax definition of "tangible personal property" in Section 12-36-60 in determining whether electricity is tangible or a service for income tax purposes. The Court's response (36) of this Order addresses this assertion. Furthermore, this Court found no conflict in the definitions of tangible property. Rather, it considered both provisions and found that both set forth the plain, ordinary meaning of "tangible." In addition, the term "corporeal" used in the first definition is well understood to be synonymous with "tangible." The Court's reason for citing the alternate definition of "tangible" was to further reflect this fact.

44. Duke Energy contends that the Court erred in concluding that electricity is tangible personal property based on the first sentence of the sales tax definition of "tangible personal property" in Section 12-36-60. To the contrary, a plain reading of the statute reflects that it clearly includes "intangibles or services" under the definition of "tangible personal property," as Duke Energy admits in its allegation (45).

45. Duke Energy contends that the Court misinterpreted the sales tax definition of "tangible personal property" in Section 12-36-60, because there the South Carolina Legislature specifically chose to define "services and intangibles, including ... sales of electricity" as tangible personal property, something the Legislature did not do in the income tax context. This issue is addressed in Footnote 32 of the Amended Final Decision. It is also notable that Duke Energy cited Consolidated Hydro, in which the court applied sales tax statutes, including Section 12-36-60, in a license fee context.

46. Duke Energy contends that the Court misinterpreted the nonbinding holding in Consolidated Hydro S.E., Inc. v. S.C. Dep't of Revenue & Taxation, No. 95-ALJ-17-0634, 1996 WL 909155 (S.C. Admin. L.J. Div. May 13, 1996). More specifically, Duke Energy submits that the court in Consolidated Hydro did not apply the sales tax definition of that term in the license tax context because the Legislature had not defined "services and intangibles, including ... sales of electricity" as "tangible personal property" for license tax purposes. I simply disagree. A license fee was at issue, yet the court in Consolidated Hydro applied sales tax statutes, devoting two paragraphs to consideration of its implications in that case.

47. Duke Energy contends that the Court erred in relying on Section 16-13-380, regarding the theft of electrical services. I agree that the Court erred, but only as to how the Court used that section. The Final Decision has been amended accordingly.

48. Duke Energy contends the Court erred in holding that electricity is a tangible product because it can be measured, felt, stored and consumed, when in fact intangibles such as sunlight, wind, and gravity are all subject to the same. Duke Energy carries the burden of proving that electricity is not tangible, which it has failed to meet. As to the implications of measuring a product, Duke Energy's argument is premised upon the contention that if intangible products can be measured, then the measurement of a product is irrelevant to the determination of whether a product is in fact tangible. It is true that just because something can be measured, felt, etc. does not necessarily mean that it is tangible. However, because that which is tangible must be measurable, demonstrating measurability, though not conclusive of tangibility, supports a showing of tangibility.⁷

As to whether, electricity may be felt, stored or consumed, those issues are addressed above.

49. Duke Energy contends that the Court erroneously concluded that Duke Energy's evidence was insufficient to establish that more than 50 percent of its gross receipts were derived from activities not covered in Section 12-6-2250. Stated more correctly, the Court concluded that Duke Energy failed to meet its burden of proving that more than 50 percent of its gross receipts were derived from activities not covered in Section 12-6-2250. Duke Energy carries the burden of proof and as the finder of fact, the Court is entitled to attribute as much or as little weight to evidence as it wishes. See MRI at Belfair, LLC, 392 S.C. at 324, 709 S.E. at 631 ("[A]s the fact-finder, the ALC was free to make factual findings based on its view of the credibility and weight of the evidence"). Here, Duke Energy introduced no evidence supporting any breakdown of its gross receipts from manufacturing, services, and/or any other activity. In fact, there was evidence to the contrary. Mr. Robinson testified as follows:

Q: Do you have any experience with respect to working in an electric utility that provided electricity on a flat-fee basis?

A: I know that all electric utilities provide a minority of their product on a flat-fee basis, but the majority is charged for.

Tr. p. 393, lines 13-18.

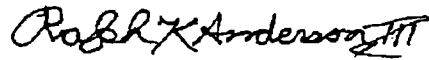
⁷ Once again, Duke Energy tramples upon the fallacy of denying the antecedent. See, Ruggero J. Aldisert, Logic for Lawyers: A Guide to Clear Legal Thinking 160 (National Institute for Trial Advocacy 3d ed. 1997); see also Irving M. Copi, Introduction to Logic 295 (5th ed. 1978).

50. Duke Energy contends that the Court failed to consider Duke Energy's argument that Duke Energy's 1977 Restated Charter is of little use in deciding whether Duke Energy is engaged in manufacturing. This allegation is perplexing. The Court did not cite the Restated Charter in its factual finding or legal conclusion. The only reference to the Charter is in the Stipulations of Fact. Since the Court failed to address even the existence of the Charter in its Final Decision – thus giving it no weight – it is difficult to understand how the Court erred in giving "little" weight.

IT IS THEREFORE ORDERED that that the Petitioners' Motion for Reconsideration is denied, in part, and granted, in part, in keeping with this Order.

IT IS FURTHER ORDERED that all additional factual findings in this Order are incorporated into the Amended Final Order and Decision as findings of fact.

AND IT IS SO ORDERED.



Ralph King Anderson, III
Chief Administrative Law Judge

December 4, 2012
Columbia, South Carolina

CERTIFICATE OF SERVICE

I, E. Harvin Belser Fair, hereby certify that I have this date served this Order upon all parties to this cause by depositing a copy hereof, in the United States mail, postage paid, in the Interagency Mail Service, or by electronic mail to the address provided by the party(ies) and/or their attorney(s).

E. Harvin Belser Fair

E. Harvin Belser Fair
Judicial Law Clerk

December 4, 2012
Columbia, South Carolina

THE STATE OF SOUTH CAROLINA
In The Court of Appeals

APPEAL FROM THE ADMINISTRATIVE LAW COURT

Ralph K. Anderson III, Administrative Law Judge

Case No. 10-ALJ-17-0270-CC

RECEIVED
JAN 14 2012

SC Court of Appeals

Duke Energy Corporation..... Appellant,
v.
South Carolina Department of Revenue..... Respondent.

MOTION TO CONSOLIDATE
AND
TO HOLD TIMELINES IN ABEYANCE PENDING ORDER OF CONSOLIDATION

The Appellant, Duke Energy Corporation, moves to consolidate the Notices of Appeal it has filed from various orders issued in the above-captioned case, all of which were decided by The Honorable Ralph K. Anderson III and all of which bear the same lower court case number. The first Notice of Appeal was filed on October 9, 2012, appealing from Judge Anderson's Order Granting Partial Summary Judgment in favor of the South Carolina Department of Revenue.¹ On October 23, 2012, an Amended Notice of Appeal was filed to include orders from October 11, 2012, one of which granted in part and denied in part reconsideration and the other of which amended the previously

¹ Duke Energy filed a motion for reconsideration on August 20, 2012, and when no order on reconsideration was issued within thirty days, Duke Energy believed reconsideration was deemed denied, and filed its Notice of Appeal within thirty days of that deemed denial. Two days after the Notice of Appeal was filed, Judge Anderson issued an order on reconsideration, explaining that the ruling on reconsideration had been stayed.

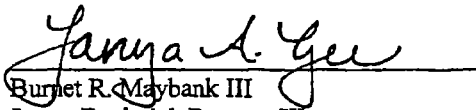
filed summary judgment order. On November 6, 2012, this Court requested that Duke Energy submit a memorandum addressing the appealability of the pending orders. Duke Energy's appealability memorandum was filed and served on November 16, 2012, and remains pending. The appellate case number for that appeal is 2012-213180.

On November 2, 2012, Judge Anderson issued a Final Order and Decision. A motion for reconsideration was filed, and pursuant to that motion, Judge Anderson issued an Order on Reconsideration and an Amended Final Order and Decision, both dated December 4, 2012. Duke Energy filed a Notice of Appeal from these orders on January 2, 2013, and the following day, on January 3, 2013, it filed an Amended Notice of Appeal from all orders issued in this matter. An appellate case number has not yet been assigned.

Pursuant to Rule 214 of the South Carolina Appellate Court Rules, Duke Energy asks that this Court consolidate their appeals from the following orders: (1) Order Granting Summary Judgment in Part and Denying Summary Judgment in Part filed on August 9, 2012; (2) The ALC's deemed denial of Appellant's August 20, 2012 Motion for Reconsideration (3) Amended Order Granting Summary Judgment in Part and Denying Summary Judgment in Part filed on October 11, 2012; (4) Order Denying Motion for Reconsideration in Part and Granting Reconsideration in Part filed on October 11, 2012; (5) Final Order and Decision filed on November 2, 2012; (6) Amended Final Order and Decision filed on December 4, 2012; and (7) the ALC's Reconsideration Order filed on December 4, 2012. This consolidation of appeals, which includes the final decision of the Administrative Law Court, should resolve any lingering appealability issues.

Duke Energy further asks that the thirty-day timeline for filing its Initial Appellant's Brief and Designation of Matter be held in abeyance while this Motion for Consolidation is pending, and that the due date for filing and serving its Initial Brief begin to run from the date such an order is issued.

RESPECTFULLY SUBMITTED,



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Attorneys for Appellant Duke Energy Corporation

January 14, 2013
Columbia, South Carolina

STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW JUDGE DIVISION

Anonymous Taxpayer,)
)
Petitioner,)
vs.)
)
South Carolina Department of Revenue,)
)
Respondent.)
_____)

CONSENT ORDER

DOCKET NO. 03-ALJ-17-0094-CC

This matter came before the Court from an appeal by the Petitioner, Anonymous Taxpayer, of a final agency determination of the Respondent, the South Carolina Department of Revenue (the "Department") regarding the calculation of interest on an agreed refund of corporate income tax due to Petitioner for periods prior to September 1, 1985.

(1)
ju
A hearing was initially scheduled in this matter for December 18, 2003. This hearing date and all discovery deadlines were postponed at the request of both parties upon their notification to the Court that settlement negotiations were underway. The parties have now reached an agreement resolving this matter on the following terms and conditions:

1. The Department agrees to allow tax credits against the South Carolina corporate income tax and license fees of Petitioner in the amount of \$554,244 for the tax year ending 2002, \$554,244 for the tax year ending 2003, and \$554,244 for the tax year ending 2004. In the event the tax credits are not fully utilized in any one year, they may be carried forward to future years until fully utilized.

2. The parties further acknowledge and agree that the Petitioner has certain refund claims pending before the Department which also relate to tax years prior to September 1, 1985. The settlement of this matter shall not constitute a resolution of the substantive issue of the

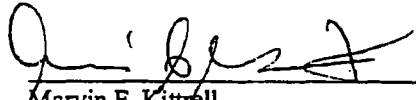
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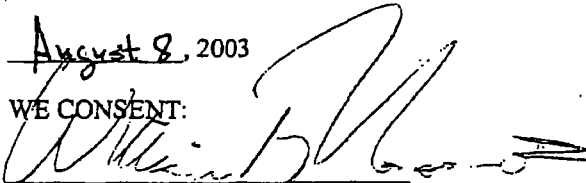
calculation of interest for pre-September 1, 1985 tax periods and shall not be binding on either party with respect to Petitioner's pending claims.

Having reviewed this Agreement in Settlement and Compromise, I hereby order its adoption and dismiss the Petition in this matter with prejudice.

IT IS SO ORDERED.

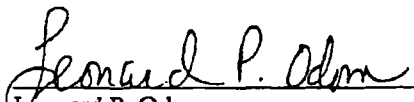

Marvin F. Kittrell
Chief Administrative Law Judge

Columbia, South Carolina

August 8, 2003
WE CONSENT:


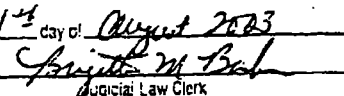
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pr
Attorney for Petitioner


Leonard P. Odom
Counsel for Revenue Litigation
State of South Carolina
Department of Revenue
Law & Compliance Division
301 Gervais Street
Columbia, SC 29214

Attorney for Respondent

CERTIFICATE OF SERVICE
This is to certify that the undersigned has this date served this order in the above entitled action upon all parties to this cause by depositing a copy hereof, in the United States mail, postage paid, or in the Interagency Mail Service addressed to the party(ies) or their attorney(s).

This 11th day of August 2003
By: 
Judicial Law Clerk

**STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT**

DUKE ENERGY CORPORATION,

Petitioner,

vs.

**SOUTH CAROLINA
DEPARTMENT OF REVENUE,**

Respondent.

Docket No.: 10-ALJ-17-0270-CC

AFFIDAVIT OF SHERWOOD L. LOVE

Appeared before the undersigned officer duly authorized to administer oaths, Sherwood L. Love, who deposed and stated as follows:

1.

My name is Sherwood L. Love. I am over the age of 18 years, and I am not under any disability that would impair my competency to provide an affidavit.

2.

This affidavit is given from my personal knowledge.

3.

During the period 1978-2001 ("Period at Issue"), Duke Energy

Corporation ("Duke Energy") was a North Carolina corporation engaged principally in the business of selling electricity, with principal offices located at 526 S. Church Street, Charlotte, North Carolina 28285.

4.

From March 1989 until April 2006, I was the Assistant Treasurer - Cash Management of Duke Energy. In that role, I was responsible for the cash management function at Duke Energy. The cash management function covered basic commercial banking; providing daily corporate liquidity through short-term borrowing and investing; and, establishing short-term bank borrowing facilities ("credit facilities").

5.

From April 2006 until the date of this affidavit, I was the General Manager Long Term Investments and Assistant Treasurer of Duke Energy. In that role, I am responsible for managing Duke Energy's long term trust investments.

6.

During the Period at Issue, Duke Energy maintained a Treasury Department and a Cash Management Group at its headquarters in North Carolina, as part of its operations.

7.

During the Period at Issue, Duke Energy's Cash Management Group

was engaged in investing Duke Energy's excess cash from its electricity sales to maximize its return, within approved investment guidelines, and providing for its short-term cash needs.

8.

The Cash Management Group maintained a daily interface with Central Cash Remittance, the department responsible for processing all direct payments from electric customers, and the daily consolidation of local branch deposits of electric customer payments across the Duke Energy service territory.

9.

The Cash Management Group received daily bank reports showing the value of checks being presented for payment on corporate disbursement accounts that needed to be funded that day. The Cash Management Group utilized reports from corporate financial models to forecast and fund maturing debt issues and all significant corporate payments, including quarterly dividends.

10.

The Cash Management Group was responsible for executing and funding all electronic payments, including all wire transfers.

11.

The Cash Management Group interfaced with various departments and subsidiaries to fund or manage cash from significant transaction settlements.

In addition, the Cash Management Group managed all short-term borrowing and investing, and the related cash settlements. Using corporate financial models, the Cash Management Group interfaced with Treasury, Finance and Corporate management to determine the sizing of short-term bank borrowing facilities that would provided required liquidity support for Duke Energy's commercial paper borrowing programs. Such programs were used for the short-term funding of additional electric generation, transmission and distribution facilities to serve our customers.

12.

The Cash Management Group was responsible for working with Duke Legal and our commercial and investment banks to negotiate and establish credit facilities.

13.

During the Period at Issue, the Treasury Department invested Duke Energy's excess operating cash in various short-term marketable securities including municipal bonds, loan repurchase agreements, and commercial paper.

14.

During the Period at Issue, all securities trading transactions were conducted, and all investment accounts were located, outside of South Carolina.

15.

During the Period at Issue, Duke Energy's Cash Management Group evolved into four subgroups: (1) Cash Operations; (2) Short-term Liquidity; (3) Credit Facilities; and (4) International Cash Management.

16.

An average of 10-12 employees were employed in the Cash Management Group.

17.

The Cash Management Group was located in Charlotte, North Carolina, and was responsible for funding Duke Energy's daily liquidity needs. The Cash Management Group provided funding for Duke Energy's operations, including purchasing fuel, payroll, acquiring and maintaining production, transmission and distribution equipment, and other capital expenditures.

18.

In addition, the Cash Management Group was responsible for forecasting cash needs and maximizing investment returns within approved investment guidelines.

19.

During the Period at Issue, the Cash Management Group maintained daily contact with investment dealers located outside of South Carolina in order to

maximize cash investment opportunities.

20.

During the Period at Issue, the Short-Term Liquidity Group generally consisted of an average of four employees located in Charlotte, North Carolina, and was responsible for gathering short-term borrowing and investment information, and for ensuring that short-term borrowings were minimized and that excess cash was appropriately invested, with a goal of minimizing cash in corporate bank accounts.

21.

Cash Management Group was responsible for setting commercial paper borrowing rates and selecting short-term investments, and, when market conditions allowed, negotiated investment rates.

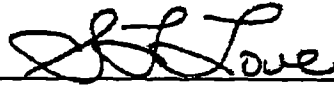
22.

Cash Management Group makes investment decisions in accordance with established investment guidelines approved by the Duke Energy Board's Finance and Risk Management Committee, which defines the type, term and ratings of permitted investment securities.

23.

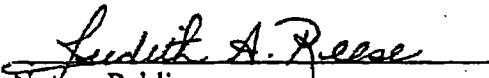
I declare under penalty of perjury that the foregoing is true and correct.

Further affiant sayeth not, this 31st day of December, 2010.



Sherwood L. Love

Subscribed before me this
31st day of December, 2010.


Notary Public

My commission expires: 02/20/12

Transcript of the Testimony of
DUKE ENERGY V. SCDOR

Date: September 5, 2013



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STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT DIVISION
Docket No. 10-ALJ-17-0270-CC

Duke Energy Corporation,)
)
 Petitioner,)
)
v.)
)
South Carolina Department of)
Revenue,)
)
 Respondent.)

ADMINISTRATIVE HEARING

Wednesday, September 5, 2012
10:06 a.m. - 4:39 p.m.

Thursday, September 6, 2012
9:48 a.m. - 3:08 p.m.

The hearing before the Honorable Ralph King Anderson, III, was taken at the Edgar A. Brown Building, 1205 Pendleton Street, Suite 224, Columbia, South Carolina, on the 5th and 6th days of September, 2012 before Cassandra E. Vance, Court Reporter and Notary Public in and for the State of South Carolina.

APPEARANCES:

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STIPULATIONS

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

1 THE COURT: All right. This is a hearing in the
2 matter of Duke Energy Corporation, Petitioner,
3 versus South Carolina Department of Revenue,
4 Respondent. The Docket Number is
5 10-ALJ-17-0270-CC.

6 Are there any motions or stipulations the
7 parties wish to make before we proceed?

8 MR. GREEN: I think we've got some -- we've entered
9 some factual stipulations for the record and
10 those have been filed with the Court yesterday,
11 I think, and so those matters are stipulated.
12 I don't think we have any -- and we also
13 stipulated to the authenticity of the
14 documents. I don't think you'll hear
15 authenticity challenges. You may hear
16 objections on the basis of relevance or hearsay
17 or whatnot, but there really won't be
18 authenticity challenges, I think, to the
19 documents you'll see today.

20 THE COURT: All right.

21 MR. TRESH: We agree, Your Honor.

22 MR. GREEN: Now, I have another point about a
23 witness that was identified to me yesterday,
24 Your Honor. And I'd like to --

25 THE COURT: Another point about a witness that was?

1 MR. GREEN: Identified to me yesterday --

2 THE COURT: Oh, identified.

3 MR. GREEN: -- by Duke Energy, I apologize. Let me
4 give you a little background, explain the basis
5 for my objection to this witness's testimony.
6 I think it was three weeks ago tomorrow, excuse
7 me, Duke Energy contacted us and we discussed
8 and we all agreed to exchange witness lists and
9 we identified the witnesses that we expected to
10 call and Duke Energy identified the witnesses
11 that they expected to call and they -- then we
12 formally did -- well, formally by email did
13 that the following Monday. On Duke Energy's
14 witness list, they did not include at that time
15 Professor Richard Pomp.

16 Fast forward to yesterday, at yesterday
17 afternoon by 4:15, I got an email saying they
18 had decided to call Richland Pomp as a witness.
19 Now -- so the problem I have with that is
20 twofold. First is the fact that they weren't
21 identified to me earlier on in response to a
22 process that was entered into at Duke's request
23 and which we were agreeable to.
24 The second and bigger problem I have with that,
25 though, is that we deposed Professor Pomp last

1 December. He was identified as a witness in
2 Duke's disclosures on the basis of the gross
3 receipts issue that Your Honor is familiar
4 with, that's not here today, and electricity.
5 So we did the deposition and as we got near the
6 end of the deposition, I began to ask some
7 questions to Mr. Pomp about electricity and it
8 was indicated to me that he was not prepared to
9 testify about those matters that day.

10 And we went off the record, talked to Counsel,
11 who is not here today, Counsel Jeff -- I forget
12 Jeff's last name at the moment -- and then we
13 went back on the record and I asked him a few
14 more questions, but the -- the language in the
15 deposition -- we have a copy of that
16 deposition. Let me read some of the
17 pertinent -- here, I have it.

18 Okay. I began, I said, "My understanding is
19 you have been asked to testify regarding the
20 treatment of electricity for tax purposes in
21 South Carolina and other states." Answer: "I
22 don't know whether that is still my mission or
23 not." Question: "Would you help me understand
24 what your mission is, then?" Answer: "Well,
25 if I could turn to counsel and ask whether that

1 is still my purview, I believe." Mr. Friedman
2 asked -- Jeff Friedman: "Go off the record."
3 And I said, "Yes, let's go off the record."
4 We came back on. I asked him a question about
5 whether he had testified about electricity in
6 the past. Then I -- we took another break and
7 then I came back on page 101 of the deposition,
8 I say, "Okay, leaving aside the electricity
9 issue, which I understand you're not prepared
10 to testify," and then I went on and asked
11 another question, and then at the end and I
12 say, Question: "And you may or may not,
13 depending on your discussion with him, review
14 the electricity issue; would that be correct?"
15 And the answer was: "I guess that's correct."
16 It was my understanding that we would be
17 notified if they decided to call him for
18 electricity issues. Well, we were notified
19 yesterday at 4:15 in the afternoon.

20 THE COURT: Well, you were notified.

21 MR. GREEN: Yes, sir, we were notified, but hardly
22 enough time. You know, if I had deposed him
23 back in December and they said, "Well, let's go
24 ahead and talk about this issue," then I'd ask
25 him questions -- I don't know what we would

1 have done. I'd know what he was going to say
2 or at least I'd had an idea. I may have
3 decided to get an expert in response. I don't
4 know what would have happened.
5 Not identifying him until yesterday permits no
6 time to depose him, no time to do anything. He
7 wasn't part of the initial exchanges that we
8 agreed into voluntarily. I move he ought to be
9 stricken from the list of witnesses today, Your
10 Honor.

11 THE COURT: All right.

12 MR. TRESH: Your Honor, a couple of points.

13 Professor Pomp is certainly on our witness list
14 from the beginning and we noticed him as an
15 expert in state tax policy regarding
16 electricity.

17 When Mr. Green took the deposition -- what he
18 read was accurate but there are some important
19 points that he left out. First, there are a
20 few questions where he asked him about tax
21 policies relating to electricity.

22 And after he asked Professor Pomp, he
23 said -- he said, "You anticipate doing" -- he
24 asked him a few questions about electricity and
25 then said at the end, "Do you anticipate doing

1 any additional work on this topic regarding
2 things that I have not explored with you
3 today?"

4 Professor Pomp said, "You've been very
5 thorough, so I doubt it." And then Mr. Green,
6 "All right. Do you anticipate doing any
7 additional work from -- between now and the
8 time of your -- if there's a trial or a hearing
9 or a proceeding in this case, do you anticipate
10 doing any additional work?"

11 "Well, I'll certainly read" -- and this is
12 Professor Pomp's response -- "read the
13 deposition and that would probably trigger
14 additional thoughts on my part, so I will do
15 some thinking, Counsel. And I have not
16 discussed whether there is anything else that
17 he would like for me to say."

18 Subsequent to that time, in the pretrial brief
19 that the Department filed, they spent no less
20 than 20 percent of their time -- this is a
21 brief that was filed I think about ten, 12 days
22 ago -- they spent 20 percent of that brief --
23 I think there were five full pages that go into
24 other states' law, other tax law; in other
25 words, analogizing different tax policies and

1 different taxes to South Carolina income taxes,
2 arguing that the bankruptcy code and the
3 Uniform Commercial Code from other states --
4 the reasoning in cases -- in other states
5 should be applied to South Carolina income tax
6 policy, and so we got that ten days ago.
7 In consultation with Professor Pomp, and that
8 additional thinking that his brief triggered,
9 it seemed to us that it would be only fair to
10 allow Professor Pomp to come and testify on a
11 matter of state tax policy, which we had
12 noticed him from the very beginning.
13 Now, as for the purported agreement that we had
14 about ten days ago --

15 THE COURT: All right. I want to be very clear,
16 because I know lawyers. They say that they're
17 going to call a witness on one matter and it
18 starts getting wider and wider and wider, kind
19 of goes on.
20 It sounds to me like the only reasonable
21 argument that you have at this point in time
22 concerning Professor Pomp, after what I heard
23 regarding the deposition interaction -- and I
24 say "interaction" to include that which y'all
25 discussed, too -- is that he would be allowed

1 to testify on the narrow issue of whether
2 consideration of bankruptcy and commercial code
3 rulings would be reflective of tax policy.

4 MR. TRESH: If I could also ask --

5 THE COURT: That's -- apparently that's -- so far
6 that's all you've argued that they raised new.

7 MR. TRESH: They also went ahead and argued in this
8 brief and suggested that they were going to
9 submit testimony on other states'
10 interpretations of how electricity is treated
11 for tax purposes, as well as how electricity is
12 treated for other taxes, including briefs that
13 they filed in the sales tax context. Mr. Green
14 alerted us this morning that he intends to --

15 THE COURT: When you say all that -- I think I can
16 read case law. So what do I need Professor
17 Pomp to tell me about case law? I don't need
18 him to tell me about case law.

19 MR. TRESH: I think --

20 THE COURT: I'm more than capable of doing that.

21 MR. TRESH: Professor Pomp is an expert in state tax
22 policy. He would -- he can give some context
23 to those cases in explaining and testifying on
24 how the law and the policy in those states
25 developed and why those cases really are not on

1 point and shouldn't be applicable in South
2 Carolina.

3 THE COURT: Well, I think the first part of your
4 statement is probably appropriate for
5 testimony. The second part of your testimony
6 (sic) I think -- I can pull it up, the South
7 Carolina cases on expert witness in the legal
8 area, you're stepping a little bit across the
9 line, or at least stepping on it, on that
10 second part. So on the policy part, I
11 understand. But is that it?

12 MR. TRESH: That's it, Your Honor. State tax policy
13 in other states, yes, Your Honor.

14 THE COURT: All right.

15 MR. GREEN: Your Honor, these cases are cited and
16 they're cited and you can read the cases.
17 We're not having anybody testify about those
18 cases. We're not putting anybody up to testify
19 about legal issues, because, frankly, that's a
20 matter for the Court. It's not for anybody
21 here. We have witnesses, which we identified,
22 to deal with more of the factual part and the
23 issues before the Court.
24 All of that, though, completely misses the
25 point, which is that he said he was not

1 prepared to testify about the electricity
2 issues in his deposition. I was not afforded
3 an opportunity to ask him about those.

4 THE COURT: All right. But the point he's making is
5 that you raised new matter in your pretrial
6 brief.

7 MR. TRESH: Yes, sir.

8 THE COURT: So what do you say to that?

9 MR. GREEN: All I ...

10 THE COURT: By citing new cases you raised ...

11 MR. GREEN: It would -- Your Honor, I do

12 not -- there were cases on different issues
13 cited from other states all along in this
14 process; not those particular cases, per se.
15 Some of them were in the summary judgment memo,
16 more of them I think had to do with the other
17 issues in the case.

18 Those are cases that are just presented for the
19 Court's information to evaluate. They are
20 not -- I don't submit those more as evidentiary
21 issues to be subject of testimony. They are
22 just case law for the Court's consideration.
23 Witness testimony would not be appropriate.
24 But, again, I didn't have any -- I didn't have
25 a chance to ask him about those cases, even if

1 I was thinking about them at that time. I
2 didn't have a chance to ask him about anything
3 because he said he wasn't prepared to testify
4 about those issues.

5 MR. TRESH: Your Honor, Professor Pomp made it clear
6 that he would at the conclusion of that --

7 THE COURT: I understand that point, but when you
8 say that you're not going to testify on an
9 issue and then you say, "Well, I may do
10 research later on," then he's got to reasonably
11 notify them about the fact that you're going to
12 have Professor Pomp testify so they can
13 properly depose him on the issue.

14 Let me -- I'm going to step out and think
15 about -- I tell you what. Before I even step
16 out, I do want to let y'all know one thing up
17 front. I don't know if I have it in my notes,
18 but if I can clarify.

19 In your pretrial brief, you made the point that
20 I made the finding concerning Section, I think
21 it was, 12-6-2250 -- is that it? -- concerning
22 the meaning of -- let me just pull that up real
23 quick -- the meaning of "or," basically is what
24 it comes down to, the two clauses.

25 Yeah, "manufacturing or" -- actually, 2250's

1 got "manufacturing or," and then it goes into
2 "a form of collecting," and then it says "or
3 selling, distributing or dealing in tangible
4 personal property."

5 I want it to be clear that, you know, South
6 Carolina case law has followed the principle
7 that "or" is a disjunctive participle and I
8 think other cases -- states have followed that,
9 in that "or" is considered generally an
10 alternative. It is not --

11 MR. TRESH: (Nods head affirmatively.)

12 THE COURT: You're taking the approach that it is an
13 exclusive alternative.

14 MR. TRESH: (Nods head affirmatively.)

15 THE COURT: And I will tell you that, so it will be
16 clear on my reading of the statute, it appears
17 to me that in instances like this that an
18 energy company can be involved in manufacturing
19 at some point at the plant and then when it
20 leaves the plant, they can be involved in
21 selling, distributing or dealing in tangible
22 personal property, upon the electricity leaving
23 the plant, depending on how -- the viewpoint
24 develops about tangible personal property.
25 So when -- I said that there's both. There's

1 the issue of "blank or blank." That doesn't
2 mean that -- that neither cannot be an issue
3 before me at the same time.

4 I do recognize your point that you wouldn't
5 necessarily be manufacturing "and," because
6 you're not reading of "and." It's not
7 a -- although, I notice Webster's, I think,
8 said "or" is a conjunctive.

9 If you go look up Webster's, I don't think --
10 I don't know if I agree with Webster's, but --
11 because I thought "and" as a conjunctive --

12 MR. TRESH: Yes, Your Honor.

13 THE COURT: -- in my life. Although, I was educated
14 in South Carolina public schools, so we'll see
15 how well that is today.

16 But -- so explaining all that, I will also go
17 ahead and I want to let you know about one
18 thing is -- or another matter is, I read
19 through your cases on electricity. The
20 California case, PacifiCorp?

21 MR. TRESH: Yes, sir.

22 THE COURT: I didn't read that one because that's
23 not -- from what I can tell is not a court
24 decision. That's more of an administrative
25 decision?

1 MR. TRESH: I believe, Your Honor, PacifiCorp was,
2 indeed, a court decision.

3 THE COURT: It was?

4 MR. TRESH: Yes, sir.

5 THE COURT: Well, the cite that -- I didn't have a
6 Lexis cite. We don't have Lexis here. We have
7 West Law, so I didn't have the -- I didn't go
8 to that case.

9 But I read -- there is a California case
10 involving use tax that says electricity
11 is -- electricity is manufacturing for the use
12 tax. Now, that was the income tax case you
13 were citing.

14 MR. TRESH: (Nods head affirmatively.)

15 THE COURT: But the Miller versus City of Los
16 Angeles case, it didn't define production of
17 electricity in the context of manufacturing.
18 And it held electricity is a tangible asset.
19 But the Massachusetts cases you cited, I'll
20 tell you that the Holden Muffin (sic) -- or
21 Mifflin case held that -- in there: "Further,
22 we have held that the production of electricity
23 to involve manufacturing." So that case didn't
24 seem to make the point that you were seeking
25 it.

1 Westinghouse Broad Company, also a
2 Massachusetts case, dealt with the broadcasting
3 process, which I don't really think is relevant
4 here, and even in that case it said that "the
5 proposition conformed to our view that the
6 production of electricity may entail
7 manufacturing." They were addressing the board
8 about it.

9 The Louisiana case that you cited dealt with an
10 interpretation of Article 29 of the
11 Constitution of 1898 of Louisiana back in 1906.
12 Not so sure about that case.

13 The New Hampshire case I really found
14 interesting, 1903 case. In that case the court
15 held, and I quote, "It is not yet been
16 discovered what electricity is," end quote. If
17 they don't know what electricity is in 1903, I
18 just don't find that case a whole lot
19 convincing.

20 The Pennsylvania case -- there was another
21 Pennsylvania case that even made that one
22 stronger, so ...

23 But, I mean, there's also, going the other way,
24 Alabama, Arkansas, Illinois, Iowa, Kentucky,
25 Minnesota, Montana, New York, Rhode Island. So

1 I was just going to let you know, that's what
2 I found on my research. So when it comes to
3 the line of cases -- and I don't even remember
4 what the DOR cited because I didn't research
5 theirs because I was trying figure out on my
6 own. And you're the one that got me interested
7 in it.

8 MR. TRESH: (Nods head affirmatively.)

9 THE COURT: So, with that said ...

10 MR. TRESH: Your Honor, if I may, just two more
11 quick points on Professor Pomp?

12 THE COURT: Yeah.

13 MR. TRESH: First is, Mr. Green started an analysis
14 or started to -- after this break and Mr. Pomp
15 said that he wasn't prepared to ask questions
16 about electricity that Professor Pomp answered,
17 such as: "Have you testified around
18 electricity in other states?" That's very
19 clear from the deposition.

20 I think that part of what Professor Pomp would
21 be -- would testify on relates exactly to some
22 of the context of these cases that you're
23 talking about.

24 There is language in those cases, of course,
25 that talk about electricity manufacturer or

1 production being part of the cases before the
2 court goes ahead and holds that electricity is,
3 indeed, tangible personal property.
4 What's particularly relevant in South Carolina
5 is that for income tax purposes, the test has
6 always been based upon revenue or receipts.
7 And you'll hear a lot of testimony today
8 from -- about long-standing Department policies
9 in place and long-standing interpretations of
10 the federal and the state level around how when
11 you're looking at an income tax, what you need
12 to look at is: What does the company earn its
13 receipts from? And that is kind of a
14 long-standing income tax policy and -- in South
15 Carolina and in other states, as Professor Pomp
16 would testify.
17 And in the context of South Carolina long (sic)
18 interpretations that have been adopted by the
19 DOR, they've always looked -- and you'll hear
20 testimony that they've always looked to the
21 "greater than 50 percent" test.
22 So even if Your Honor's interpretation around
23 you can -- the test is disjunctive,
24 manufacturing versus dealing, the use of that
25 term "or," ultimately the way that South

1 Carolina has settled that is with regard to
2 looking at over 50 percent, what is -- what do
3 they earn their receipts.

4 THE COURT: I agree -- I understand that. Now, all
5 that you just said, is that a new epiphany for
6 you?

7 MR. TRESH: That is not a new epiphany at all. What
8 is -- what is --

9 THE COURT: Well, if it's not a new epiphany, then
10 you knew about. You knew it could be an issue
11 and yet you -- apparently, you are now coming
12 at the last minute and saying you need
13 Professor Pomp to testify about that which you
14 knew was an issue.

15 MR. TRESH: We knew about the 50 percent test. But
16 if the Court were to adopt the reasoning in the
17 Department's recently filed pretrial brief, the
18 Court might say, as Mr. Green has pointed out,
19 "Well, South Carolina treats -- or South
20 Carolina and other states look at how they
21 treat electricity and the production of
22 electricity for property taxes and for other
23 taxes, and let's go over here and look at how
24 courts have treated electricity in the
25 bankruptcy context and the Universal -- or the

1 Uniform Commercial Code test and let's take all
2 of those extraneous pieces of information, I
3 knew about the way South Carolina treats
4 electricity for income tax purposes, but let's
5 take that extraneous information and let's say,
6 you know, from a matter of both law and policy,
7 this Court should go ahead and adopt those
8 policies in other contexts to the income tax
9 portion. That's all new. And that happens to
10 be Professor Pomp's expertise. That analysis
11 doesn't make any sense.

12 Now, for Mr. Green to say, "Well, I just cited
13 those cases for the Court's informational
14 purposes"? In a 20-page brief, I got five
15 pages -- no less than five full pages, not just
16 citing those cases, but discussing them. And
17 the purpose of a pretrial brief is not really
18 to offer argument. It's to give the Court a
19 preview about what would be testified to.

20 It's --

21 THE COURT: Well --

22 MR. TRESH: -- pretty elaborate.

23 THE COURT: -- when you say that, if the purpose is
24 to what it's going to -- you just said the
25 purpose of pretrial brief is not just argument,

1 but what is going to be testified to -- I think
2 I quoted that.

3 MR. TRESH: Yes, sir, both.

4 THE COURT: And Mr. Green just said there will be no
5 testimony regarding that; therefore, the need
6 to call Professor Pomp in response to that
7 testimony will -- is completely not probative
8 because there will be no probative testimony to
9 offer.

10 MR. TRESH: But the argument in the brief that
11 Mr. Green did, it's not just citing cases. He
12 spent five pages arguing about it and asking
13 the Court to adopt this rationale. It's only
14 fair that ten days before the --

15 THE COURT: Now you're moving to --

16 MR. TRESH: I said argument and --

17 THE COURT: Oh, okay.

18 MR. TRESH: Yeah. So argument and to go ahead and
19 inform the Court what the testimony was going
20 to be.

21 Now, this is the first time I've heard that
22 Mr. Green is not going to offer any testimony
23 on this. That wasn't clear.
24 I do know that there's five pages and it urges
25 the Court to adopt an analysis in other context

1 and insert it into the income tax context.
2 It's only fair having recently introduced
3 this -- Professor Pomp was notified as a
4 witness. Surely Mr. Green didn't come up with
5 this whole line of thinking in the last ten
6 days. If he knew he was going to go down this
7 road, Mr. Pomp was always available. We never
8 received any request to depose them.
9 At the end of the deposition, it was made clear
10 that Professor Pomp would consider new
11 information as it came up. If Mr. Green
12 planned on introducing this, he could have come
13 back to us at any time and say, "Hey, I'm going
14 to go down this other path. Heads up, we're
15 going to file this brief and we should have
16 Mr. Pomp in and let's -- let's continue the
17 deposition."

18 THE COURT: All right.

19 MR. GREEN: Your Honor, all that is an attempt to
20 avoid the fact, he was tendered for a
21 deposition. They said he wasn't prepared to
22 testify. He said he wasn't prepared to
23 testify. They didn't let me know. The burden
24 was on them to let me know.
25 The only question I asked about electricity

1 after they came back, the one he referenced,
2 was whether he testified on the issue in any
3 other cases so we could do research if and when
4 the deposition was rescheduled, which it never
5 was.

6 It is not my job to keep asking them weekly,
7 "Are you going to update what he's called for?
8 Are you going to update what he's called for?"
9 The cases that are cited are just cases. They
10 can argue what the cases mean. I can argue
11 what the cases mean. They are trying to
12 introduce a witness, I didn't get a chance to
13 find out what he might say at any time on this
14 issue.

15 THE COURT: All right. I'm going to step out a
16 second. The problem I now have is, I got my
17 computer in the courtroom, so I can't go get on
18 it elsewhere.

19 I'm going to step out.

20 (Off the record from 10:36 to 10:46 a.m.)

21 THE COURT: One thing is helpful when y'all make
22 arguments like this is the standard of which I
23 consider the decisions, but the cases -- there
24 are other cases, but -- I just accidentally
25 went away from it. It's Bryson versus Bryson.

1 I'll get you the cite in a second.
2 There's other cases, too, but 378 S.C. 502,
3 62 S.E.2d 611. It's a 2008 Court of Appeals
4 case. It gave -- sets forth that before
5 imposing the sanction of excluding a witness --
6 that case is not directly on point, but it gave
7 several factors to evaluate the type of witness
8 involved, this being an expert witness, not a
9 fact witness; the context of the evidence
10 emanating from the proffered witness; the
11 nature of the failure or neglect or refusal to
12 furnish the witness's name. Here, the nature
13 in failure of neglect -- I mean, I wouldn't
14 call it "neglect." It's just -- I don't even
15 see it as anything intentional on your part,
16 but ...

17 MR. TRESH: (Shakes head negatively.)

18 THE COURT: But I do think DOR was mislead, and
19 rightfully so, by that the testimony -- or his
20 testimony would be limited and not in this
21 area, even though you said that he reserved the
22 right -- I mean, to further evaluate. You can
23 take that in the context of "further evaluate"
24 that which he had already been proffered as an
25 expert, but it is more speculative to say that