THE STATE OF SOUTH CAROLINA
In the Court of Appeals

APPEAL FROM THE ADMINISTRATIVE LAW COURT
HONORABLE RALPH KING ANDERSON, III, CHIEF ADMINISTRATIVE LAW JUDGE

Case No. 14-ALJ-17-0158-CC
Appellant Case No. 2015-001509

DIRECTV, Inc. and Subsidiaries, ... Appellant,

v.

South Carolina Department of Revenue, ... Respondent.

FINAL BRIEF OF RESPONDENT

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STATEMENT OF THE CASE

This matter came before the Administrative Law Court (ALC) in accordance with the Administrative Procedures Act, S.C. Code Ann. § 1-23-310, et. seq. (2005). DIRECTV, Inc. & Subsidiaries (Appellant or DIRECTV) requested a contested case hearing to challenge a Department Determination issued by the South Carolina Department of Revenue (Department) on February 18, 2014. (R. pp. 58-64; Resp't Ex. 13). The Department denied a claim for refund of South Carolina corporate income taxes for the tax years 2006 through 2008; assessed South Carolina corporate income taxes, interest, and penalties for the tax years 2009 through 2011; and assessed license fees, interest, and penalties for the tax years 2010 through 2012 ("Tax Periods at Issue"). (R. p. 58; Resp't Ex. 13 p. 1). Specifically, the Department denied the refund claim and issued the assessments because DIRECTV is required to source all of its South Carolina subscription revenue to South Carolina since all of the income-producing activity ("IPA") related to DIRECTV's South Carolina subscription revenue occurred in South Carolina. (R. p. 64; Resp't Ex. 13 p. 7).

The ALC held a hearing on January 13 and 14, 2015, and issued its Final Order and Decision (Initial Order) on May 12, 2015, finding for the Department on all issues. (R. pp. 1-22; Initial Order pp. 2, 22). DIRECTV filed a motion for reconsideration pursuant to Rule 59(e), SCRCP and ALC Rule 29(D). (R. pp. 65-79; Mot. for Recon., pp. 1-15). The Department filed a response to DIRECTV'S motion for reconsideration, and DIRECTV filed a Reply to the Department's response. (R. pp. 102-123; Response pp. 1-22). On June 12, 2015, the ALC issued a Reconsideration Order (Recon. Order) and an Amended Final Order and Decision, reflecting the changes made to the Initial

Order upon reconsideration (Amended Order). (R. pp. 23-30; 31-53; Recon. Order pp. 1-8; Amended Order pp. 1-23). The Amended Order modified certain language from the Initial Order, partially abated the substantial underpayment penalty imposed on DIRECTV, and found for the Department on all remaining issues. (R. pp. 31-53; Amended Order pp. 1-23). In the Amended Order, the ALC ordered that DIRECTV's refund claims be denied and that DIRECTV be assessed $6,646,168.00 in tax and license fees, $653,425.00 in interest, and $1,246,155.75 in penalties with regard to its 2009 through 2011 income tax returns. (R. p. 52; Amended Order pp. 22).

On July 14, 2015, DIRECTV filed its notice of appeal of the ALC's decision to the South Carolina Court of Appeals. (R. pp. 535-536; Notice of Appeal).

STATEMENT OF FACTS

I. DIRECTV's Business Operations

DIRECTV is a multistate taxpayer that offers direct broadcast satellite video services to customers throughout the country. (R. p. 136; Hr'g Tr. 49:18-50:1). Its headquarters are located in Los Angeles, California. (R. p. 137; Hr'g Tr. 53:3-12). For a subscription fee, DIRECTV grants its customers access to television programming and other audio/visual options that are transmitted nationwide to customer's homes or businesses via satellites. (R. pp. 136-137; 139; 142; 143; Hr'g Tr. 49:23-50:1; 52:24-53:2; 61:5-62:8; 73:15-21; 74:14-20; 77:10-78:1). DIRECTV receives programming produced by third parties through satellite, fiber-optic cables, and over-the-air broadcast. (R. pp. 139-141; Hr'g Tr. 63:3-69:15). DIRECTV collects programming from local broadcast television stations through the use of local collection facilities. (R. pp. 139; 141; Hr'g Tr. 63:3-64:18; 71:11-72:5). During the Tax Periods at Issue, DIRECTV had

four to six local collection facilities in South Carolina. (R. pp. 139; 214; Hr'g Tr. 64:19-25; 364:17-25). The signals for the programming content are collected at broadcast and uplink centers. (R. p. 139; Hr'g Tr. 63:3-64:18). The broadcast centers and uplink facilities transmit the programming content signals to the satellites. (R. pp. 139; 140; Hr'g Tr. 63:3-64:18, 68:18-23). The satellites then transmit the signals directly to DIRECTV satellite dishes mounted on or near customer homes. (R. pp. 139; 140; 142; Hr'g Tr. 63:3-64:18, 68:18-23, 73:22-74-20). The signals are then relayed from the dish on or near the home to a set-top box (often located in the customer's living room) which delivers the signals to the customer's television set. (R. p. 142; Hr'g Tr. 73:22-74:20).

Customers pay a monthly subscription fee for access to basic channels and can also purchase premium channels and pay-per-view programs for an additional fee. (R. pp. 213-214; Hr'g Tr. 360:20-361:23). Before DIRECTV will deliver programming, it requires each customer to sign a contract, and DIRECTV must provide and install a satellite dish, remote controls, and a set-top box in order for the customer to access DIRECTV's programming in his home or business. (R. pp. 143; 144; Hr'g Tr. 77:10-78:1, 81:25-82:10). During the Tax Periods at Issue, third-party contractors provided the services related to the installation of equipment in homes of new customers in South Carolina. (R. p. 143; Hr'g Tr. 78:2-10). DIRECTV also had a few employees who lived and/or worked in South Carolina during the Tax Periods at Issue. (R. p. 214; Hr'g Tr. 363:1-25).

DIRECTV is considered a "cash cow business," and its primary source of revenue was the subscription revenue it received from its approximately twenty million subscribers. (R. p. 144; Hr'g Tr. 81:10-11). DIRECTV's revenue from customers

includes monthly fees for subscribing to one or more packages of video programming; revenue from pay-per-view programming; revenue from the sale or lease of the set-top boxes; revenue from optional warranties on the leased boxes (protection plans); and revenue from fees associated with high definition set-top boxes, set-top boxes with DVR, and multi-room viewing charges. (R. pp. 213-214; Hr'g Tr. 360:20-361:23). The parties agree that all rental income from the set-top boxes received by DIRECTV from South Carolina customers should be sourced to the numerator of the gross receipts ratio for apportionment purposes. (R. p. 530-534; Stip. of Facts, filed January 12, 2015).

II. DIRECTV's Income Tax Returns

On its originally filed corporate income tax returns in South Carolina for 2006-2008, DIRECTV sourced 100% of its subscription receipts and 100% of its rental receipts from South Carolina customers to the numerator of the gross receipts ratio. (R. pp. 194-195; 369; 417; 438; Hr'g Tr. 282:13-283:15, 284:8-19, 284:20-285:7; Resp't Ex. 1, 4, and 6). By doing so, DIRECTV used gross receipts ratios of 1.9539%, 2.0016%, and 2.0543% for years 2006 through 2008, respectively, to apportion its net income to South Carolina. Id. The Department conducted a field audit of DIRECTV's 2006-2008 tax returns. (R. pp. 193-194; Hr'g Tr. 280:22-281:4). As a result of the audit, the Department accepted DIRECTV's original 2006-2008 corporate income tax returns as filed (i.e., the Department did not make any adjustments to the tax returns). (R. p. 195; Hr'g Tr. 285:8-14). DIRECTV subsequently filed amended corporate income tax returns for the 2006-2008 tax years, and the single change was the removal from the numerator of the gross receipts ratio all of the subscription receipts from South Carolina customers that DIRECTV originally included in the numerator. (R. p. 216; Hr'g Tr. 369:15-23,

371:6-19). DIRECTV's amended gross receipts ratios for years 2006-2008 were 0.0246%, 0.0810%, and 0.1137%, respectively. (R. pp. 195; 196; 399; 425; 444; Hr'g Tr. 288:21, 289:16, 290:8; Resp't Ex. 3, 5, and 7). DIRECTV explained the amendments in a statement attached to each of the three amended returns:

> This return is being amended to apportion sales receipts to the state under S.C. Code Ann. § 12-6-2295 (Supp. 2007) which sources sales of services under a pro-rata cost of performance method. The originally filed return incorrectly apportioned satellite television subscription receipts to South Carolina using market based sourcing, rather than the cost of performance sourcing that is prescribed by statute.

(R. pp. 195; 413; 430; 449; Hr'g Tr. 286:21-287:7; Resp't Ex. 3, Attachment A; Resp't Ex. 5, Attachment A; and Resp't Ex. 7, Attachment A). By amending returns for 2006-2008, DIRECTV sought to decrease its income tax and license fee liability by $5,976,816.00 and sought a refund of this amount. (R. pp. 389-414; 423-431; 441-450; 470-481; Resp't Ex 2,3,5,7 and 11). In a field audit report dated November 29, 2011, the Department denied the amended returns and related refunds and accepted the original returns as filed. (R. pp. 470-481; Resp't Ex. 11).

DIRECTV then filed its original 2009-2011 corporate income tax returns using the same cost of performance method that it used on its 2006-2008 amended returns.[1] (R.

[1]Although on its amended 2006-2008 returns and on its original 2009 and 2010 returns, DIRECTV did not include any of the subscription receipts from South Carolina customers in the numerator of the gross receipts ratio. On its 2011 South Carolina return, DIRECTV changed its method again by including approximately $22 million of its $410 million subscription receipts from South Carolina customers in the numerator. (R. pp. 466; 539). DIRECTV did this by sourcing a percentage of its total subscription receipts to South Carolina based on a ratio of its alleged payroll in South Carolina to its total payroll. (R. p. 218; Hr'g Tr. 377:20-387:23). In its last amended returns from 2006-2010, DIRECTV did not source any subscription receipts to South Carolina because it

pp. 197; 451-469; Hr'g Tr. 294:21-23; 295:10-11; 296:1-2; Resp't Ex. 8-10). The Department audited these returns as well, and in a field audit report dated January 28, 2014, the Department assessed DIRECTV for income taxes and license fees for 2009-2011 using a gross receipts ratio that included all of DIRECTV's subscription receipts from South Carolina customers in the numerator. (R. pp. 482-489; Resp't Ex. 12).

The Department subsequently issued its Determination and found that the IPA of DIRECTV was its delivery of the signal into South Carolina customers' homes and onto the customers' television sets, which occurred entirely in South Carolina, and that, accordingly, DIRECTV should include 100% of the subscription receipts received from South Carolina customers in the numerator of the gross receipts ratio. (R. p. 64; Resp't Ex. 13 p. 7).

III. Department's Policy Regarding Sourcing Income of Service Providers

Under the Department's longstanding policy with respect to the sourcing of gross receipts to South Carolina, the Department does not source gross receipts of all service providers to South Carolina in the same manner but examines the specific activities of each applicable service industry to determine sourcing. (R. pp. 201; 207; 209-210; Hr'g Tr. 310:10-311-3, 333:2-7, 341:19-343:1, 344:12-345:9). For example, when sourcing the income of an engineering firm, the Department looks to the actual engineering services rendered as constituting the IPA since it is the "expertise and time" of a specific engineer that the customer is purchasing. Lockwood Greene Engineers, Inc. v. S.C. Tax Comm'n, 293 S.C. 447, 449, 361 S.E.2d 346, 347 (Ct. App. 1987). Therefore, the income

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claims that the vast majority of its payroll and property were located outside of South Carolina. (R. pp. 216; 218; Hr'g Tr. 372:17-24; 377:11-378:8).

is sourced to the location of the engineer rendering that specific service. (R. p. 201; Hr'g Tr. 311:4-10). On the other hand, the Department sources income received from the licensing of intangibles and from a financing operation to the location of the sale (in the case of intangibles) and the location of the borrower (in the case of a financing company). (R. pp. 201; 210; 520-529; Hr'g Tr. 311:11-312:8, 345:10-346:20; Resp't Ex. 21). Likewise, the Department sources subscription receipts received by a cable company and telephone company similar to the method it used in this case to source DIRECTV's subscription receipts to South Carolina. (R. pp. 201; 209; Hr'g Tr. 312:12-313:8, 342:9-18).

DIRECTV originally filed its 2006-2008 income tax returns in accordance with the Department's longstanding policy by sourcing 100% of its South Carolina subscription revenue to South Carolina. (R. pp. 366-388; 415-422; 432-440; Resp't Ex. 1, 4, 6).

IV. Dr. Glenn W. Harrison's Testimony

A. Identification Of The Income-Producing Activity

Dr. Harrison, the Department's expert economist, testified that the Department's Determination in this matter is completely appropriate from an economic perspective. (R. p. 225; Hr'g Tr. 405:18-407:1). First, the "only activity that we are talking about that actually generates income is the purchase of the product in South Carolina" and that activity is the delivery of the service in South Carolina. (R. pp. 224; 225; Hr'g Tr. 404:13-15, 405:4-6). Dr. Harrison stated that "it is the provision of television services in your home" that gives value and generates income for DIRECTV. (R. p. 225; Hr'g Tr.

406:14-18). Customers do not want to drive to DIRECTV's headquarters in California to watch the programming. (R. p. 225; Hr'g Tr. 406:17-407:1).

Dr. Harrison's determination of the IPA is consistent with the broad manner in which DIRECTV's economic expert, Dr. Cody, would determine the IPA: by determining "what is really creating the value that consumers ultimately pay for." (R. p. 180; Hr'g Tr. 228:3-19). Dr. Harrison believes that a customer is paying for DIRECTV to deliver the signal into his home and onto his television screen; however, Dr. Cody sought to find the value in a more nebulous way by "look[ing] at the important functions, risks and assets that are employed in the business." (R. p. 180; Hr'g Tr. 228:10-13).

B. Location Of DIRECTV's Income-Producing Activities

Dr. Harrison testified, from an economic perspective, that it is appropriate to source the subscription revenue received by DIRECTV from South Carolina customers to the numerator of the gross-receipts ratio because "that's the most direct way to represent [the extent of DIRECTV's business in South Carolina] and calculate [it]." (R. p. 225; Hr'g Tr. 406:3-13). Dr. Harrison further testified that it is unnecessary to develop "proxies" or approximations – like payroll and assets – to measure the value of DIRECTV's services in South Carolina. (R. p. 225; Hr'g Tr. 405:9-10). DIRECTV and the customer have placed a direct value of the delivery of the service into homes – the amount of the subscription fee paid. (R. p. 225; Hr'g Tr. 405:3-17). Dr. Harrison stated that the most accurate way to measure the value of the service that DIRECTV provided to its South Carolina customers is "the amount of money that the subscriber paid in South Carolina" and that such a measure was a transparent item that comes from DIRECTV's own accounting information. (R. pp. 225; 227; Hr'g Tr. 405:10-17, 415:11-17).

V. Professor John A. Swain's Testimony

The Department's tax policy expert, Professor John A. Swain, explained that the Department's approach in this matter is good tax policy for several different reasons. (R. p. 237; Hr'g Tr. 454:5-8). First, S.C. Code Ann. § 12-6-2290 mandates the use of a single gross-receipts ratio, and the purpose of a single gross-receipts ratio is to reflect the contribution of the market state – "to give South Carolina its due as a market state for providing a market for DIRECTV, even though DIRECTV is . . . not located [in South Carolina]." (R. p. 237; Hr'g Tr. 454:10-18, 456:18-23). Second, the General Assembly's approach to sourcing by adopting statutes mandating the use of single sales/gross receipts apportionment ratios reflects the nationwide movement to a single-sales factor apportionment: what began as an economic development tool has now become an "economic sort of preservation tool" that allows states to "run with the pack in a competitive environment with mobile capital[.]" (R. p. 237; Hr'g Tr.455:7-19). Unlike the General Assembly's approach, Prof. Swain further explained that DIRECTV's approach to sourcing in this case is a "stealth property/payroll/expense factor" and that is "exactly the opposite of what Legislatures . . . want to do when they adopt single-sales factor. It defeats the purpose of it." (R. p. 237; Hr'g Tr. 456:9-14). Third, the Department's approach promotes equity by attempting to "treat like taxpayers in a like manner" unlike DIRECTV's approach that would treat "functionally similar or very similar business competitors" differently. (R. p. 238; Hr'g Tr. 457:7-21; 459:5-21).

Prof. Swain further explained that the Department's interpretation of S.C. Code Ann. § 12-6-2295(A)(5), in addition to being good tax policy, is consistent with authority in other jurisdictions, including jurisdictions that had costs of performance statutes. (R.

p. 239; Hr'g Tr. 461:9-462:9). He stated that "there's room to interpret the statute "as the Department has without changing the law. (R. p. 239; Hr'g Tr. 462:15-21, 464:11-18). Finally, Prof. Swain testified that reading section 17 of the UNIFORM DIVISION FOR INCOME TAX PURPOSES ACT'S (1957) (UDITPA) cost of performance standard into South Carolina's statute may provide "flexibility" but that flexibility leads to uncertainty for both taxpayers and the Department because the cost of performance standard is "confusing and indefinite, plagued by vagueness, ambiguity, substantial debate, lack of clear guidance, whipsawing, tremendous flexibility," and that flexibility turns into "uncertainty." (R. p. 239; Hr'g Tr. 462:22-464:10).

VI. Gross Receipts at Issue

The Department concurs with DIRECTV's statement regarding the Gross Receipts at Issue.

ARGUMENTS

This Court should affirm the Amended Order of the ALC because, under the applicable standard of review, the factual findings of the ALC are supported by substantial evidence, the ALC made no errors of law, the Amended Order did not violate any of DIRECTV's constitutional rights, and the Amended Order was not arbitrary or capricious or characterized by abuse of discretion.

In an appeal from the decision of an administrative agency, S.C. Code Ann. § 1-23-610(B) provides the applicable standard of review and provides the grounds under which this Court may reverse or modify the ALC's decision. The Administrative Procedures Act states that an appellate court's review of an ALC order "must be confined to the record" and that an appellate court "may not substitute its judgment for the

judgment of the ALJ as to the weight of the evidence on questions of fact." S.C. Code Ann. § 1-23-610. To affirm on the basis of substantial evidence, the South Carolina Supreme Court explained that "this Court need only find, looking at the entire record on appeal, evidence from which reasonable minds could reach the same conclusion that the ALC reached." Barton v. S.C. Dep't of Prob. Parole & Pardon Servs., 404 S.C. 395, 401, 745 S.E.2d 110, 113 (2013) (citing Hill v. S.C. Dep't of Health and Envtl. Control, 389 S.C. 1, 9–10, 698 S.E.2d 612, 617 (2010)). "The mere possibility of drawing two inconsistent conclusions from the evidence does not prevent a finding from being supported by substantial evidence." Original Blue Ribbon Taxi Corp. v. S.C. Dep't. of Motor Vehicles, 380 S.C. 600, 605, 670 S.E.2d 674, 677 (2008) (internal citations omitted).

I. THE ADMINISTRATIVE LAW COURT APPLIED THE PROPER BURDEN OF PROOF AND CORRECTLY CONCLUDED THAT APPELLANT FAILED TO MEET ITS BURDEN OF PROOF

The ALC applied the correct burden of proof and properly found that DIRECTV failed to meet its burden of proof because DIRECTV failed to prove by a preponderance of the evidence that DIRECTV's IPA extended beyond the delivery of the signal into the homes and onto the television screens of its South Carolina customers. (R. pp. 40-41; Amended Order pp. 10-11). Further, the ALC properly found that, while some evidence reflected that DIRECTV's advertising may produce some income, the evidence did not reflect what portion of the advertising was attributable to South Carolina sales leaving the ALC "to speculate." (R. pp. 40-42; Amended Order pp. 10-12).

The standard of proof in a contested case is by a preponderance of the evidence. Section 1-23-600(A)(5). "[T]he 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." Ford v. Atl. Coast Line R. Co., 169 S.C. 41, 168 S.E. 143, 167 (1932); see also Leventis v. S.C. Dep't of Health & Envtl. Control, 340 S.C. 118, 132, 530 S.E.2d 643, 651 (Ct. App. 2000). The ALC properly recognized that "[b]ecause DIRECTV is challenging a determination by the Department that it must source its South Carolina subscription receipts from South Carolina customers to the numerator of the gross receipts ratio, DIRECTV has the burden of proof." (R. p. 37; Amended Order p. 7) (citations omitted).

The ALC hears a contested case as the de novo fact finder and may draw its own conclusions. Young v. S.C. Dep't of Health and Envtl. Control, 383 S.C. 452, 680 S.E.2d 784 (Ct. App. 2009); Risher v. S.C. Dep't of Health and Envtl. Control, 393 S.C. 198, 207, 712 S.E.2d 428, 433, reh'g denied (July 21, 2011). As the finder of fact, the ALC can choose to accept, in part or in whole, the testimony of witnesses based on its own view of a witness' credibility and the weight of the evidence. 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. DIRECTV had the burden of proof in this matter, and as the finder of fact, the ALC is entitled to assign as much or as little weight to evidence as it wishes. Id. Furthermore, the ALC is free to reach its own conclusions of law. Engaging and Guarding Laurens County's Environment (EAGLE) v. S.C. Dep't of Health and Envtl. Control, 407 S.C. 334, 344, 755 S.E.2d 444, 449 (2014).

The ALC established that DIRECTV did not satisfy its burden of proof because its evidence was insufficient to prove that there were other IPAs. (R. pp. 41-43; Amended Order pp. 11-13). Although DIRECTV asserts that it established that the

Department's assessment was incorrect, (Appellant's Initial Br. at 17), after its review of the evidence, the ALC properly concluded that "pursuant to Section 12-6-2295(A)(5), DIRECTV's income-producing activity includes the customers' subscriptions and delivery of the signal into the location and onto the television screens of its customers," (R. pp. 40-51; Amended Order pp. 10- 21). Simply put, the Department established that the IPA in this matter is the delivery of the signal into South Carolina homes – without this activity – DIRECTV would not have generated the income in this matter. For instance, the Department witnesses testified that the IPA in South Carolina should include South Carolina subscription revenue and this is consistent with how similar businesses in South Carolina file their corporate tax returns.[2] (R. pp. 196-197; 202; 208-209; Hr'g Tr. 292:14-293:5, 313:22-25, 340:19-341:6, 341:19-343:1). DIRECTV is providing a service to customers in South Carolina, and the subscription revenue precisely identifies that IPA occurring in South Carolina.[3] (R. p. 209; Hr'g Tr. 344:17-24). As Dr. Harrison testified, the service being sold in South Carolina is "the provision of television services in your home." (R. p. 225; Hr'g Tr. 406:17-18).

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[2]In its brief, DIRECTV states the Department auditor expressly stated in his audit report that market base sourcing was used in this matter. However, as testified at trial, DIRECTV first used the phrase "market-based sourcing" in its own statement attached to the amended returns for tax years 2006, 2007, and 2008. (R. p. 199; Hr'g Tr. 303:16-304:1). Moreover, as acknowledged by the ALC in its Amended Order, the Department clarified its position during trial. (R. p. 36; Amended Order p. 6, n. 5).

[3]Although the Department witnesses state that the Department looked to the customer's location in apportioning DIRECTV's South Carolina subscription revenue, each witness further testified that the Department's focus in identifying and sourcing the income-producing activity of a taxpayer is the transaction itself. (R. pp. 198; 203; 209; 211; Hr'g Tr. 297:11-14; 318:16-20; 344:17-24; 350:17-22). Any analysis related to the customer in this matter is incidental to the primary focus of DIRECTV's activit(ies).

Although the ALC stated that DIRECTV's IPAs may not be limited to this activity, DIRECTV retained the responsibility to prove its case by a preponderance of the evidence and failed to do so. (R. pp. 40; 25; Amended Order p. 10; Recon. Order p. 3). More specifically, the ALC made the following findings of fact, stating that "DIRECTV's evidence was either insufficient or not credible":

> (1) "The 'payroll-and-assets method does not provide a reasonable approximation of the income-producing activities performed by DIRECTV in South Carolina or the value attributable to such activities.'"
>
> (2) "Though [DIRECTV's] evidence did reflect that its advertising probably produced some income, the evidence did not reflect what portion of DIRECTV's cost was either attributable to South Carolina customers or may have influenced South Carolina customers to subscribed to DIRECTV."
>
> (3) "[I]t is possible that advertising performed within or without [] South Carolina could be considered income-producing activity. However, DIRECTV did not provide any evidence that reflected how much of its advertising was directed at South Carolina and what impact such advertising had on revenue generated in South Carolina. Therefore, the Court cannot consider advertising in this case."
>
> (4) "DIRECTV simply did not provide sufficient information on how to apportion its subscription receipts between states in which it believes income-producing activities occur."

(R. pp. 25-26; 41-42; 49-50; Recon. Order pp. 3-4; Amended Order pp. 11-12, 19-20). Moreover, the following excerpt from the Amended Order summarizes the ALC's view of DIRECTV's evidence:

> Dr. Cody's payroll-and-assets method does not provide a reasonable approximation of the income-producing activities performed by DIRECTV in South Carolina or the

> value attributable to such activities. Though its evidence did reflect that its advertising *probably* produced some income, the evidence did not reflect that portion of DIRECTV's cost was attributable to South Carolina customers or may have influenced South Carolina customers to subscribe to DIRECTV. Instead, the Court was left to speculate as to the extent to which DIRECTV's content and programming, acquisition and distribution thereof, advertising, and customer service in installing and maintaining its equipment within this State influenced customers' decision to subscribe to DIRECTV. Moreover, it does not appear that some of the activities that DIRECTV attributed to income production are actually income-producing activities.[4]

(R. pp. 41-42; Amended Order pp. 10-11 (emphasis added)).

The above discussion demonstrates that the Court properly applied the proper burden of proof in this case. DIRECTV cites to a property tax case – in which the Department was not a party – as support for its assertion that the ALC should have dismissed this case because DIRECTV allegedly met its burden of proof by showing that the Department's determination was incorrect. Specifically, DIRECTV cites Cloyd v. Mabry, 295 S.C. 86, 367 S.E.2d 171 (Ct. App. 1988) to incorrectly assert that if DIRECTV established that the Department's assessment was incorrect, then it met its burden of proof, and therefore, the Department's assessment should be dismissed. Even if DIRECTV could somehow establish that it met its burden of proof and proved the Department's Determination is incorrect, DIRECTV's suggestion that the appropriate remedy is dismissal of the determination is disingenuous at best.

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[4]The ALC found that many of the activities that DIRECTV says are income-producing activities, which the ALC calls pre-order and preparatory activities, are too attenuated to the production of income to be considered income-producing activities. (R. pp. 42-44; Amended Order, 12-14). Such activities include many of the so-called "value drivers" that DIRECTV called income-producing activities. (R. pp. 41-42; Amended Order, 11-12).

First, DIRECTV's use of Cloyd is misguided and not applicable here. Cloyd was decided in the context of a property tax matter and not with regard to corporate income tax. Cloyd, at 87, 367 S.E.2d at 172. Second, the Court of Appeals did not conclude that "appropriate relief" included absolving the taxpayer of any property tax liability through dismissal of the assessment. Id. at 88-89, 367 S.E.2d at 173.

Further, the ALC had the ability to determine the proper assessed value based on the evidence presented even when the county assessor's value is deemed incorrect. See Smith v. Newberry County Assessor, 350 S.C. 572, 578-79, 567 S.E.2d 501, 504-05 (Ct. App. 2002). Dismissal of the case is not the so-called "appropriate relief."

Moreover, DIRECTV is not entitled to a complete abatement of the assessment in this case because the ALC suggested that there may be IPAs in South Carolina in addition to the delivery of the signal into subscribers' homes and onto their televisions.

Finally, remanding this matter to the ALC for DIRECTV to present additional evidence permits DIRECTV to take a second bite at the apple when it had every opportunity to present relevant evidence at the hearing before the ALC. See City of Myrtle Beach v. Tourism Expenditure Review Comm., 407 S.C. 298, 755 S.E.2d 425, n. 5 (2014) (citing Porter v. S.C. Pub. Serv. Comm'n, 333 S.C. 12, 32, 507 S.E.2d 328, 338 (1998) (citing Parker v. S.C. Pub. Serv. Comm'n, 288 S.C. 304, 342 S.E.2d 403 (1986))).

Simply put, DIRECTV failed to meet its burden of proof as it did not prove its IPA extended beyond the delivery of the signal into the homes and onto the television sets of its South Carolina customers. Furthermore, it failed to prove that less than 100% of the South Carolina subscription receipts should be sourced to South Carolina. Because

DIRECTV failed to make such a showing and evidence supports the ALC's finding that the Department's determination was correct, the ALC's decision was proper.[5] [6]

II. THE ADMINISTRATIVE LAW COURT APPROPRIATELY CONSIDERED THE EVIDENCE IN THE RECORD AND CORRECTLY CONCLUDED THAT THE DELIVERY OF THE SIGNAL INTO THE HOMES OF APPELLANT'S CUSTOMERS WAS APPELLANT'S INCOME-PRODUCING ACTIVITY

Based on substantial evidence and in accordance with the applicable statutes, the ALC properly determined that on a subscription-by-subscription basis Appellant's IPA was the delivery of the signal into its customers' homes and onto their television sets.

A. DIRECTV Is A Service Provider

DIRECTV is a media broadcasting company, and its primary income is derived from providing direct broadcast satellite video services to subscribers throughout the country. (R. pp. 213; 136; Hr'g Tr. 358:22-25; Hr'g Tr. 49:21-50:1). DIRECTV acknowledges that it is a service provider. (Appellant's Initial Br. p. 23, n. 6).

B. Standard Apportionment Method

The purpose of the South Carolina allocation and apportionment provisions is to provide for imposition of income tax "upon a base which reasonably represents the

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[5]"Our Supreme Court 'has long realized the practical impossibility of a state's achieving a perfect apportionment of expansive, complex business activities such as those of Appellant, and has declared that "rough approximation rather than precision" is sufficient.' Covington Fabrics Corp. v. S.C. Tax Comm'n, 264 S.C. 59, 66-67, 212 S.E.2d S.E.2d 574, 577-78 (1975). The Court also noted that '[a]lthough exactness in apportionment is desirable, all that is required is a reasonable approximation.'" (R. p. 41; Amended Order p. 11).

[6]DIRECTV continuously asserts that the Department presented no credible evidence on the identity or location of DIRECTV's income-producing activities. However, as noted by the ALC, "whether the evidence was presented by the Department or DIRECTV, the evidence as set forth in the findings, established the income-producing activities that occurred in this State." (R. p. 27, n.6; Recon. Order p. 5).

proportion of the trade or business carried on within this State." S.C. Code Ann. § 12-6-2210(B) (2014); Hertz Corp. v. S.C. Tax Comm'n, 246 S.C. 92, 142 S.E.2d 445 (1965). The method of apportionment to be used depends upon the nature of the taxpayer's business in this State. Because DIRECTV's principal income is not derived from manufacturing or dealing in tangible personal property, DIRECTV shall apportion its adjusted net income to South Carolina under § 12-6-2290. This provision mandates the following gross-receipts method:

> If the principal profits or income of a taxpayer are derived from sources other than those described in Section 12-6-2252 or Section 12-6-2310[7], the taxpayer shall apportion its remaining net income 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. For purposes of this section, items included in gross receipts are as provided in Section 12-6-2295.

S.C. Code Ann. § 12-6-2290 (Supp. 2007).[8]

Thus, as a service provider, DIRECTV was required to use the single gross-receipts ratio, as supplemented by § 12-6-2295(A)(5) after 2006.[9] The relevant subsection states:

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[7]S.C. Code Ann. § 12-6-2310 designates the apportionment factor to use for the following specific regulated industries: railroads, motor carriers, telephone service companies, pipelines, airlines, and shipping lines. For example, telephone companies must apportion its net income using a gross-receipts factor.

[8]In 1995, the General Assembly repealed Chapter 7 and added Chapter 6 of Title 12. Accordingly, section 12-7-1190 was replaced by § 12-6-2290 as the statute that directed service providers how to apportion their net income. In 2007, the General Assembly amended § 12-6-2290 by adding an additional sentence to the end of the existing statute. That sentence reads as follows: "For purposes of this section, items included in gross receipts are as provided in § 12-6-2295." (R. p. 38, n.9; Amended Order at 8, n.9 (citing 2007 South Carolina Laws Act 110 (S.B 91))).

> (A) The terms "sales" as used in Section 12-6-2280 and "gross receipts" as used in Section 12-6-2290 include, but are not limited to, the following items if they have not been separately allocated:
>
> * * *
>
> (5) receipts from services if the entire income-producing activity is within this State. If the income-producing activity is performed partly within and partly without this State, sales are attributable to this State to the extent the income-producing activity is performed within this State[.]

S.C. Code Ann. § 12-6-2295(A)(5) (2014).

Section 12-6-2295(A)(5) requires DIRECTV to determine its IPAs, to identify the location of such IPAs, and then to source all of its subscription receipts based on the location of the IPAs. See id. If the entire IPA related to DIRECTV's South Carolina customers occurs in this State, then all of DIRECTV's subscription receipts from South Carolina customers must be sourced to the numerator of the gross-receipts ratio. Id.

C. ALC Holding That The Income-Producing Activity Is The Delivery Of The Signal Is Supported By The Substantial Evidence In The Record

The administrative law judge is the fact finder in this matter and has discretion. MRI at Belfair, 392 S.C. 314, 709 S.E.2d 626. While S.C. Code Ann. § 1-23-350 requires a final decision from the ALC to be in writing and include findings of fact, there is no requirement that the ALC list all witnesses and evidence and then confirm each was considered by the judge. Nevertheless, the extensive analysis contained in the Amended Order here should convince even the most skeptical reader that the ALC properly considered all of the evidence before it.

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[9]2007 South Carolina Laws Act 110 (S.B. 91) also added § 12-6-2295, the companion statute to § 12-6-2290. See 2007 South Carolina Laws Act 110, § 51.A; eff. June 21, 2007. These additions were effective for DIRECTV's 2007 tax year.

Effective in 2007, § 12-6-2295(A)(5) added the "income-producing activity" language to the sourcing statute for service providers.[10] Pursuant to § 12-6-2295(A)(5), the ALC properly determined that DIRECTV's IPA was "the delivery of the signal into the homes and onto the television screens of its customers." (R. pp. 40; 51; Amended Order pp. 10, 21). It is this "final act," which excludes all of the pre-order and other preparatory acts which are too attenuated to the production of income (R. pp. 43-44; Amended Order pp. 13-14), that generates DIRECTV's monthly subscription receipts, (R. pp. 62; 225; Resp't Ex. 13 p. 5; Hr'g Tr. 406:14-18). As Dr. Harrison said, "[I]t is the provision of television services in your home" that generates the subscription receipts for DIRECTV, not the pre-order and other preparatory activities which are merely "prior, secondary, intermediate activities." (R. pp. 224; 225; 228; Hr'g Tr. 404:6-12, 406:14-18, 417:9-10).

Regarding DIRECTV's pre-order activities, the ALC concluded that they were not IPA:

> [T]he beaming of the satellite signals through the air of South Carolina to the customer's dish, set-top box, and television screen, and the collection of charges for such service, are also analogous to the loading, hauling, and delivery of freight following the customer's solicitation of that freight, and the collection of charges therefor. However, the other prior activities that prepare the way for DIRECTV's provision of services, i.e., the infrastructure for producing and collecting the programming content and transmitting the signals would, in comparison to the facts in

[10]Notably, when adding § 12-6-2295(A) for the 2007 tax year, the General Assembly stated the following in 2007 South Carolina Laws Act 110, § 51.A, eff. June 21, 2007: "To Amend . . . by adding §§ 12-6-2252 and 12-6-2295 so as to further provide for allocation and apportionment of business income for state income tax purposes by basing the determination only on a sales factor and to define the terms 'sales' and 'gross receipts' consistently and specifically for that purpose[.]"

> the *Mercury* case, be akin to the manufacturing and transfer of the freight through its infrastructure to a storage location, from which it is later – **only after an order is placed** (or "solicited," as the Supreme Court put it) – loaded, hauled, and delivered, and for which charges are collected. Though *Mercury* did not address such pre-order activities, I find that the ones at issue in this case are too attenuated to be considered income-producing.

(R. pp. 43-44; Amended order pp. 13-14 (emphasis in original)).

Similarly, the ALC concluded that DIRECTV's other preparatory activities also were not IPAs. The ALC found that DIRECTV "engages in other 'preparatory' activities that eventually lead to satellite signals being beamed into this State", and such other preparatory activities include, but are not limited to, gathering, editing, and distributing programming and satellite and uplink activities. (R. p. 43; Amended Order p. 13). Importantly, "those activities have no bearing on a customer's decision to subscribe to, i.e. solicit, [DIRECTV's] services, nor do they occur as a result of that decision to subscribe." Id. (Emphasis added). Simply put, it is common sense that "the national programming through the CONUS beams would exist regardless of whether there were any subscribers in South Carolina. Thus, such 'preparatory' activities are too attenuated to the production of income to be considered 'income-producing activity' for purposes of § 12-6-2295(A)(5)." Id.

Regarding the identification of the IPA as the delivery of the signal into the homes and onto the television sets of DIRECTV's customers, the Department looked at the direct broadcast satellite services industry and the sources of income within the industry. (R. pp. 196-197; 200-201; Hr'g Tr. 292:10-293:5, 306:16-20, 312:12-20). The Department found that the primary source of income for DIRECTV was the monthly

subscription receipts that customers pay to DIRECTV in order to view selected packages of video and pay-per-view video programs in their homes and businesses. (R. pp. 196; 200; Hr'g Tr. 292:14-19, 306:14-20). These subscription receipts relate directly to the Department's Determination that the delivery of the signal into the customer's home and onto the customer's television is the income-producing activity. (R. p. 62; Resp't Ex. 13).

Although South Carolina law does not define "income–producing activity," the Multi-State Tax Commission defines it as the transactions and activity engaged in by a taxpayer to produce an item of income and that income-producing activity applies to "each separate item of income." 1 JEROME R. HELLERSTEIN ET AL., STATE TAXATION ¶9.18(3)(b) (3d ed. 2000). Therefore, when considering what DIRECTV's IPA is, it is appropriate to look only at it on a subscription-by-subscription basis. Looking at it this way, the Department concluded that the IPA for each subscriber was the delivery of the satellite signal into his home. All of the pre-order and other preparatory activities of DIRECTV do not create the income produced by the next subscription. The income from the next subscription is produced at the subscriber's home, which is where the value of the next subscription is delivered by DIRECTV.

The Amended Order establishes that the ALC properly considered the testimony of DIRECTV's witnesses regarding DIRECTV's IPA and sufficiently understood the operations of DIRECTV as was described by a corporate officer. (R. pp. 33-35; 39-44; Amended Order pp. 3-5, 9-14). Specifically, the ALC considered the evidence regarding DIRECTV's operations from Mr. Goswitz, its vice president of space, communications, and video. (R. pp. 33-35; 42-43; 135-144; Amended Order pp. 3-5, 12-13; Hr'g Tr.

47:14-48:7, 49:16-81:11). The ALC undoubtedly considered that testimony and the operational activities of DIRECTV in its decision, as demonstrated by its references to "content and broadcast of signals," "infrastructure" related to content and transmission, and "production and collection of programming content signals and transmission to broadcast centers and uplink facilities and then to the satellites." (R. pp. 33-34; Amended Order pp. 12-13). In addition, Mr. Goswitz admitted that the activities that DIRECTV performs at its customers' homes are the IPAs by stating that DIRECTV provides "direct to home" video services and must install a satellite dish, a coaxial cable, and a set-top box at each customer's home and connect the set-top box to each customer's television. (R. pp. 136; 142; Hr'g Tr. 49:21-23, 73:22-74:20). The ALC correctly determined that DIRECTV could be generating subscription revenue from millions of other customers, but, on a subscription-by-subscription basis, the IPA for the next customer is the activity that DIRECTV performs at that next customer's home.

Dr. Cody testified that he was engaged by DIRECTV "to identify from an economic perspective the income-producing activities of" DIRECTV. (R. p. 174; Hr'g Tr. 204:11-16). The ALC fully analyzed Dr. Cody's testimony and report but did not find it sufficient or persuasive. (R. pp. 40-41; 44; 47; Amended Order pp. 10-11, 14, 17). Specifically, the ALC recognized in its decision that DIRECTV presented evidence through Dr. Cody of the so-called four "value drivers" that could identify DIRECTV's IPA. (R. pp. 40-41; Amended Order pp. 10-11). These value drivers included major components of DIRECTV's operations, including (1) content and programming, (2) acquisition and distribution of programming content, (3) marketing and sales of its service, and (4) customer service. (R. p. 175; Hr'g Tr. 206:2-16). Dr. Cody described

these activities of DIRECTV in great detail in his testimony. (R. p. 175-179; Hr'g Tr. 206:2-221:1). Dr. Cody testified about his calculations using DIRECTV's payroll and assets as proxies in identifying DIRECTV's IPAs. (R. pp. 181-185; Hr'g Tr. 229:7-245:22). The ALC discusses in detail Dr. Cody's testimony about value drivers, and the ALC openly considered Dr. Cody's testimony to include reciting his analysis in the Amended Order. (R. pp. 40-42; 47-48; Amended Order pp. 10-12, 17-18).

After considering the testimony of Dr. Cody, the ALC found that Dr. Cody's payroll and asset proxies for identifying DIRECTV's IPAs were "of no practical value," that DIRECTV "did not sufficiently explain the effect of [Dr. Cody's] value drivers on income production in this State," and that DIRECTV's evidence was "just too nebulous" to make the connection between Dr. Cody's value drivers and IPAs. (R. p. 41; Amended Order p. 11). For example, Dr. Cody sought to find IPAs by looking at DIRECTV's "important functions, risks and assets." (R. pp. 180-181; Hr'g Tr. 228:3-229:29). He did not explain why each "important" function or taking a 'risk" is necessarily an IPA. The basic statement made by the ALC that the testimony was unpersuasive clearly indicates the Court considered the testimony given by Dr. Cody and was enough to establish the ALC properly considered the evidence in the record. (R. pp. 41; 47; Amended Order p. 11, 17).

Because the ALC heard and considered extensive evidence from Dr. Cody, Mr. Goswitz, Dr. Harrison, and the Department's fact witnesses, and because the ALC found that DIRECTV failed to sufficiently prove its alleged IPAs, the ALC made a decision regarding what DIRECTV's IPA was and such decision was supported by substantial evidence in the record.

D. The ALC Properly Interpreted And Applied Mercury Motor Mercury Motor Express, Inc. v. South Carolina Tax Commission, 244 S.C. 134, 141, 135 S.E.2d 756, 759 (1964).

Just as the South Carolina Supreme Court determined that the IPA of a trucking company was the actual hauling of freight over the highways, not its other "incidental" activities, Mercury Motor Express, Inc. v. South Carolina Tax Commission, 244 S.C. 134, 141, 135 S.E.2d 756, 759 (1964), the ALC properly found that DIRECTV's delivery of its signal into the homes and onto the television sets of its South Carolina customers was the IPA related to its South Carolina subscription receipts, not its pre-order and other preparatory activities, which are to attenuated to the production of income. (R. pp. 43-44; Amended Order pp. 13-14).

In Mercury, the court addressed IPA of an interstate freight hauler. Mercury at 141, 135 S.E.2d at 759. The court listed a series of transactions that occur in the freight hauling business including solicitation of freight, picking up the freight, hauling the freight, dropping off the freight, and collecting the hauling charges and noted that many of these activities may occur outside of South Carolina. Id. The Supreme Court held that, while each of these activities is "incidental to the production of income," the IPA is the hauling of freight "through and over the highways of the State of South Carolina." Id.

By stating that only the hauling of freight was the IPA while excluding the other incidental activities, the Supreme Court adopted a narrow construction of IPAs. DIRECTV however asserts that the Supreme Court in Mercury rejected a narrow construction of IPAs and that the ALC acknowledged that the Supreme Court considered "incidental" activities to be IPAs. (Appellant's Initial Br. at 29). Both of these assertions by DIRECTV are wrong.

Likewise, the term "income-producing activities" should have a narrow meaning under § 12-6-2295(A)(5). First, the General Assembly's use in § 12-6-2295(A)(5) of the limiting adjective, "income-producing," to describe the noun, "activities," means that all activities of a taxpayer, even if important to the overall service, are not IPAs and are not used to source gross receipts to South Carolina. Second, contrary to DIRECTV's argument, the General Assembly did not say in § 12-6-2295(A)(5) that – if the taxpayer operates a unitary business – all of its activities are to be used to source gross receipts to South Carolina. See § 12-6-2295(A)(5). Third, the Supreme Court in Mercury referred to each of the activities in the identified series of activities as being "incidental to the production of income," but it determined only that the hauling of freight was an "income producing activity." Mercury at 141, 135 S.E.2d at 759. Fourth, the Supreme Court's use in Mercury of the phrase "incidental to the production of income" to describe the taxpayer's activities does not mean that each of those activities are also IPAs that should be used to source gross receipts to South Carolina. "Incidental" is defined as (1) "[s]ubordinate to something of greater importance" and (2) "having a minor role." BLACK'S LAW DICTIONARY 765 (7th ed. 1999). Therefore, incidental activities are merely subordinate to or have a minor role with the main, primary, and principal activities. Fifth, DIRECTV's expert, Dr. Cody, confirmed the different nature of IPAs and the other incidental activities by stating that DIRECTV performed the other incidental activities "in anticipation of – and in order to deliver that signal in anticipation of customers signing up and paying" and that these other incidental activities have "a risk" because DIRECTV has only "an anticipation of future profits." (R. pp. 178; Hr'g

Tr. 219:15-19; 220:1-5). Finally, Dr. Harrison distinguished a taxpayer's intermediate activities from its IPAs. (R. pp. 227-228; Hr'g Tr. 415:18-418:2).

Based on the above, the ALC's analysis of IPAs was consistent with Mercury. Although DIRECTV performed many important activities connected with the IPA of delivering the signal into subscribers' homes and onto their television, activities such as content acquisition and development, satellite launches, and broadcasting and transmitting are intermediate to, incidental to, and prior to the actual IPA.

E. The ALC Properly Interpreted § 12-6-2295(A)(5)

In its brief, DIRECTV asserts that the ALC misinterpreted the language of § 12-6-2295(A)(5) to require "(i) an analysis of a customer's subjective intent and (ii) a market-based sourcing methodology." (Appellant's Initial Br. at 31). More specifically, DIRECTV asserts that the ALC's interpretation of § 12-6-2295(A)(5) is inconsistent with Mercury and Lockwood because those cases focus "exclusively on the activities of the taxpayers." (Appellant's Initial Br. at 21).

First, although the subjective intent of the customer may be relevant to the identification of the IPA, the ALC focused on the activities of DIRECTV. The ALC (and the Department) focused on DIRECTV's activities, not the activities of the customers. For example, the ALC determined that the IPA was DIRECTV's delivery of the signal into its customers' homes. Further, the ALC closely analyzed Dr. Cody's so-called value drivers and concluded that they consisted of pre-order and other preparatory activities, not IPAs.

The ALC specifically compared the activities of DIRECTV to the activities of the taxpayer in Lockwood and concluded that some of DIRECTV's activities were in fact

"preparatory" – similar to the taxpayer in Mercury - rather than IPA as required by § 12-6-2295(A)(5):

> Unlike the taxpayer in Lockwood Greene, a DIRECTV customer did not hire specific professionals and is not paying for those professionals' expertise and time, or that of any other DIRECTV employee or contractor. Instead, the customer is paying for video programming to be viewed on the customer's television at the time and place the customer demands. DIRECTV does not sell contract negotiations. It does not sell network management services. It does not sell broadcast infrastructure or satellite triangulation. Rather, DIRECTV is in the business of selling television broadcast subscriptions to customers; and without the actual delivery of that broadcast signal into South Carolina homes, it would not have generated the income at issue here. Indeed, as noted above, the national programming through the CONUS beams would exist regardless of whether there were any subscribers in South Carolina; therefore, such broadcasting is preparatory activity.

(R. p. 47; Amended Order p. 17). The ALC, in recognition of the applicable statute, considered the activities of DIRECTV to determine its IPA in South Carolina and concluded that DIRECTV's activity of delivering the signal into the homes and onto the television sets of DIRECTV's customers is the income-producing activity in South Carolina. (R. p. 51; Amended Order p. 21).

Regardless several examples show that the subjective intent of the customer is relevant to the IPA: (a) the Lockwood court referred to what the customer was paying for when determining the sourcing of Lockwood's gross receipts, Lockwood; (b) Dr. Cody recognized that the Lockwood court was "looking at what the customers of the engineering firm were actually paying for," (R. p. 180; Hr'g Tr. 228:18-20), (c) a Texas administrative court addressed what the customer was contracting for and paying to

receive in a similar case against a direct broadcast satellite provider, Anonymous Taxpayer v. Texas Comptroller of Public Accounts, 2013 WL 3490605 (Tex. Cptr. Pub. Acct), (May 17, 2013); and (d) Dr. Harrison testified that a customer wants the programming delivered in his home and that is what creates the value. (R. p. 225; Hr'g Tr. 406:14-18).

Second, the ALC did not interpret § 12-6-2295(A)(5) as imposing a "market-based sourcing" method, and it properly interpreted and applied the IPA language of § 12-6-2295(A)(5). In fact, the ALC made numerous statements throughout the order that demonstrate that it properly sought to identify, locate, and measure the IPAs pursuant to § 12-6-2295(A)(5) including:

> At the outset, the Court disagrees that DIRECTV has sufficiently identified its activities to be sourced. (R. p. 44; Amended Order p. 14).
>
> In sum, the payroll-and-assets method of Dr. Cody does not provide a reasonable approximation of the income-producing activities performed by DIRECTV in South Carolina . . . . (R. p. 47; Amended Order p. 17).
>
> For instance, it is possible that advertising performed within or without South Carolina could be considered income-producing activity. However, DIRECTV did not provide any evidence that reflected approximately how much of its advertising was directed at South Carolina and what impact such advertising had on revenue generated in South Carolina. (R. pp. 49-50; Amended Order pp. 19-20).

As Prof. Swain testified, the Department's interpretation of § 12-6-2295(A)(5) reaches a "market state result," but it does not impose a market-based sourcing method on all taxpayers. (R. pp. 241; Hr'g Tr. 469:18 (emphasis added)). Contrary to a market-based sourcing method, the Department's witnesses testified that the Department

examines the specific activities of each applicable service industry to determine where the taxpayer's income should be sourced. (R. pp. 201; 207; 209-210; Hr'g Tr. 310:21-311:3, 333:2-7, 341:19-343:1. 344:12-345:9).

Additionally, contrary to DIRECTV's assertion, under the ALC's holding and the Department's interpretation of "income-producing activity" in § 12-6-2295(A)(5), sourcing revenue to the location of the taxpayer's customer would not occur in every instance. For instance Mr. Donovan, an audit supervisor with the Department, testified that the Department would source the income received by an engineering firm to the place where the services were performed, i.e., the location of the engineering firm. (R. p. 201; Hr'g Tr. 311:4-10). Likewise, Mr. Swearingen – a longtime employee of the Department – testified that architects' and engineers' income is sourced to the state in which the engineer's or architect's services are performed. (R. p. 208; Hr'g Tr. 338:8-339:21). See also Lockwood, at 448-50, 361 S.E.d2d at 347-48 (stating that gross receipts from within the state for an engineering firm were sourced to the location where the services that generate the income are performed [i.e., at the office of the engineer]); Rent-A-Center Texas, L.P. v. S.C. Dep't of Rev., Final Order & Decision, 09-ALJ-17-0206-CC (C.J. Anderson, Jan. 6, 2012) (holding that the taxpayer performed and was paid only for management services performed by skilled professional in Texas, and accordingly, its revenue from management fees must be sourced to Texas pursuant to Lockwood).

Accordingly, the ALC did not err in determining the IPA under § 12-6-2295(A)(5) and did not interpret that section to require market-based sourcing.

III. THE ADMINISTRATIVE LAW COURT APPROPRIATELY CONSIDERED THE EVIDENCE IN THE RECORD ESTABLISHING THAT 100% OF APPELLANT'S INCOME-PRODUCING ACTIVITIES OCCURRED IN SOUTH CAROLINA

Based on substantial evidence and in accordance with the applicable statutes, the ALC properly determined that Appellant's IPA occurred entirely in South Carolina and that 100% of its subscription receipts from its South Carolina customers must be included in the numerator of the gross-receipts ratio. After performing a thorough analysis, the ALC found two main problems with DIRECTV's claim that some of its subscription receipts from South Carolina customers should be sourced to states other than South Carolina: (1) the ALC found that DIRECTV failed to sufficiently identify and prove that it had IPAs occurring outside of South Carolina, and (2) the ALC found that, "even if it had identified those activities, DIRECTV failed to sufficiently establish that those activities should be sourced elsewhere." (R. p. 44; Amended Order p. 14).

The ALC found sufficient evidence that DIRECTV's IPA related to its South Carolina subscription receipts occurred entirely within South Carolina; therefore, it affirmed the Department's determination that 100% of those subscription receipts should be sourced to South Carolina (i.e., included in the numerator of the gross-receipts ratio) pursuant to the first prong of § 12-6-2295(A)(5). (R. pp. 44-52; Amended Order pp. 14, 22). The ALC's determination of the IPA - DIRECTV's delivery of the signal into South Carolina homes - is entirely consistent with an analysis of IPA on a subscription-by-subscription basis, which is consistent with the previously mentioned Multistate Tax Commission's definition of IPA. The ALC's determination that all of the IPA for each South Carolina subscriber occurred in South Carolina is also consistent with the

evidence. For example, the ALC considered DIRECTV's reliance on Lockwood, but the ALC distinguished the activities of Lockwood, an engineering firm, from the activities of DIRECTV; considered many of DIRECTV's activities to be pre-order and other preparatory activities, not IPAs; and found Dr. Cody's approach to sourcing gross receipts to be "too nebulous." (R. pp. 43-50; Amended Order pp. 13-20). Finally, since DIRECTV's subscription receipts from South Carolina subscribers are a known amount, no costs-of performance methodology, no proxies, and no other estimates using costs are needed to measure how much of the IPA occurred in South Carolina.

DIRECTV's misunderstanding of the Lockwood decision has led it to erroneously assume that its IPAs are determined and located and that its gross receipts are sourced (i.e., measured) on a state-by-state basis using a costs-of-performance method under the second prong of § 12-6-2295(A)(5). DIRECTV's desire to measure how much of its IPA occurred in each state using costs-of-performance, proxies, or other cost elements is a red herring in this case because: (a) the IPA regarding the subscription receipts from South Carolina customers occurred entirely within South Carolina, (b) the actual subscription receipts received by DIRECTV from its South Carolina customers is the best, most accurate, and most transparent way to measure "the proportion of . . . business carried on within this State" by DIRECTV, see S.C. Code Ann. § 12-6-2210(B) (2014), and DIRECTV's "gross receipts from within this State," see § 12-6-2290 and (c) even if it could be used, costs-of-performance would be used only under the second prong of § 12-6-2295(A)(5), and that prong is not applicable in this case.

DIRECTV's position on how to determine and locate the IPA and how to measure the IPA in each applicable state is flawed in numerous ways. First, the General

Assembly excluded the phrase "based on costs of performance" when it enacted § 12-6-2295(A)(5), so DIRECTV improperly used the costs-of-performance methodology to exclude its subscription receipts from South Carolina from the numerator of the gross-receipts ratio on its amended 2006-2008 and its original 2009-2011 income tax returns. Second, DIRECTV misread and misapplied the decision in Lockwood, to mistakenly assume that the Court of Appeals in Lockwood stated that the so-called "place of activity" test should be applied to all service providers and that costs-of-performance was the mandated way to measure the extent of IPA in multiple states. Third, DIRECTV fails to acknowledge that the Lockwood court recognized the Department's longstanding policy of sourcing gross receipts on an industry-by-industry basis when it distinguished in its opinion the activities of finance companies and media broadcasters from the activities of engineering firms like Lockwood. See Lockwood, at 450, 361 S.E.2d at 348. Therefore, because DIRECTV's use of Lockwood to apply the "place of activity" test and cost of performance methodology to all service providers is incorrect, its tax position in this case is incorrect.

A. Costs-Of-Performance Is Not Required In South Carolina

DIRECTV misinterpreted and misapplied § 12-6-2295(A)(5) by using a costs-of-performance methodology to both determine and locate the IPAs and to measure how much IPA occurred in each applicable state.

First, unlike the sourcing statute in the 1950s model act, UDITPA, the General Assembly omitted the phrase "based on costs of performance" in the second prong of § 12-6-2295(A)(5). Even Professor Pomp, DIRECTV's tax policy expert, admitted that § 12-6-2295(A)(5) does not require costs-of-performance to be used to source gross

receipts. (R. p. 254; Hr'g Tr. 522:20-523:5). Accordingly, the ALC found that "[i]t is clear that South Carolina is not a UDITPA state, and it does not require apportionment of the net income of service providers based on costs-of-performance elements." (R. pp. 47-48; Amended Order pp. 17-18). The ALC also found that Dr. Cody's approach "unduly emphasizes what amounts to 'costs of performance.'" (R. p. 47; Amended Order p. 17).

Second, costs-of-performance is not needed in this case. After holding that the IPA is the delivery of the signal into the homes and onto the television sets of DIRECTV's customers and that all of the IPAs related to South Carolina customers occurred entirely in South Carolina, the ALC held under the first prong of § 12-6-2295(A)(5) that "100% of DIRECTV's subscription receipts from South Carolina customers must be in the numerator of the gross receipts ratio." (R. p. 51; Amended Order p. 22). Accordingly, there was no need to use the second prong of § 12-6-2295(A)(5) which is used when IPAs occur in more than one state and is the only prong under which a costs-of-performance method would even be considered.

Third, DIRECTV asserts that it is not using a costs-of-performance method, which is an incredulous statement. The crux of DIRECTV's case was that Lockwood imposed a cost of performance method on service providers when sourcing gross receipts to South Carolina. (Appellant's Initial Br. at 37). Further, the Department presented evidence and the Court noted in its decision that, when DIRECTV amended its South Carolina corporate income tax returns, it amended the returns to source gross receipts under a "cost of performance method" and that the cost of performance sourcing was "prescribed by statute." (R. pp. 35-36; Amended Order, 5-6).

Fourth, when appropriate, costs-of-performance is used only to measure the extent of the IPAs occurring in more than one state, It is not used to identify the IPA or to locate the states in which the IPA occurred. DIRECTV however improperly used costs-of-performance to not only measure the extent to which IPAs occurred in multiple states but also to identify the IPAs and determine in which states they occurred. For example, when asked what DIRECTV believes that the IPA is in this case and after he testified that a payroll factor was used in Lockwood, Bill Spina, DIRECTV's Rule 30(b)(6), SCRCP witness, testified, "Well, the formula in Lockwood and also potentially adding a property factor to that." (R. p. 218; Hr'g Tr. 378:4-379:9). Additionally, when asked by DIRECTV's counsel how he determined the IPA and then measured the IPA in various states, Dr. Cody, DIRECTV's expert economist, stated, "There are a number of measures that can be used to identify and then locate the income producing activities. A couple of very common factors or proxies are payroll and assets. . . . So I developed methodologies using those measures." (R. p. 181; Hr'g Tr. 229:11-21). Responding to how he determined the location of the IPAs, Dr. Cody continued, "I did two analyses. One analysis looked just at the location of payroll. So the payroll that's in South Carolina as a proxy for the income-generating activities that takes place in South Carolina versus payroll everywhere." (R. p. 181; Hr'g Tr. 229:25-230:5). Dr. Cody also took assets into account in determining the location of the IPAs. (R. p. 181; Hr'g Tr. 231:3-6). It therefore appears that DIRECTV improperly used costs-of-performance to identify, locate, and measure IPAs.

In conclusion, the ALC properly construed DIRECTV's sourcing methodology as a costs-of-performance methodology; however, even if permitted, costs-of-performance

was not necessary because the first prong of § 12-6-2295(A)(5) was applicable since all of the IPA occurred in South Carolina.

B. Lockwood Greene Engineers, Inc. v. S.C. Tax Comm'n, 293 S.C. 447, 449, 361 S.E.2d 346, 347 (Ct. App. 1987) Did Not Adopt Place Of Activity and Costs-of-Performance On All Service Providers

Contrary to DIRECTV's argument in this case, the Court of Appeals in Lockwood did not adopt one sourcing rule (i.e., the place of activity test) for all service providers and did not impose costs-of-performance as the means to source gross receipts for all service providers. Lockwood, at 449-50, 361 S.E.2d at 347-48. The ALC acknowledged that the "Court of Appeals did not accept the taxpayer's argument that § 12-7-1190 was a one-rule statute and that all net income to be apportioned under § 12-7-1190 must be apportioned under the same method." (R. p. 45; Amended Order p. 15).

In Lockwood, the Court of Appeals stated that the purpose of the applicable apportionment statute was to apportion net income "upon a base which reasonably represents the proportion of the trade or business carried on within this State." Id. at 448, 361 S.E.2d at 347. The Court of Appeals concluded that sourcing an engineering firm's revenues to the place where the services were performed met this purpose because the customer of an engineering firm is purchasing "the expertise and time" of an engineer and that such services were performed at the engineer's location. Id. at 449, 361 S.E.2d at 347. Unlike other service providers, an engineer renders that service that his customer is buying (i.e., giving his expertise and time to a specific customer) primarily in his office. In the instant case, DIRECTV provides its direct-to-home video service, which is what DIRECTV's customers are purchasing, in its customers' living rooms.

The applicable apportionment statute for apportioning net income from a taxpayer whose principal profits were derived from services at the time of Lockwood was § 12-7-1190 (1976), which is the predecessor statute to the current § 12-6-2290. In applying § 12-7-1190, the Department's audit division used, and the Lockwood court acknowledged, a set of written guidelines ("Guidelines"). Lockwood, at 450, 361 S.E.2d at 348. (R. pp. 520-529; Resp't Ex. 21). In these Guidelines, the Department listed eight industries and set forth how a taxpayer should source gross receipts to South Carolina in accordance with § 12-7-1190. Id.; (R. pp. 520-529; Resp't Ex. 21). The Guidelines did not impose one manner of sourcing gross receipts to South Carolina on all industries. Based on the Court of Appeals' analysis, those Department guidelines sourced gross receipts differently by industry. See id. at 448-49, 361 S.E.2d at 347. The Court of Appeals wrote:

> Lockwood refers to Tax Commission guidelines concerning computation of the gross receipts of finance companies and media broadcasters. We are not persuaded these businesses are comparable to Lockwood. By contrast, the Tax Commission guidelines concerning law firms, accounting firms, entertainment and sports companies, and hospital management companies all focus on whether the services are performed in South Carolina. These situations are analogous and consistent with the situation of Lockwood.

Id. at 450, 361 S.E.2d at 348. Accordingly, in 1987 the Court of Appeals recognized that the Department had sourcing guidelines and that such guidelines sourced gross receipts differently based on industry.

Based on the specifics of Lockwood's business, the Court of Appeals concluded, "[t]herefore, an engineering firm's business carried on in a state is reasonably measured by the services rendered by its personnel in the state," which "is epitomized by the 'place

of activity' test advanced by" the Department. Id. Again, it would not have been necessary for the Court of Appeals to address the specifics of Lockwood's business if § 12-7-1190 was a "one-rule statute."

Despite DIRECTV's contention, in no way did the Court of Appeals in Lockwood impose a "place of activity" test for apportioning service-related income in South Carolina on *all* multi-state service-providing taxpayers. The Court clearly supported the Department's use of different methods for different industries and did not reject Lockwood's "one-rule" argument only to replace it with a different one-rule requirement.

The ALC's analysis distinguishes DIRECTV from the taxpayer in Lockwood:

> Unlike the taxpayer in Lockwood Greene, a DIRECTV customer did not hire specific professionals and is not paying for those professionals' expertise and time, or that of any other DIRECTV employee or contractor. Instead, the customer is paying for video programing to be viewed on the customer's television at the time and place the customer demands. DIRECTV does not sell contract negotiations. It does not sell network management services. It does not sell broadcast infrastructure or satellite triangulation. Rather, DIRECTV is in the business of selling television broadcast subscriptions to customers; and without the actual delivery of that broadcast signal into South Carolina homes, it would not have generated the income at issue here. Indeed, as noted above, the national programming through the CONUS beams would exist regardless of whether there were any subscribers in South Carolina; therefore, such broadcasting is preparatory activity.

(R. pp. 47; 62; Amended Order, 17; Resp't Ex. 13 p. 5 (stating nearly identical language)).

As a result, it is clear from a plain reading of § 12-7-1190, the Guidelines, and Lockwood that neither the South Carolina statute nor the Department imposed one

method of determining whether gross receipts were from within South Carolina and sourced to South Carolina. In fact, it is apparent from the Guidelines and the Lockwood opinion that the Department used different methods when addressing different service industries based on the *activities* of the companies in each industry.

C. The Department's Longstanding Sourcing Policy For Service Providers Has Been Consistently Applied

The Department has had a longstanding policy to source gross receipts of business taxpayers other than manufacturers and dealers in tangible personal property to the numerator of the gross-receipts ratio on an industry-by-industry basis after reviewing the activities of the respective industry. Under this longstanding policy gross receipts of personal service firms like an engineering firm are sourced to the state in which the personal services were performed while gross receipts of firms such as finance companies and media broadcasters are sourced differently. Lockwood, at 449-50, 361 S.E.2d at 347-48. (R. pp. 520-529; Resp't Ex. 21).

The Department's analysis and audits subsequent to Lockwood support the fact that (1) the Department continued to apply its longstanding policy of sourcing gross receipts on an industry-by-industry basis by analyzing the activity of each industry[11], (2) Department never interpreted Lockwood as mandating the "place of activity" test (or a cost-of-performance method) for apportioning net income of all service providers, and (3) the Department never interpreted any statutory changes after Lockwood to make the

[11]In 1995 the General Assembly replaced § 12-7-1190 with § 12-6-2290. A review of the text of these statutes reveals that § 12-6-2290 closely parallels former § 12-7-1190. Consequently, the Department's existing guidelines and analysis concerning the apportionment of net income and sourcing of gross receipts of service providers, as examined, reviewed, and upheld in Lockwood, remained in place.

substantive change of requiring a the place of activity test and cost-of-performance on all taxpayers whose income is apportioned using the gross-receipts ratio. (R. pp. 201-202; 208; 210; Hr'g Tr. 310:10-313:8; 338:8-17; 339:15-21; 346:21-347:5).

The 2007 enactment of § 12-6-2295(A)(5) and § 12-6-2290's reference to it also did not change the Department's longstanding sourcing policy under § 12-6-2290. First, the Department's auditors were already examining the activities of taxpayers and assessing the extent to which gross receipts should be sourced to South Carolina. Second, § 12-6-2295 certainly did not adopt the "place of activity" test (as was applied to Lockwood) for all taxpayers. If the General Assembly had intended to adopt the Lockwood "place of activity" test for all taxpayers, it would certainly have used phrases like "place of activity" or "where the service was rendered" rather than using the phrase "income-producing activity."

Third, the applicable statute that addresses how to apportion net income from services is found in the first sentence of § 12-6-2290 (added in 1995). This is the provision that continued the legislative mandate to use a "gross receipts" ratio to apportion net income from services. This mandate has not changed, and South Carolina law still requires (and has since 1958) that net income from services be apportioned based on a gross-receipts ratio. Even the statutory use of the term "gross receipts" strongly implies an emphasis on *sales* rather than on *costs*.

In conclusion, the Department has had, and consistently applied, its longstanding sourcing policy of sourcing gross receipts on an industry-by-industry basis since at least 1976, and this Court should give deference to the Department's consistent application of its sourcing policy in this case. Where the construction or administrative interpretation of

a statute has been applied for a number of years and has not been changed by the General Assembly, there is created a strong presumption that such interpretation or construction is correct. Ryder Truck Lines, Inc. v. S.C. Tax Comm'n, 248 S.C. 148, 149, S.E.2d 435 (1966); Etiwan Fertilizer Cp. V. S.C. Tax Comm'n, 217 S.C. 354, 60 S.E.2d 682 (1950). Additionally, "the construction of a statute by the agency charged with executing it is entitled to the most respectful consideration and should not be overruled without cogent reasons." Faile v. S.C. Employment Sec. Comm'n, 267 S.C. 536, 540, 230 S.E.2d 219, 221-222 (1976); Stephenson Finance Co. v. S.C. Tax Comm'n, 242 S.C. 98, 130 S.E.2d 72 (1963).

D. Other Jurisdictions

DIRECTV argues that its activities occurring outside of South Carolina generate the income in this matter. While § 12-6-2295(A)(5) does not include a definition of "income-producing activity," ample authority exists to support the ALC's and the Department's interpretation of IPA in this case. Further, courts throughout the country have found that many important activities of a taxpayer are not necessarily IPAs.

A review of applicable South Carolina case law, as well as similar cases in other jurisdictions, illustrate that the "income-producing activity" language of § 12-6-2295(A)(5) requires the sourcing of gross receipts to a state in which the taxpayer did not incur significant costs, and courts have made this determination even when the state's sourcing law includes costs-of-performance.

In Anonymous Taxpayer v. Texas Comptroller of Public Accounts, 2013 WL 3490605 (Tex. Cptr. Pub. Acct). (May 17, 2013), a Texas administrative court also determined that the IPA of a direct broadcast service provider occurred in the

subscriber's home. The Texas Administrative Law Judge characterized the IPA for a direct broadcast satellite service provider as follows:

> The act Petitioner's customer contracts and pays to receive and the act that produces the receipts at issue, is the act performed by the receiver (i.e., the set top box) that Petitioner sells or leases to its subscribers. Petitioner's customers contract for the receipt of television programming. Petitioner contracts to provide the programming, and it is the microchips within the receiver that unscramble and decode the satellite's encrypted signal that completes the transaction and produces the programming receipt.

Id. Because this IPA occurred within the receiver in the customer's home or business, the Texas ALJ concluded that the taxpayer's programming receipts at issue should be sourced to Texas. Id. at *10-11.

Importantly there is no requirement that the IPA of a taxpayer occur in the state where the taxpayer incurs its costs. Even in states that have adopted the costs-of-performance language within the applicable statutes or regulations, gross receipts are often not sourced to the state(s) in which the taxpayer incurred its costs.

In Ameritech Publishing, Incorporated v. Wisconsin Department of Revenue, 327 Wis.2d 798, 788 N.W.2d 383 (Ct. App. 2010) (unpublished), 2010 WL 2519583, the Wisconsin Court of Appeals affirmed the taxing authority's determination that the IPA of a company that received advertising revenue by placing the advertisements in telephone directories that it distributed in Wisconsin "was performed in Wisconsin when the advertisement reached its intended, Wisconsin audience." Id. at 2010 WL 2519583, 5. Although the vast majority of the taxpayer's costs to gather the advertising and to publish the telephone directory were incurred outside of Wisconsin, and (unlike the South

Carolina statute) the applicable Wisconsin statute *included* the phrase "costs of performance," the court held that the entire income-producing activity was within Wisconsin although the majority of the costs were incurred in other states and the applicable sourcing statute in Wisconsin included "costs of performance." Id. at 9-10.

Similarly, in Walter E. Heller Western, Inc. v. Arizona Dep't of Revenue, 161Ariz. 49, 51, 53, 775 P.2d 1113, 1115, 1117 (1989), the Arizona Supreme Court also determined that the IPA occurred in Arizona, despite the fact that the California-based commercial financing company that received income from loans it made to Arizona borrowers incurred much of its costs in California. Walter E. Heller, at 51, 53, 775 P.2d at 1115, 1117. Like Ameritech above, the applicable Arizona statute *actually used* the phrase "costs-of-performance," giving the taxpayer's cost-of-performance argument more merit but not enough to convince the Court. The Arizona Supreme Court held, "[t]hough borrowing of funds [in California] may be an important step in Heller Western's financing process, the direct generation of the loans occurred in Arizona. We conclude that Heller Western's sales activity in Arizona constituted the IPA contemplated by our tax regulations." Walter E. Heller at 53, 775 P.2d at 1117.

The Florida Department of Revenue recently issued two Technical Assistance Advisement ("TAA") memoranda in which the IPA was determined to be located in Florida, although the taxpayers incurred significant costs outside of Florida. As in other cases cited herein, the Florida Department of Revenue made these determinations

although the applicable sourcing statute included both "income producing activity" and "based on costs of performance" language.[12]

Finally, the Indiana Department of Revenue issued a decision on January 29, 2015, affirming the auditor's determination that the tuition fees received by an out-of-state educational services company that provided online educational services to Indiana students should be sourced entirely to Indiana because the IPA occurred in Indiana: "the Taxpayer's services were rendered here in Indiana because Indiana is the location where the students purchased the taxpayer's services." Indiana Department of Revenue, Letter of Findings: 02-20140455, at 8 (Jan. 29, 2015) (stating that Taxpayer does not earn money because its Indiana online students pay Taxpayer to incur out-of-state expenses or conduct out-of-state research or development activities on those students' behalf. Taxpayer earns money because it prepares online educational services and then sells those services to Indiana customers within their home state).

The applicable Indiana statute also *included* the phrase "costs of performance," and Indiana concluded that the taxpayer's IPA "consists of the individual transactions that it engaged in with Indiana residents when the residents purchased educational services from Taxpayer, and it is these receipts and only these receipts that are subject to the corporate income tax." Id. at 8.

Based on the foregoing highly illustrative cases and analyses, the ALC correctly determined that DIRECTV's IPA occurred in the homes and businesses of South

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[12]See TAA 12C1-006, Fla. Dep't of Revenue, May 17, 2012, available at https://revenuelaw.state.fl.us/LawLibrarydocuments/2012/05/TAA-111027_12C1-006.pdf; TAA 13C1-011, Fla. Dep't of Revenue, Nov. 21, 2013, available at https://revenuelaw.state.fl.us/LawLibraryDocuments/2013/11/TAA-117960_13C1-011%20RLL.pdf.

Carolina customers, that significant authority, and the Department's longstanding policies support this view. Consequently, it is proper to source 100% of the subscription receipts from every South Carolina customer to the numerator of the gross receipts ratio because 100% of the income-producing activity for DIRECTV's transactions with South Carolina customers occurred in South Carolina homes and business. Additionally, the Department's application of its long-standing policy to source gross receipts on an industry by industry basis should be given great deference.

IV. THE ADMINISTRATIVE LAW COURT PROPERLY FOUND THAT THE IMPOSITION OF SUBSTANTIAL UNDERSTATEMENT PENALTIES WAS APPROPRIATE

The ALC's finding that the imposition of substantial understatement penalties was proper is clearly supported by the substantial evidence in the record.[13]

"If there is an underpayment attributable to . . . a substantial understatement of tax for a taxable period . . . there **must** be added to the tax an amount equal to twenty-five percent of the amount of the underpayment." S.C. Code Ann. § 12-54-155(A)(1) (2014) (emphasis added). For purposes of this subsection, "understatement" means the excess of the amount of the tax required to be shown on the return for the taxable period over the amount of the tax imposed which is shown on the return. Section 12-54-155(B)(2)(a).

Further, § 12-54-155 provides for the following:

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[13]In the Initial Order, the ALC ordered that DIRECTV be assessed $1,661,541.00 in penalties – the original assessment of penalties as stated in the Department Determination. (R. pp. 21; 58; Initial Order, p. 21; Resp't Ex. 13 p.1). However, in the Amended Order, the ALC ordered that DIRECTV's penalty assessment be reduced by 25%; thus, the ALC ordered that DIRECTV be assessed $1,246,155.75 in penalties. (R. pp. 51-52; Amended Order, pp. 21-22). The Department respectfully requests this Court to affirm the ALC's determination that DIRECTV be assessed $1,246,155.75 in penalties as outlined in the Amended Order. Id.

> The amount of the understatement . . . must be reduced by that portion of the understatement which is attributable to the tax treatment of an item: (i) by the taxpayer if there is or was substantial authority for that treatment, or (ii) with respect to which the relevant facts affecting the item's tax treatment are adequately disclosed in the return or in a statement attached to the return and there is a reasonable basis for the tax treatment of the item by the taxpayer.

Moreover, "[a] penalty must not be imposed pursuant to this section with respect to a portion of an underpayment if it is shown that there was a reasonable cause for the portion **and** that the taxpayer acted in good faith with respect to the portion." Section 12-54-155(D)(1) (emphasis added).

The ALC properly found that the Department correctly calculated the amount of the understatement of taxes for 2009-2011 and found "no substantial authority for DIRECTV's treatment of subscription receipts" and that DIRECTV's treatment of the subscription receipts was unreasonable. (R. p. 51; Amended Order p. 21). The ALC further found that the Department was correct to apply a substantial understatement penalty for understatement of taxes owned for 2009-2011 because "DIRECTV did not have '**reasonable** cause' . . . for the unpaid taxes, i.e., DIRECTV'S method of calculating subscription receipts was unreasonable." (R. p. 51; Amended Order p. 21).

The ALC properly held that the substantial underpayment penalty was appropriate and the following supports the ALC's holding. First, DIRECTV did not have substantial authority for how it sourced its South Carolina-based subscription receipts. It erroneously relied upon Lockwood and Mercury to support its treatment of subscription revenue even though it correctly sourced its 2006-2008 South Carolina-based subscription receipts to South Carolina on its original returns for those years.

The Lockwood decision does not explicitly or implicitly direct taxpayers such as DIRECTV to file its corporate tax returns based on a cost of performance method. As noted above, this Court recognized in Lockwood that the Department sourced revenues of service providers such as engineering, law, and accounting firms to the place of activity, while sourcing income from other service industries, such as finance companies and media broadcasters, to the location of the borrower and the advertisers, respectively. The ALC found that DIRECTV is not like the taxpayer in Lockwood finding that DIRECTV's customers do not hire specific professionals and are not paying for those professionals' expertise and time. Rather, "the customer is paying for video programming to be viewed on the customer's television at the time and place the customer demands." (R. p. 47; Amended Order p. 17). Next, DIRECTV asserts that the decision in Mercury supports the position taken with respect to its tax returns at issue. Specifically, DIRECTV argues that Mercury "rejected a narrow view of income-producing activities . . . that would have considered only isolated 'end-point' activities.'" (Appellant's Initial Br., p. 40). The court in Mercury actually did the opposite by narrowing the IPA to "the hauling of freight 'through and over the highways of the State of South Carolina.'" (R. p. 42; Amended Order p. 12). As the ALC properly recognized, the facts in this case "are akin" to the transactions discussed in Mercury, and that "DIRECTV failed to sufficiently identify its outside income-producing activities." (R. p. 43-44; Amended Order, p. 12-13). Accordingly, from the plain reading of Mercury, DIRECTV's reliance upon a taxpayer's total business activities to justify sourcing South Carolina-based subscription receipts to other states is not proper.

Finally, DIRECTV did not act in good faith to comply with §§ 12-6-2290 and 12-

6-2295(A)(5). Initially, for 2006-2008 DIRECTV sourced 100% of the subscription revenue received from South Carolina customers to the numerator of the gross receipts ratio. (R. pp. 369; 417; 438; Resp't Ex. 1, 4, and 6). DIRECTV subsequently changed its position, and on its amended 2006-2008 returns as well as its original 2009 and 2010 returns, DIRECTV did not include any of the subscription receipts from South Carolina customers in the numerator of the gross receipts ratio, (R. pp. 396-414; 423-431; 441-450; 451-469; Resp't Ex. 3, 5, 7, 8, and 9), although Dr. Cody's testified that DIRECTV had both payroll and property in South Carolina, (R. p. 181-185; Hr'g Tr. 229:7-245:22). Further, because South Carolina is not a cost of performance state, DIRECTV also did not act in good faith in 2011 when it used a payroll factor to source a small amount of subscription receipts to South Carolina.

Based on the above and because the statute says that a substantial understatement penalty "must be added," DIRECTV must be assessed the substantial understatement penalties as there is no substantial authority for its position and it did not act in good faith.

CONCLUSION

As explained more fully above, this Court should affirm the ALC's decision as the decision is supported by substantial evidence in the record and the ALC did not make any errors of law.

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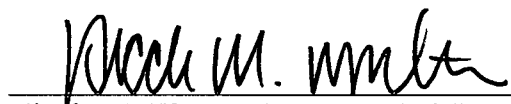
Respectfully Submitted,



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March 8, 2016
Columbia, South Carolina

THE STATE OF SOUTH CAROLINA
In The Court Of Appeals

APPEAL FROM THE ADMINISTRATIVE LAW COURT

Honorable Ralph King Anderson, III, Chief Administrative Law Judge

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Appellant Case No. 2015-001509

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

CERTIFICATE OF COUNSEL

The undersigned certifies that the foregoing Final Brief complies with Rule 211(b), SCACR

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Columbia, South Carolina
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PROOF OF SERVICE

I, Jean M. O'Connor, hereby certify that I have caused to be mailed a copy of the South Carolina Department of Revenue's Final Brief regarding the above-referenced case by depositing the same in the United States Mail, postage prepaid, to John. C. von Lehe, Jr., Esquire and Bryson M. Geer, Esquire, Nelson Mullins, PO Box 1806, Charleston, SC 29402 this 8th day of March 2016.

Jean M. O'Connor