EXHIBIT A

AMENDED FINAL ORDER

STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT

Dish DBS Corporation, f/k/a/ EchoStar, DBS Corp., and Affiliates, Petitioner, v. South Carolina Department of Revenue, Respondent.	Docket No.: 14-ALJ-17-0285-CC **AMENDED FINAL ORDER**[1]

APPEARANCES: Petitioner: Burnet R. Maybank, III, Esquire
Jim Rourke, Esquire

Respondent: Nicole M. Wooten, Esquire
William J. Condon, Esquire

STATEMENT OF THE CASE

This matter is before the South Carolina Administrative Law Court ("the ALC" or "the Court") pursuant to a Request for a Contested Case Hearing filed by Dish DBS Corporation, f/k/a EchoStar DBS Corp., and Affiliates ("Petitioner") challenging the South Carolina Department of Revenue's ("Respondent's" or "the Department's") final determination, in which the Department assessed Petitioner taxes, interest, and understatement penalties following an audit for tax years 2004-2010.[2] In its determination, the Department assessed Petitioner $544,286.00 in income taxes, $399,496.00 in related interest, and $276,307.00 in related penalties for tax years 2004-2010. It also assessed Petitioner $90,551.00 in license fee taxes, $32,196.00 in related interest, and $21,846.00 in related penalties for tax years 2006-2011. The Department assessed Petitioner a total of $1,364,682.00 in taxes, interest, and related penalties. In this case, Petitioner contests: (1) the apportionment method the Department used to determine the amount of income tax owed by Petitioner for tax years 2004-2010; (2) the Department's assessment of additional taxes,

[1] This order is amended for clarification of issues raised in Petitioner's Motion for Reconsideration, filed May 31, 2016. Specifically, the Court seeks to dispel any impression that the "audience," or "market share," method was applied in this case.

[2] The Department auditor testified tax year 2004 was included "exclusively for the purpose of auditing [Petitioner's South Carolina net operating loss] that was carried forward" to the following year, 2005. The Department determined Petitioner had a "substantial understatement" for tax year 2004, but did not include the 2004 assessment because the statute of limitations had expired. Additionally, the tax years noted relate to income tax years. Income taxes are generally due in arrears, while license fees are due in advance. For example, when tax year 2008 is referred to, reference is being made to income taxes for 2008 and license fees due for 2009.

interest, and civil penalties for tax years 2004-2010; and (3) the Department's assessment of license fees, interest, and related penalties for tax years 2006-2011.

The Department issued its final determination on May 13, 2014. Petitioner timely appealed to this Court on June 12, 2014. Subsequently, the parties filed cross motions for summary judgment, which this Court denied in an order dated February 10, 2015. Thereafter, on September 23-25, 2015, this Court held a hearing on the merits of the case.

ISSUE

Did the Department Correctly Assess and Calculate Petitioner's Income Tax Liability Following its Audit of Petitioner for Tax Years 2004-2010?

FINDINGS OF FACT

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

Petitioner's Business Operations

Petitioner is a multistate taxpayer organized under the laws of the State of Nevada with principal executive offices located in Englewood, Colorado. Petitioner provides direct broadcast satellite video services across the United States, including in South Carolina. These services are provided through the transmission of digital signals (programming) from several satellites to receiver boxes ("set-top boxes") located in subscribers' homes. Subscribers pay Petitioner a monthly subscription fee for access to this programming, which Petitioner purchases from vendors. Subscribers also pay Petitioner to lease a small satellite dish, a set-top box, and remote control(s).

Englewood, Colorado is the primary location for Petitioner's business functions. It is the location of Petitioner's corporate headquarters, legal department, accounting department, product development department, and advertising department. In addition, all programming contracts and licensing agreements are executed in Englewood.

Petitioner has approximately 14.057 million subscribers nationwide, and employs approximately 22,000 domestic employees. Approximately 227,000 of Petitioner's subscribers are located in South Carolina, which represents about 1.6% of Petitioner's total subscribers. Petitioner also maintains an infrastructure to support its services. This infrastructure includes uplink centers, broadcast centers, customer call centers, service and remanufacturing centers, and warehouses. One of Petitioner's two service and remanufacturing centers is located in

Spartanburg, South Carolina. Petitioner has no other principal properties located in South Carolina.

The distribution of Petitioner's satellite programming is comprised of five main elements: (1) the programming source; (2) the uplink center; (3) the satellite; (4) the receiving dish; and (5) the in-home receiver/set-top box. Petitioner does not create original programming, rather, Petitioner licenses the vast majority of its programming from vendors, like ESPN, who distribute their programming to purchasers through satellite, fiber-optic cable, or over-the-air broadcast. In addition, Petitioner purchases and collects programming from local broadcast television stations using local receiver facilities. Programming content is collected at the uplink centers.

Petitioner's witness, Rex Povenmire, a former Project Manager for Petitioner, spoke extensively about the costs of obtaining programming. According to Povenmire's estimation, Petitioner's contract to televise ESPN costs around $725 million annually. Povenmire also testified that local programming in South Carolina is collected and sent to an uplink center in Texas, for example, where it is then processed before it is distributed. Incoming programming is processed at uplink centers to assure quality (e.g., amplifying the signal), to protect copyrights (e.g., by encrypting the data),[3] to insert content (e.g., public service announcements), and to put the signal into a form that can be transmitted from the uplink centers to satellites orbiting the Earth. After the programming is transmitted to the satellites, the satellites transmit the signal to small satellite dishes mounted on or near subscribers' homes. The small satellite dishes then relay the signal to subscribers' set-top boxes, which un-encrypt the signal and deliver the programming to the subscriber's television for viewing. Petitioner uses two types of satellites: Continental United States "CONUS" satellites and spot beam satellites. Povenmire testified to the hundreds of millions of dollars Petitioner spends to purchase/lease, launch, or otherwise operate and use the satellites. Petitioner owned or leased thirteen satellites during the tax years in question.

Attracting Subscribers and Contracting for Service

To attract subscribers and retain existing subscribers, Petitioner engages in advertising. For example, Petitioner expended $17 million in 2010 on retention marketing and $309 million on subscriber acquisition marketing. Petitioner utilizes direct mail, radio, media, and contracts with national firms to conduct its advertising activities.

[3] Povenmire indicated Petitioner spends a lot of time, effort, and money on anti-fraud devices to protect its signal.

Once a person decides to become a subscriber, he or she must execute a contract for service, which provides that Petitioner will install or provide a small satellite dish, a set-top box, and remote control(s) at the subscriber's home to allow Petitioner to deliver its signal into the subscriber's home. During the years at issue, a subscriber could not contract for services online. Rather, a subscriber had to call a vendor (who calls one of Petitioner's eleven call centers) or call one of Petitioner's call centers directly.

When a call center is contacted for service, a call center representative determines what service packages are available based on the subscriber's location. After the subscriber selects a service package, the subscriber pays for the service package with a credit card. The representative then sets up a time for installation, during which the installer activates the set-top box and trains the subscriber on how to use the system. Call centers are responsible for billing, customer complaints, inquiries, and promotion of optional plans and services.

Petitioner's Revenue

Subscribers pay a monthly subscription fee for Petitioner's service. This monthly subscription fee from its approximately fourteen million subscribers is Petitioner's primary source of revenue. However, Petitioner's total revenue from customers includes revenue from the following: (1) monthly fees for subscribing to one or more programming packages (including pay-per-view programming); (2) the sale or lease of the set-top boxes; (3) the sale of an optional warranty on the leased boxes; and (4) fees associated with high definition set-top boxes, set-top boxes with DVR, multi-room viewing charges, and in-home services (installation of TVs, surround sound, etc.). The parties do not dispute that all income associated with the set-top boxes (installation, rental, repair and/or warranty) that Petitioner receives from South Carolina subscribers should be sourced to South Carolina for apportionment purposes. However, the parties dispute whether all monthly subscription fees from South Carolina purchasers should be sourced to South Carolina.

Petitioner's Tax Returns

For the tax years at issue, Petitioner filed original and amended tax returns in South Carolina using inconsistent methods to calculate its corporate income tax liability in South Carolina: sometimes Petitioner used versions of the gross receipts ratio and sometimes Petitioner

used the four factor method.[4] The Department used the gross receipts ratio during the tax years in question. When Petitioner filed using the gross receipts ratio, it only sourced a portion of its income from South Carolina subscription receipts to the numerator of the ratio instead of 100% of its South Carolina subscription receipts.[5] Using the four factor method and the gross receipts ratio, Petitioner calculated ratios of 0.2384%,[6] 0.2086%, 0.1258%, 0.2400%, 0.3086%, and 0.2717% for years 2005 through 2010, respectively.

In contrast, during its audit, the Department assessed Petitioner for income taxes and license fees for 2005 through 2010 using a gross receipts ratio that sourced 100% of Petitioner's South Carolina subscription receipts to the numerator of the ratio. The Department's method resulted in gross receipts ratios of 1.3467%, 1.3563%, 1.4537%, 1.4075%, 1.4982%, and 1.6144% for years 2005 through 2010, respectively. In its Report of Field Audit dated June 29, 2012, the Department noted:

> The auditor feels the taxpayer's predominant business is selling access to cable programing (intangible property) via subscriber fees which are required before the cable programing can be accessed and 100% of SC subscriber receipts should be sourced to SC.

Later, in its Department Determination issued May 13, 2014, the Department sourced 100% of Petitioner's South Carolina subscription receipts to the numerator, asserting the Petitioner's South Carolina subscription receipts represent its income-producing activity in South Carolina pursuant to the applicable statutes defining the gross receipts ratio. Discussing Petitioner's income-producing activity, the Department found:

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[4] Methods of apportioning income to a state for tax purposes are based in part on the type of business operated by the taxpayer. The "gross receipts," or "single factor," method is used in South Carolina for service companies or other businesses not dealing in tangible property, or as otherwise provided for by law. See S.C. Code Ann. § 12-6-2290 (2014). The "gross receipts ratio" represents a single fraction used for multistate taxpayers "in which the numerator is [the taxpayer's] gross receipts from within this State during the taxable year and the denominator is total gross receipts from everywhere during the taxable year." Id. The four factor method consists of similar fractions based on a property factor, a payroll factor, and a doubled sales factor. The four factor method is a variation on the three factor method previously used in South Carolina for businesses dealing in tangible property. See S.C. Revenue Ruling #09-15. Petitioner used the four factor method in filing its 2005 return. Petitioner also filed using the four factor method in 2008, but amended its return to use the gross receipts method.

[5] The president of Petitioner's Tax Division, Matthew Shears, testified 100% of South Carolina set-top rentals and set-top repairs were sourced to South Carolina in the numerator. The parties agree as to the allocation of this income. The issue raised by this case is how to correctly apportion income to the numerator, i.e., whether 100% of the subscription receipts from South Carolina should be sourced to South Carolina in the numerator of the gross receipts ratio.

[6] This ratio was derived from the four factor method. See Petitioner's Exhibit #1.

> It is ***the final act***, the culmination of those enumerated activities[7]—the delivery of the signal into the homes and onto the television screens of its customers—that produces income for [Petitioner]. [Petitioner] does not sell contract negotiations. It does not sell network management services. It does not sell broadcast infrastructure or satellite triangulation. [Petitioner] 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. It is that act alone for which South Carolina customers sign contracts and pay their monthly fees.

The Department's determination appears, at least in part, to rely on the audience method[8] to determine how to source Petitioner's income. For example, the Department maintains it sources gross receipts related to cable companies and telephone companies to the location of the sale, as it similarly did with Petitioner.

According to the Department's Corporate Income Tax policy manual published in 2005,

> South Carolina is not a "cost of performance state;" *i.e.*, a state where receipts are always sourced to the state where the costs to produce the receipts are incurred. It is also not a "market state;" *i.e.* a state where receipts are always sourced to the state where the item or service is consumed or the location of the payer.

Rick Handel, Deana West & William West, South Carolina Department of Revenue Policy: South Carolina Corporate Income Taxes 17 (2005) (hereinafter "2005 Policy"). In support of its theory, the Department introduced the testimony of John Swain, a law professor specializing in state and local taxation, whom the Court qualified as an expert in Tax Policy and Multi-state Apportionment. Professor Swain testified he is one of the authors of the "Hellerstein & Hellerstein" treatise on state taxation,[9] and opined the treatise does not state South Carolina is a strict costs of performance state, nor does the treatise definitively state South Carolina is a pro rata costs of performance state.[10]

Professor Swain discussed the Department's method of income sourcing/apportionment in this case and described the Department's method as good tax policy for three specific reasons.

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[7] The "enumerated activities" refer to the activities Petitioner alleged were its income-producing activities, including: selecting, negotiating, and acquiring programming; managing and servicing its subscriber network; managing its broadcast infrastructure; and receiving programming content.

[8] The audience, or market share, method is based upon the origin of payment (the location of the customer).

[9] Walter Hellerstein & John A. Swain, State Taxation (3d ed. 2016) (hereinafter "Hellerstein Treatise").

[10] Professor Swain testified he did not author the particular section of the treatise on multi-state apportionment, but he is familiar with it and the author, Hellerstein.

First, he stated section 12-6-2290 of the South Carolina Code mandates the use of a gross receipts ratio, and commonly the purpose of a gross receipts ratio is to "reflect the contribution of the market state" (in this case, South Carolina) to Petitioner's income production, even though Petitioner is not principally located in South Carolina. Second, he noted the General Assembly's adoption of statutes mandating the use of a sales/gross receipts apportionment ratio reflects the nationwide movement to a "single-sales factor apportionment," which allows states to compete with other states in an age when "capital and labor are mobile." Third, he explained the Department's approach promotes equity by attempting to treat like taxpayers in a like manner, unlike Petitioner's approach, which would result in similar businesses in comparable industries being treated differently.[11] Professor Swain contrasted the Department's policy, which he described as easily applied, with UDIPTA's costs of performance method, which he described as leading to uncertainty for both taxpayers and the Department because the costs of performance method is "[c]onfusing and indefinite and plagued by vagueness, ambiguity, substantial debate, lack of clear guidance, whipsawing,[12] tremendous flexibility, and hence tax planning opportunities, [and] frequent litigation." See Hellerstein Treatise at ¶ 9.18, 51 (quoting J. Swain, Reforming the State Corporate Income Tax: A Market State Approach to the Sourcing of Receipts, 83 Tel. L. Rev. 285, 306 (2008)). Finally, Professor Swain stated the Department's method of sourcing, in addition to being good tax policy, is consistent with authority in other jurisdictions, including jurisdictions that have cost of performance statutes.

The Department's Historic Tax Policy

Historically, however, the Department has relied on Lockwood Greene Engineers, Inc. v. South Carolina Tax Commission, 293 S.C. 447, 361 S.E.2d 346 (1987), in apportioning income based upon the location of the activity that generated the income without utilizing an audience approach. See, e.g. S.C. Private Letter Ruling #13-3. In fact, the Department has a long-standing policy of examining the specific activities of each applicable industry to determine what activities are income-producing prior to determining how gross receipts are sourced. See Lockwood Greene,

[11] For example, at the hearing, the Department explained that for cable broadcast companies, like Time Warner Cable, and telephone companies it sources gross receipts from South Carolina subscription revenue. However, Petitioner requests its income be sourced differently although it competes with Time Warner Cable in the same industry and has a similar, but not exactly the same business model.

[12] Professor Swain described "whipsawing" as when "[y]ou can have very similar businesses, but when you have a difference in the rule, the treatment of those [businesses] can turn on slight differences in the[ir business] model[s] when they're substantially in the same business and competitors."

293 S.C. at 450, 361 S.E.2d at 348 (noting the Tax Commission's guidelines for different type of businesses focusing on "whether the services are performed in South Carolina"). For example, when the Department sources the taxable income of an engineering firm, it looks to the actual engineering services performed as constituting the income-producing activity generating the gross receipts. See S.C. Private Letter Ruling #13-3. In addition, the 2005 Policy manual provides the following comment discussing the two leading tax cases in South Carolina addressing gross receipts and apportionment:

> Considering Lockwood Greene and Geoffrey,[13] together, it appears that gross receipts are sourced to the state which is most significantly associated with the production of the income; *e.g.*, personal services, where those services are performed; intangibles, where those intangibles are used in a business for the production of income. This conclusion is consistent with the longstanding administrative policy of the department, which was referenced in the Lockwood Greene case, that the gross receipts of loans from finance companies are sourced to the location of the companies' customers.

2005 Policy at 20.

The Department also introduced evidence of minutes from a Department meeting held on August 24, 1977, in which the Department reviewed a proposed regulation describing the gross receipts ratio. This proposed regulation provided that a taxpayer rendering "personal services . . . shall include in the numerator and denominator of the gross receipts ratio the amount charged for services performed within this State" and the denominator shall include the total charged for services without the state. According to handwritten notes on the minutes, instead of approving the regulation, the Department adopted it as a "rule of construction." Id. John Swearingen, a Department employee at the time this rule of construction was adopted, testified the rule has been followed ever since for businesses engaged in personal services, such as engineering firms.

CONCLUSIONS OF LAW

Standard of Review

This Court has jurisdiction to hear this contested case pursuant to section 1-23-600(A) of the South Carolina Code (Supp. 2015) and section 12-60-460 of the South Carolina Code (2014). The Court hears contested cases *de novo*. Hill v. S.C. Dep't of Health & Envtl. Control, 389 S.C. 1, 9, 698 S.E.2d 612, 616 (2010) ("The proceeding before the ALJ was a de novo hearing, which

[13] Geoffrey, Inc. v. S.C. Tax Comm'n, 313 S.C. 15, 437 S.E.2d 13 (1993).

included the presentation of evidence and testimony."). The Court makes its factual findings based upon a preponderance of the evidence. See S.C. Code Ann. § 1-23-600(A)(5) (Supp. 2015). Generally, the party asserting the affirmative issue in an adjudicatory administrative proceeding has the burden of proof. See Leventis v. S.C. Dep't of Health & Envtl. Control, 340 S.C. 118, 133, 530 S.E.2d 643, 651 (Ct. App. 2000) (citing 2 Am.Jur.2d *Administrative Law* § 360 (1994)). Here, Petitioner requested a contested case hearing and, therefore, has the burden of proof to show by a preponderance of the evidence that the Department's tax assessment is incorrect. See id.; Anonymous (M-156-90) v. State Bd. of Med. Examiners, 329 S.C. 371, 375, 496 S.E.2d 17, 19 (1998) (holding the standard of proof in "administrative hearings is generally a preponderance of the evidence"). Although a tax assessment is initially presumed correct, if a taxpayer establishes an assessment is incorrect, either by proving the actual valuation or through other evidence establishing that the assessment is incorrect, the presumption of correctness is removed and the taxpayer is entitled to appropriate relief. Cloyd v. Mabry, 295 S.C. 86, 88-89, 367 S.E.2d 171, 173 (Ct. App. 1988).

South Carolina Corporate Income Tax Generally

In South Carolina, corporate income tax "is imposed annually at the rate of five percent on the South Carolina taxable income of every corporation . . . transacting, conducting, or doing business within this State or having income within this State, regardless of whether these activities are carried on in intrastate, interstate, or foreign commerce." S.C. Code Ann. § 12-6-530 (2014). "A corporation's taxable income in South Carolina is computed using the Internal Revenue Code with modifications as provided by South Carolina law, and this amount is 'subject to allocation and apportionment as provided in Article 17 of this chapter.'" Media Gen. Commc'ns, Inc. v. S.C. Dep't of Revenue, 388 S.C. 138, 145, 694 S.E.2d 525, 528 (2010) (citing S.C. Code Ann. § 12-6-580 (2000)). Further, when "a taxpayer is transacting or conducting business partly within and partly without this State, the South Carolina income tax is imposed upon a base which reasonably represents the proportion of the trade or business carried on within this State." S.C. Code Ann. § 12-6-2210(B) (2014); see Lockwood Greene, 293 S.C. at 449, 361 S.E.2d at 347 ("The purpose of the allocation statutes is to provide for imposition of South Carolina income tax 'upon a base which reasonably represents the proportion of the trade or business carried on within this State.'" (citation omitted)). This method of imposition is consistent with constitutional requirements for the taxation of corporations engaged in interstate commerce. See Geoffrey, 313

S.C. at 23, 437 S.E.2d at 18 ("A tax will survive challenge under the Commerce Clause so long as it 1) is applied to an activity with a substantial nexus with the taxing state, 2) is fairly apportioned, 3) does not discriminate against interstate commerce, and 4) is fairly related to the services provided by the State.").

Petitioner is a Service Provider

Petitioner is a media broadcasting company, and its primary income is derived from providing direct broadcast satellite video services to subscribers throughout the country. Recently, in a nearly identical matter, this Court concluded that DIRECTV, also a media broadcasting company, was a service provider for corporate income tax purposes. See DIRECTV, Inc. & Subsidiaries, Amended Final Order and Decision, Docket No. 14-ALJ-17-0158-CC, 9 (filed Jun. 12, 2015), *appeal docketed*, No. 2015-001509 (Ct. App. Jul. 14, 2015); see also Anonymous Taxpayer v. Texas Comptroller of Public Accounts, 2013 WL 3490605 (Tex. Cptr. Pub. Acct.) (May 17, 2013) (finding that a direct broadcast satellite company was a service provider for purposes of its apportionment laws). Additionally, the parties agree Petitioner is a service provider; therefore, I begin by concluding Petitioner is a service provider.

Apportionment Methods Generally

Generally, there are two predominate methods for apportioning income from services to the numerator of the gross receipts ratio used for service providers: the "costs of performance" method and the "market share," or "audience," method. The costs of performance method

> requires the taxpayer first to determine which of its activities are the income-producing activities for its service income and then to determine where the costs of performing those income-producing activities were incurred. The taxpayer then compares the amount of costs of performance incurred in the taxing state to the amount of such costs in the other individual states. The sales are attributed to the state with the greatest amount of costs of performance.

Hellerstein Treatise, at ¶ 9.18, 47 (footnote omitted). Costs of performance is the method utilized in the Uniform Division of Income for Tax Purposes Act ("UDIPTA"). Section 17 of UDIPTA utilizes standard costs of performance language:

> Sales, other than sales of tangible personal property, are in this state if:
>
> > (a) the income-producing activity is performed in this state; or
> > (b) the income-producing activity is performed both in and outside this state and a greater proportion of the income-producing activity is performed in this state than in any other state, *based on costs of performance*.

Unif. Div. of Income for Tax Purposes Act § 17 (emphasis added). Under the costs of performance method, income is sourced based on where the costs are incurred for the income-producing activity. This method creates an "all-or-nothing" situation because, out of all states where costs are incurred, only the one with the greatest costs is apportioned the income.

There is a modified version of costs of performance known as "pro rata costs of performance," which Petitioner asserts is South Carolina's method for sourcing income. This approach eliminates the all-or-nothing factor associated with strict costs of performance and allocates the costs of performance between states:

> Under the pro rata cost-of-performance approach, in contrast to the "all-or-nothing" methodology, gross receipts derived from the performance of a service are prorated among multiple states based on the costs of performing the service in each state.

See Sutton et al., The Increasingly Complex Apportionment Rules for Service-Based Businesses: Basic Issues, 17-OCT JMTAX 24, 30-31 (2007 WL 3201540).

In contrast, the market share/audience method or, as it has been referred to in this State, the "origin of payment" method, sources receipts "to where a taxpayer's customers are located and payments made." Lockwood Greene, 293 S.C. at 448, 361 S.E.2d at 347. Under this method, even if all the costs of performance take place in a foreign state, the taxing state can source income from the receipts of in-state purchasers. The Hellerstein Treatise provides several examples of market share language, including the following phrases: sales are in this state "if the taxpayer's market for the sale is in this state;" sales are attributable to the state in which the purchaser "received the benefit of the service;" or sales from services are assigned to the state "to the extent the purchaser of the service received the benefit of the service in this state." Hellerstein Treatise, at ¶ 9.18, 54-55.

South Carolina's Apportionment Statute

In South Carolina, the applicable apportionment statute for service providers directs that:

> [T]he taxpayer shall apportion its remaining net income using a fraction [ratio] 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 (2014).[14] Thus, a service-providing taxpayer is required to use a gross receipts apportionment ratio. Section 12-6-2295 defines "gross receipts" depending upon the type of business in which the corporation is engaged. S.C. Code Ann. § 12-6-2295 (2014). For corporations that provide services, subsection (A)(5) applies, and provides the following:

> (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).

Here, the parties disagree about what receipts are to be included in the numerator of the gross receipts ratio pursuant to section 12-6-2290 and 12-6-2295(A)(5). Specifically, the parties disagree about whether the Department properly sourced 100% of Petitioner's South Carolina subscription receipts to the numerator of the gross receipts ratio. However, I note the parties agree that receipts from the sale/lease, installation, repair, and warranty sales of set-top boxes in South Carolina should be included in the numerator of the gross receipts ratio because these are income-producing activities that take place in South Carolina. See S.C. Code Ann. § 12-6-2295(A)(5).

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[14] In 2007, the General Assembly amended section 12-6-2290 by adding the last sentence: "For purposes of this section, items included in gross receipts are as provided in Section 12-6-2295." 2007 S.C. Act Nos. 110 & 116. Therefore, only section 12-6-2290 is applicable for tax years 2005-2006, and sections 12-6-2290 and 12-6-2295(A)(5) are applicable for tax years 2007-2010. This does not significantly affect the Court's analysis in this case, since the additional statutory language was intended to provide consistency in interpretation. See 2007 S.C. Act Nos. 110 & 116 (stating intent to achieve consistency); see also State v. Ramsey, 311 S.C. 555, 562, 430 S.E.2d 511, 516 (1993) (citation omitted) (presumption that legislature intended to achieve a consistent body of law); State v. McKnight, 352 S.C. 635, 648, 576 S.E.2d 168, 175 (2003) (citations omitted) (presumption that legislature has knowledge of prior judicial decisions on the related subject when enacting legislation); Hoogenboom v. City of Beaufort, 315 S.C. 306, 318 n.5, 433 S.E.2d 875, 884 n.5 (Ct. App. 1992) (citation omitted) (presumption that new legislation is enacted with reference to existing law and that the legislature does not intent by statute to change common law rules). Although the Department adopted an approach in this case that could be characterized as audience-based, the longstanding practices and policies of the Department, in addition to the existing case law, prior to the enactment of the statute appear consistent with the approach adopted by the legislature. See Etiwan Fertilizer Co. v. S.C. Tax Comm'n, 217 S.C. 354, 359, 60 S.E.2d 682, 684 (1950) (citations omitted) ("We have held in many cases that where the construction of the statute has been uniform for many years in administrative practice, and has been acquiesced in by the General Assembly for a long period of time, such construction is entitled to weight, and should not be overruled without cogent reasons.").

Petitioner claims the Department should not source 100% of South Carolina subscription receipts to the numerator of the gross receipts ratio. It claims South Carolina subscription receipts do not accurately reflect its income-producing activities in South Carolina. Additionally, Petitioner claims it has several income-producing activities that take place within and without South Carolina and this activity is best measured by costs of performance principles. Petitioner's method of income sourcing is based on its assertion that South Carolina is a pro rata costs of performance state. As support for its sourcing theory, Petitioner offered the testimony of Ray Stevens, a tax attorney, and former Director of the Department and former Administrative Law Judge. The Court qualified Mr. Stevens as an expert in Policy Issues in Multi-State Taxation. Mr. Stevens testified that to his knowledge, South Carolina is not a strict costs of performance state or a market share state; rather, he believes it is a pro rata costs of performance state. He cited to the Hellerstein Treatise to support his theory, contending that Hellerstein & Hellerstein found South Carolina to be a pro rata costs of performance state.[15] Mr. Stevens also cited Mercury Motors[16] and Lockwood Greene, cases in which South Carolina courts rejected the argument that South Carolina is a market share state, to further suggest South Carolina sources income based on cost-based principles in contrast to market based principles. He then recounted his time litigating Lockwood Greene and opined Lockwood Greene stands for the principle that income tax is apportioned based on where the costs of performance are located. Although Mr. Stevens acknowledged that the court in Lockwood Greene mentioned different types apportionment methods for different types of industry, he asserted this was merely dicta and has no legal bearing on the current case. Mr. Stevens further acknowledged that the services provided by the taxpayers in Lockwood Greene, Mercury Motors, and Rent-A-Center[17] are different from the media broadcasting services at issue here, but opined that in each of these cases the underlying apportionment principles were based on pro rata costs of performance.

[15] See Hellerstein Treatise, ¶9.18, 46 n.1187 (quoting P. Mata & M. Smith, The Implementation of "Market" Sourcing Rules: Practical Concerns, State Tax Notes, Sept. 6, 210, p. 649)): "According to two knowledgeable observers, as of late 2010 "[f]our states use a proportionate costs-of-performance method: Arkansas, Mississippi, North Carolina (services only) and South Carolina (services only)."

[16] Mercury Motor Express, Inc. v. S.C. Tax Comm'n, 244 S.C.134, 135 S.E.2d 756 (1964).

[17] Rent-A-Center v. S.C. Dep't of Revenue, Docket No. 09-ALJ-17-0206-CC (filed January 6, 2012).

Analysis

Having reviewed the applicable statutes, case law, and testimony at the hearing, I reject the Petitioner's contention that South Carolina is a pro rata costs of performance state.

Initially, I find South Carolina is not a strict costs of performance state. Comparing section 12-6-2295(A)(5) to Hellerstein's description of strict costs of performance and section 17 of UDIPTA, it is clear South Carolina has not adopted strict costs of performance. Specifically, while section 12-6-2295(A)(5) is similar to section 17 of UDIPTA, the differences between the two are determinative. The General Assembly, while aware of section 17 of UDITPA, *specifically chose not* to include the phrase "based on costs-of-performance" in section 12-6-2295(A)(5).[18] Moreover, unlike section 17 of UDIPTA or the Hellerstein example of costs of performance, section 12-6-2295(A)(5) does not result in an all-or-nothing outcome where only the state with the most income-producing activity, *as measured by costs of performance*, can source receipts for tax purposes. Rather, section 12-6-2295(A)(5) focuses solely on the "income-producing activity" and where that activity takes place. The only real similarity between the South Carolina statute and UDIPTA is that both rely on "income-producing activity" as a measure of sales; however, as noted above, unlike section 12-6-2295(A)(5), section 17 of UDIPTA requires the use of cost of performance as a proxy for income-producing activity. Additionally, the Department's policy manual from 2005 claims South Carolina is not a cost of performance state. See 2005 Policy at 17. Therefore, based on the clear language of section 12-6-2295(A)(5) and its marked differences from section 17 of UDIPTA, I find South Carolina is not a strict cost of performance state.

[18] The phrase "cost of performance" has only been mentioned in South Carolina law once, in a statue related to manufacturers and dealers in tangible personal property, and the General Assembly deleted the reference to "cost of performance" in 2006. From 1958 until 2006, the sales factor in the three-factor apportionment formula for manufacturers and dealers in tangible personal property included cost of performance language. See S.C. Code Ann. § 12-6-2280(C)(2) (1995); S.C. Code Ann. § 12-6-2250 (1995). However, the cost of performance language, which was deleted by the General Assembly in 2006, has never been included in the statute governing apportionment for service providers, like Petitioner. See also Whitmer v. State, 328 S.C. 1, 6, 492 S.E.2d 777, 779 (1997) ("[T]here is a basic presumption that the legislature has knowledge of previous legislation as well as of judicial decision construing that legislation when later statutes are enacted concerning related subjects.").

Next, it is equally clear South Carolina is not a market share or audience state, although, as the Department points out, many states have adopted this method for media broadcasting companies.[19] Indeed, Hellerstein comments:

> Most states have modified their general apportionment rules for apportioning the income of radio and television broadcasters. Many states have done so by adopting regulations identical or similar to the Multistate Tax Commission's (MTC's) special rule for radio and television broadcasting and, in particular, the "audience factor" for assigning receipts from programming and advertising.

Hellerstein Treatise, at ¶ 10.05, 1 (footnotes omitted). However, section 12-6-2295(A)(5) does not include language typical of a market share statute because it does not include language referencing the taxpayer's "market for the sale" or "the place in which the purchaser received the benefit of the service." See Hellerstein Treatise, at ¶ 9.18, 54-55. Rather, section 12-6-2295(A)(5) focuses solely on the "income-producing activity" and where this activity is performed. Further, the Department's 2005 policy manual states South Carolina is not a market share state. See Rick Handel, Deana West & William West, South Carolina Department of Revenue Policy: South Carolina Corporate Income Taxes 17 (2005). Therefore, based on the foregoing, I find South Carolina is not a market share state.

Now we turn to Petitioner's contention that South Carolina is a pro rata costs of performance state. While pro rata costs of performance eliminates the all-or-nothing aspect of strict cost of performance, it still uses costs of performance as a proxy for income-producing activity. Section 12-6-2295(A)(5) focuses exclusively on income-producing *activity* and where it takes place without requiring or referencing a proxy to measure income-producing activity. Therefore, I conclude South Carolina is not a pro rata costs of performance state. Rather, as this Court suggested in its decision in DIRECTV, I find South Carolina's apportionment statute provides a flexible standard based upon the income-producing activity for a given industry. See DIRECTV, Inc. & Subsidiaries v. South Carolina Department of Revenue, Amended Final Order and Decision, Docket No. 14-ALJ-17-0158-CC, 18 (finding "S.C. Code Section 12-6-2295(A)(5) provides 'flexibility' in determining the relative amount of income-producing activities in the State. This approach necessitates flexibility in application of law and policy to different and often

[19] The Department Determination noted: "South Carolina is not alone in this method of sourcing receipts for taxpayers like [Petitioner]. Twenty-three states have adopted the 'audience approach' for assigning receipts from programming and broadcasting companies." This Court overrules the Department's Determination to the extent that it relies on the audience method. While the results of the Department's Determination and the Court's analyses are the same, the reasoning is different.

diverse service industries."). In essence, South Carolina's statute was constructed to avoid a one-size fits all apportionment method because one size does not fit every industry. This position is supported by the Court of Appeals decision in Lockwood Greene.

In Lockwood Greene, the issue was how to define "gross receipts from within this State" under what is now codified as section 12-6-2290. Lockwood Greene, 293 S.C. at 448, 361 S.E.2d at 347. Notably, at the time Lockwood Greene was decided, South Carolina had not yet adopted section 12-6-2295(A)(5) defining "gross receipts," but Lockwood Greene is relevant because, in defining "gross receipts within this State," the court was essentially providing the definition later codified in section 12-6-2295(A)(5). Id. The taxpayer in Lockwood Greene asserted "receipts" should be sourced to where the taxpayer's customers were located and payments made. Id. This was a version of the market share method or, as the court phrased it, the "origin of payment" method. Id. In contrast, the Tax Commission asserted "receipts" should be sourced to the place where the services were performed, or what the court phrased the "place of activity" method. Id. 293 S.C. at 448-49, 361 S.E.2d at 347. The court agreed with the Tax Commission. Specifically, the court determined:

> A client pays an engineering firm for the expertise and time of its employees. Therefore, an engineering firm's business carried on in a state is reasonably measured by the services rendered by its personnel in the state. This approach to "gross receipts from within this State" is epitomized by the "place of activity" test advanced by the Tax Commission.

Id. 293 S.C. at 449, 361 S.E.2d at 347.

Essentially, the court chose to use the phrase "place of activity," and never used the phrase "cost of performance" in its opinion even though it used payroll (a cost) as a proxy for income-producing activity. Id. Further, while the "place of activity" method resembles the cost of performance method to some extent, an all-or-nothing component was not applied based upon the location of the "greater proportion" of the activities. Thus, the court's "place of activity" method resembles pro rata costs of performance. However, the court's comments in Lockwood Greene suggest the type of industry being taxed may affect the application of the statute:

> Lockwood also argues the statute has not been consistently interpreted by the Tax Commission. *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., 293 S.C. at 450, 361 S.E.2d at 348 (emphasis added). It is important to note that, in the context of the engineering firm in Lockwood Greene, the costs of performance and income-producing activity took place in the same location.[20] In Lockwood Greene, the court affirmed the use of the engineering firm's payroll to determine the location of the income-producing activity. In the case of an engineering firm, the location of the employee personally providing the service is perhaps the best representation of the income-producing activity available to the court. See S.C. Private Letter Ruling #13-3 (determining that another engineering firm's South Carolina payroll demonstrates the location of its income-producing activity because the firm "only uses employees to perform its services"). However, the use of payroll to determine location of the engineering service activity does not mean that the court was using the *cost* of the payroll as a proxy, nor would such a proxy always be the appropriate way to determine where an industry's services are performed.

Thus, the decision in Lockwood Greene does not, as Petitioner contends, clearly demonstrate South Carolina is a pro rata costs of performance state. Rather, Lockwood Greene could be interpreted to apply a flexible standard based on where the income-producing activity takes place, which varies upon industry type.

This Court's 2012 decision in Rent-A-Center v. South Carolina Department of Revenue, Docket No. 09-ALJ-17-0206-CC (filed January 6, 2012), is consistent with my determination that South Carolina's apportionment method does not require income-producing activity to be measured using costs of performance. In Rent-A-Center, this Court determined that management services performed in Texas for a South Carolina affiliate could not be sourced to South Carolina because the income-producing activity—the professional management services—took place in Texas, not South Carolina. Id. at 7, 9, 10. This Court in Rent-A-Center referred to Lockwood Greene's "place of activity" test, but at no time described the method of apportionment as costs of performance. See id. at 1-13. The focus was solely on where the income-producing activity took place.

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[20] Indeed, this overlap may explain Hellerstein's description of South Carolina as a pro rata cost of performance state since the decision in Lockwood Greene, read only in the context of an engineering firm without regard for its discussion of other industries, would appear to suggest South Carolina is a pro rata cost of performance state. See Hellerstein Treatise, at ¶ 9.18, 46 n.1187.

Further, my determination is in accordance with this Court's decision in DIRECTV, Amended Final Order and Decision, Docket No. 14-ALJ-17-0158-CC. In DIRECTV, a similarly-situated taxpayer to Petitioner, DIRECTV, asserted that South Carolina is a cost of performance state and, therefore, the Department should not source 100% of gross receipts from South Carolina subscribers to South Carolina. Id. at 1-2. Ultimately, this Court rejected DIRECTV's attempt to source the income from South Carolina subscription receipts to other states based upon cost of performance elements or factors. Id. at 21. Specifically, the Court noted DIRECTV's approach "unduly emphasizes what amounts to 'costs of performance.'" Id. at 17. This Court also noted "South Carolina courts have never imposed a costs-of-performance approach to sourcing receipts of service providers to South Carolina." Id. at 18. Finally, just as the Department concluded in its Determination here, and this Court noted in its Order Denying Cross Motions for Summary Judgment, the DIRECTV decision concluded section 12-6-2295(A)(5) focuses solely on income-producing activity and where the income-producing activity is performed without requiring a particular method of sourcing. Id. at 18 ("South Carolina has not adopted any such 'blanket approach, be it market-based, costs of performance, or otherwise.'").

Simply put, South Carolina is neither a strict nor pro rata costs of performance state because South Carolina law does not require sourcing of a service provider's gross receipts based upon costs of performance principles. See S.C. Code Ann. § 12-6-2290; S.C. Code Ann. § 12-6-2295(A)(5); Lockwood Greene, 293 S.C. at 447, 361 S.E.2d at 346; DIRECTV, Amended Final Order and Decision, Docket No. 14-ALJ-17-0158-CC; Rent-A-Center, Docket No. 09-ALJ-17-0206-CC. Neither is it a market share state. See id. South Carolina's applicable statutes merely require the apportionment of a service provider's net income using a gross-receipts ratio, and the gross receipts are attributable to South Carolina if the income-producing activity occurs within South Carolina or, if it occurs within and without South Carolina, it is attributable to the extent it occurs within South Carolina. See S.C. Code Ann. § 12-6-2290; S.C. Code Ann. § 12-6-2295(A)(5). Where the income-producing activity takes place may vary upon industry, and South Carolina statutes do not require the income-producing activity to be measured using any particular method or proxy. Rather, the focus is on using a method that fairly represents the taxpayer's business activities in South Carolina. See S.C. Code Ann. § 12-6-2210(B) ("[T]he South Carolina income tax is imposed upon a base which reasonably represents the proportion of the trade or business carried on within this State.").

What Constitutes Petitioner's "Income-Producing Activity"?

Having determined that South Carolina applies a flexible income tax apportionment standard based on where the income-producing activity takes place for a particular industry, I now address what constitutes Petitioner's income-producing activity in the context Petitioner's industry of media broadcasting and the facts of this case. Initially, I note Petitioner and the Department agree that the lease/sale of set-top boxes, their installation and repair, and the sale of related warranties are income-producing activities that take place within South Carolina. The parties disagree as to whether South Carolina subscription receipts adequately reflect Petitioner's income-producing activity in South Carolina for the purposes of section 12-6-2295(A)(5).

Unfortunately, South Carolina's statutory law does not define "income-producing activity." Petitioner argues this Court should apply the Multi-state Tax Commission's[21] definition of income-producing activity developed for section 17 of UDIPTA to determine Petitioner's income-producing activities. This definition provides:

> The term "income producing activity" applies to each separate item of income and means the transactions and activity engaged in by the taxpayer in the regular course of its trade or business for the ultimate purpose of producing that item of income. Such activity includes transactions and activities performed on behalf of a taxpayer, such as those conducted on its behalf by an independent contractor.

Multi-state Tax Commission, Regulation IV.17(2). This definition was developed in the context of UDIPTA's costs of performance approach for sourcing receipts for tax purposes. Because I have already established South Carolina is not a UDIPTA/costs of performance state and South Carolina is not a member of the Multi-state Tax Commission, I find the definition proposed by Petitioner to be unpersuasive.

Petitioner argues South Carolina subscription receipts do not accurately represent its income-producing activities in the state. Petitioner claims it has eight income producing activities, including: (1) the acquisition of programming/content; (2) the operation of satellites and uplink centers; (3) advertising; (4) providing subscriber equipment; (5) installation of equipment; (6) in-home repair; (7) the operation of call centers; and (8) general and administrative activities. Petitioner provided the testimony of Mr. Povenmire to describe the costs associated with these eight activities. And additionally, Mr. Stevens expressed his belief that these eight activities

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[21] The Multi-State Tax Commission (MTC) is a commission composed of State Revenue Departments, which issues various policy documents. The South Carolina Department of Revenue is not a member.

represent Petitioner's income-producing activities. When asked about the DIRECTV decision, which determined many of these activities are not income-producing, Mr. Stevens stated the decision in DIRECTV was a result of DIRECTV's failure in that case to provide sufficient evidence of its income-producing activities for the court to perform the correct apportionment analysis based on costs of performance factors.

In contrast, the Department argues the income-producing activity of businesses within the direct broadcast services industry is limited to the delivery of a signal into the customer's home and onto the customer's television. The Department contends subscribers' monthly payments are directly tied to the delivery of the signal onto the television and fairly represent Petitioner's income-producing activity in South Carolina. Accordingly, the Department contends 100% of the subscription receipts from Petitioner's South Carolina subscribers should be sourced to the numerator of the gross-receipts ratio.

To support its position, the Department introduced the testimony of Glenn Harrison, who this Court qualified as an expert in Applied Economics. Dr. Harrison testified that in his opinion, subscriber revenue is the simplest way to determine Petitioner's income-producing activity. He noted that Petitioner acknowledges in its own corporate filing to the United States Securities and Exchange Commission that it recognizes its subscription receipts as revenue when the service has been delivered.[22] Dr. Harrison opined Petitioner's expenditures on satellites, engineering skills, the purchasing of programming and networking licenses, etc., are intermediate inputs that generate costs rather than income, and stated he would not include these intermediate activities in a calculation of revenue. He further explained that while call centers, for example, are necessary to the ultimate income-producing activity of delivering the broadcasting service into customer homes, the call center itself does not actually produce income.

Dr. Harrison also opined it is appropriate to source Petitioner's income differently than a professional service firm like an engineering firm. Making the distinction, he explained an engineering firm does not "have to provide the services in the place that [the services are] actually produced; whereas in the case of [Petitioner], and media services generally, [the services are] produced at the place in which they're consumed, whether it was my house in Irmo or counsel's

[22] Dr. Harrison read the following quotation from Petitioner's Form 10-K during his testimony: "[Petitioner] recognize[s] revenue when . . . the goods and services have been delivered. Revenue from our subscription television services is recognized when programming is broadcast to subscribers."

house in Edisto Island." Dr. Harrison testified he believes the most accurate way to measure Petitioner's income-producing activity in South Carolina is to use Petitioner's subscription receipts from its South Carolina customers.

I agree with Dr. Harrison and the Department's description of Petitioner's income-producing activity. Accordingly, I find the activities Petitioner puts forth as income-producing are preparatory activities that are all necessary for it to ultimately broadcast its signal. However, none of these activities—the acquisition of programming, the operation of uplink centers, etc.—is sufficient to be categorized as producing income. Petitioner's income-producing activity is the delivery of Petitioner's signal into the subscriber's home and onto the subscriber's television. While Petitioner's preparatory activities are lurking behind delivery of its signal subscribers would not pay for Petitioner's preparatory activities/infrastructure alone without access to its programming on their television sets.

Both parties cite to the South Carolina Supreme Court's decision in Mercury Motor Express, Inc. v. South Carolina Tax Commission, 244 SC 134, 135 S.E.2d 756 (1964) to support its theory of income-producing activity. As Petitioner notes, because Mercury Motor focused on a constitutional issue, its holding is not directly applicable, but is instructive, and I find it is consistent with my determination that the income-producing activity in this case is the delivery of Petitioner's signal into subscribers' homes and onto their television sets. In Mercury Motor, a trucking company, Mercury Motor, contracted with various businesses to haul freight. The supreme court described Mercury Motor's business operations as follows:

> Here the series of transactions consists of the solicitation of freight, the picking up of freight, the hauling of freight, the delivery of the same and the collections of charges therefor. Each transaction in the series contributes to the earnings and net income of the appellant, and, while each transaction is necessarily incidental to the production of its income, the transaction which primarily earns the income is the hauling of the freight.

Id. 244 S.C. at 141, 135 S.E.2d at 759. Thus, the income-producing activity in Mercury Motor was the "hauling of freight." Petitioner seeks to analogize its preparatory activities, such as the acquisition of programming and processing at its uplink centers, to Mercury Motor's "picking up of freight, the hauling of freight, the delivery of the same and collections of charges therefor." Id. I disagree with this analogy and find the analogy drawn by this Court in the DIRECTV decision to be more apt:

> Analogizing the facts in this case to the holding in Mercury [Motor], the 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 the Mercury [Motor] 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.

DIRECTV, Amended Final Order and Decision, Docket No. 14-ALJ-17-0158-CC, at 13.

Although this Court in DIRECTV found delivery of the signal into subscribers' homes and onto their television sets is the income-producing activity, the Court also suggested "other activities," particularly advertising, may be an income-producing activity. Id. at 14 n.15, 19-20. However, this Court ultimately found 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" and therefore did not include advertising as an income-producing activity.

In this case, Petitioner has presented evidence of its 2010 advertising costs within and without South Carolina in a chart, but it has presented no evidence as to how this advertising affected its revenue generated in South Carolina. See Petitioner's Exhibit #36. Accurately measuring the effect advertising had on Petitioner's South Carolina revenue as opposed to its national revenue would be a difficult task and highlights one of the problems associated with using cost-based factors to estimate income-producing activity. Based on the lack of evidence of the effect advertising had on Petitioner's South Carolina revenue, I decline to include advertising in this Court's analysis.

Also, I find it is appropriate, as Dr. Harrison opined, to distinguish the income-producing activity of media broadcasting company services from other services, like professional engineering services. Specifically, I agree with DIRECTV's differentiation between the income-producing activity of media broadcasting companies and the income-producing activity of personal professional service providers like the engineering firm in Lockwood Greene. Analogizing Petitioner to DIRECTV, I agree with this Court's comment in DIRECTV that

> [u]nlike 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.

DIRECTV, Amended Final Order and Decision, Docket No. 14-ALJ-17-0158-CC, at 17.

In sum, I conclude that pursuant to section 12-6-2295(A)(5), Petitioner's income-producing activity is the delivery of its signal into a subscribers' homes and onto their television screens. Because South Carolina subscription receipts are directly tied to the income producing activity, I find Petitioner's South Carolina subscription receipts most accurately represent Petitioner's income attributable to this State. I also find subscription receipts, rather than Petitioner's costs of performance, most accurately reflect the proportion of business Petitioner carries on within this State in accordance with section 12-6-2210(B) of the South Carolina Code. S.C. Code Ann. § 12-6-2210(B) ("[T]he South Carolina income tax is imposed upon a base which reasonably represents the proportion of the trade or business carried on within this State."); see also Geoffrey, Inc., 313 S.C. at 23, 437 S.E.2d at 18 ("A tax will survive challenge under the Commerce Clause so long as it 1) is applied to an activity with a substantial nexus with the taxing state, 2) is fairly apportioned, 3) does not discriminate against interstate commerce, and 4) is fairly related to the services provided by the State."); Exxon Corp. v. S.C. Tax Comm'n, 273 S.C. 594, 606, 258 S.E.2d 93, 99 (1979) ("A court's primary concern in the due process area is not to improvise a method for computing taxes, but to inquire as to whether or not the method provided imposes a tax which bears a reasonable relationship to the taxpayer's activities in this State."). Petitioner's costs of performance in South Carolina are not a fair representation of Petitioner's business in South Carolina because its costs of performance are relatively small in South Carolina compared to the revenue Petitioner's reaps from South Carolina subscribers.[23]

[23] For example, although Petitioner's South Carolina subscribers make up approximately 1.6% of Petitioner's total subscribers (and one would assume approximately 1.6% of its revenue as a result), Petitioner's gross receipts ratios that it calculated using pro rata costs of performance for the tax years at issue are much lower than 1.6%, illustrating its costs in South Carolina are a poor representation for the income Petitioner receives from its activity in South Carolina. See Petitioner's Exhibit #36.

Where Does Petitioner's Income Producing Activity Take Place?

Pursuant to Section 12-6-2295(A)(5), a service provider's gross receipts are sourced to South Carolina based on the location of the income-producing activity using a two-prong test. In the first prong, all of the gross receipts are sourced to South Carolina "if the entire income-producing activity is within this State." S.C. Code Ann. § 12-6-2295(A)(5). In the second prong, "[i]f the income-producing activity is performed partly within and partly without this State, [gross receipts are sourced to South Carolina] to the extent the income-producing activity is performed in this State." Id. I conclude all of the income producing activity—the delivery of Petitioner's signal into South Carolina subscribers' homes and onto their television sets—occurs within South Carolina.

Substantial Understatement Penalties

Civil penalties are applied to every South Carolina tax law that requires a return unless otherwise provided. S.C. Code Ann. § 12-54-43 (2014). Such penalties are considered a tax owed to this State. Id. Further, "[i]f any tax is not paid when due, interest is due on the unpaid portion from the time the tax was due until paid in its entirety." S.C. Code Ann. § 12-54-25(A) (2014). Section 12-54-155(A)(1) states that "[i]f 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." 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. S.C. Code Ann. § 12-54-155(B)(2)(a) (2014). "[T]here is a substantial understatement of tax for a taxable period if the amount of the understatement for the taxable period exceeds the greater of ten percent of the tax required to be shown on the return for the taxable period or five thousand dollars." S.C. Code Ann. § 12-54-155(B)(1)(a) (2014).

However, section 12-54-155(B)(2)(b) adds the following:

> 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. . . .

Subsection (D)(1) further adds that "[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." S.C. Code Ann. § 12-54-155(D)(1) (2014). Finally, "[u]nless specifically prohibited, the department may waive, dismiss, or reduce penalties provided for in this chapter." S.C. Code Ann. § 12-54-160 (2014).

Based on its audit, the Department determined Petitioner is responsible for a substantial understatement for the tax years at issue. As a result, the Department assessed Petitioner civil penalties. The Department's Determination shows it calculated Petitioner owes $544,286.00 in income taxes, $399,496.00 in related interest, and $276,307.00 in related penalties. The Department also calculated Petitioner owes $90,551.00 in license fee taxes, $32,196.00 in related interest, and $21,846.00 in related penalties. Based on my finding that the Department calculated the correct gross receipts ratio during its audit to determine Petitioner's tax liability for tax years 2004-2010, I find the Department correctly assessed the taxes, interest, and penalties owed by Petitioner for this time period.

Regarding the penalties, I find there was no substantial authority for Petitioner's treatment of subscription receipts. Upon review, it is quite clear that South Carolina authority has consistently applied an activity test to service providers like Petitioner and never used costs of performance. Also, although Petitioner disclosed the relevant facts regarding the subscription receipts, I find there was no reasonable basis for Petitioner's tax treatment of the subscription receipts. Furthermore, Petitioner's wildly different treatments of its income in its multiple original and amended returns suggests no good faith belief in any particular method of apportionment. Therefore, I uphold the Department's assessment of penalties in this case.

CONCLUSION

Based on the foregoing, I find South Carolina statutes provide a flexible apportionment standard based on where the income-producing activity takes place for the particular industry being assessed. Further, in this case, I find the income-producing activity was the delivery of Petitioner's signal to South Carolina subscribers' set-top boxes and onto the subscribers' television sets. Moreover, I find the income-producing activity takes place entirely within South Carolina. Because South Carolina subscription receipts accurately represent the income-producing activity taking place in South Carolina, I find the Department appropriately sourced 100% of Petitioner's South Carolina subscription receipts to South Carolina in the numerator of the gross receipts ratio pursuant to sections 12-6-2290 and 12-6-2295(A)(5) of the South Carolina Code. Accordingly, I uphold the Department's Determination in its result.

ORDER[24]

THEREFORE, IT IS HEREBY ORDRED that Petitioner be assessed $544,286.00 in income taxes, $399,496.00 in related interest,[25] and $276,307.00 in related penalties for tax years 2004-2010.

IT IS FURTHER ORDERED that Petitioner be assessed $90,551.00 in license fees, $32,196.00 in interest,[26] and $21,846.00 in related penalties for tax years 2006-2011.

AND IT IS SO ORDERED.

SHIRLEY C. ROBINSON
Administrative Law Judge

July 11, 2016
Columbia, South Carolina

CERTIFICATE OF SERVICE

This is to certify that the undersigned has this date served this order in the above entitled action upon all parties to this cause by depositing a copy hereof in the United States mail, postage paid, or in the interagency Mail Service addressed to the party(ies) or their attorney(s)

This 11th day of July 2016

By _____
Judicial Law Clerk

[24] To the extent the Court has modified this order to reflect concerns raised by Petitioner inn its Motion for Reconsideration, that motion is **GRANTED**. The remainder of the motion is **DENIED**;

[25] Interest was calculated through May 31, 2014, and will continue to accrue until this matter is resolved.

[26] Interest was calculated through May 31, 2014, and will continue to accrue until this matter is resolved.