RECEIVED
MAR - 8 2017
S.C. SUPREME COURT

THE STATE OF SOUTH CAROLINA
In The Supreme Court

APPEAL FROM THE ADMINISTRATIVE LAW COURT

Ralph King Anderson, III, Chief Administrative Law Judge

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

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

v.

South Carolina Department of Revenue.....Petitioner.

PETITION FOR A WRIT OF CERTIORARI

William J. Condon, Jr.
Sean G. Ryan
Milton G. Kimpson
PO Box 12265
Columbia, SC 29211
(803) 898-5278
Attorneys for Petitioner

Other Counsel of Record:

John C. Von Lehe, Jr.
Bryson M. Geer
Nelson Mullins
151 Meeting Street, Sixth Floor
Charleston, SC 29401-8700
(843) 853-5200
Attorneys for Respondent

INDEX

Pursuant to Rule 242 of the Appellate Court Rules, Petitioner, South Carolina Department of Revenue ("Department" or "Petitioner"), petitions the Court to issue a writ of certiorari to review the decision of the Court of Appeals styled Rent-A-Center West, Inc. v. South Carolina Department of Revenue, 418 S.C. 320, 792 S.E.2d 260 (Ct. App. 2016). (Appendix ("App.") pp. 1-14.) For the below reasons, this Court should grant this Petition and ultimately reverse the decision of the Court of Appeals.

CERTIFICATE OF COUNSEL REGARDING REHEARING

Counsel for Petitioner certifies that the Petition for Rehearing was made and finally ruled upon by the Court of Appeals on January 20, 2017. (App. p. 15.)

QUESTIONS PRESENTED FOR REVIEW

I. Did the Court of Appeals err by finding that the Department failed to meet its burden of proof to show that the statutory apportionment formula used by the Respondent, Rent-A-Center West, Inc., did not fairly reflect the extent of Respondent's business activity in South Carolina?

II. Did the Court of Appeals err by not ruling on whether Respondent's retail and trademark activities are unitary activities and, thereby, allowing Respondent to improperly combine Respondent's unrelated and non-unitary activities into one gross-receipts formula for apportionment purposes?

STATEMENT OF THE CASE

Procedural History and Case Issues

A. The Department's Determination.

On May 6, 2009, the Department issued its Determination in which the Department sought to require Rent-A-Center West, Inc. ("Respondent" or "RAC West") to apportion its net income to South Carolina based on an alternative method pursuant to S.C. Code Ann. Section 12-6-2320(A) (2014). (R. pp. 29-37.) At the time of the Determination, Respondent had been apportioning its net income to South Carolina using the three-factor apportionment formula

applicable to sellers of tangible personal property under S.C. Code Ann. Section 12-6-2250 (2014). (R. p. 31.) Respondent was using the wrong standard apportionment method because its principal income in South Carolina was from royalties, not from the sale of tangible personal property. (R. p. 32.) The correct standard apportionment method for Respondent was the gross-receipts method under S.C Code Ann. Section 12-6-2290 (2014).[1] (R. p. 34.) However, the Department determined that neither the standard three-factor nor the standard gross-receipts formulas fairly reflected the extent of Respondent's business activity in South Carolina. (R. pp. 31-34.)

Because of this finding, the Department sought to require the use of a reasonable alternative apportionment method. This method was a form of separate accounting in which the South Carolina taxable income would be calculated by determining Respondent's royalty income from South Carolina based on Respondent's own royalty contract with its South Carolina affiliate, (R. pp. 383-390), and then subtract applicable expenses related to the royalty income. (R. pp. 35-36.)

B. The Administrative Law Court's Decision.

On January 6, 2012, the Administrative Law Court (ALC) found in favor of the Department on all issues, except the penalty, which the ALC dismissed. (R. p. 23.) The ALC imposed the proper two-part burden of proof on the Department pursuant to Section 12-6-2320(A) and the subsequently issued decision in Carmax Auto Superstores West Coast, Inc. v. South Carolina Department of Revenue, 411 S.C. 79, 89, 767 S.E.2d 195, 200 (2014). (R. p. 10.) The ALC also found that the Department met this two-part burden. (R. p. 9). Accordingly, the ALC upheld the Department's assessment of income tax and interest because it found that the standard apportionment formula did not fairly represent the extent of Respondent's business activities in

[1]In July of 2011, and one month before the ALC heard this case, Respondent amended its South Carolina corporate income tax returns for the years at issue to change its apportionment method from the three-factor formula to the gross-receipts method. (R. p. 4.)

South Carolina, that the Department's alternative apportionment formula was reasonable in light of Respondent's business activities in South Carolina, that the alternative method did not violate the Constitution, and that Respondent did not substantiate any expenses to be deducted from its South Carolina royalty income. (R. p. 23.) Further, the ALC found that Respondent was able to separate its retail business from its trademark business, (R. p. 8), and that Respondent failed to establish that its retail business and its trademark businesses were inextricably linked, all of which supported the ALC's conclusion that the Department's separate accounting method was appropriate in this case. (R. p. 15.)

C. The Appeal of the ALC's Final Order and Decision.

The Respondent appealed the ALC's decision to the Court of Appeals, which issued its decision in this matter on October 26, 2016. See Rent-A-Center West, 418 S.C. 320, 792 S.E.2d 260. (App. pp. 1-14.) The Court of Appeals reversed the decision of the ALC finding that this case was Carmax redux, meaning that the Department had not met its burden of proving that the standard apportionment method did not fairly reflect the extent of Respondent's business activity in South Carolina. (App. p. 13.) On November 28, 2016, the Department petitioned the Court of Appeals for a rehearing, (App. pp. 16-34.), which the Court of Appeals, subsequently, denied. (App. p. 15.)

Summary of Facts

Rent-A-Center, Inc. is a holding company that controls at least three affiliated entities: Respondent, Rent-A-Center East, Inc. (RAC East), and Rent-A-Center Texas, LP (RAC Texas). (R. p. 398.) Respondent, RAC Texas, and RAC East[2] operate retail stores that rent and sell tangible

[2]RAC RR, Inc. and Rainbow Rentals also made retail sales in South Carolina during one or more of the tax years at issue and are subject to a trademark licensing agreement with Respondent. (R. pp. 346-347.) The Department's audit report and its Department Determination included the South Carolina retail operations of these entities. (R. pp. 346-347.) When the

personal property to customers on a rent-to-own business model. (R. p. 125, lines 83:17-21, lines 84:18-25.) The three retailers offer tangible consumer goods to customers pursuant to a rental purchase agreement. (R. p. 125, lines 83:19-21.)

Respondent operated retail stores in the western states. (R. p. 125, lines 84:20-22.) RAC Texas operated retail stores in Texas. (R. p. 125, lines 84:22-25.) RAC East operated retail stores in the eastern states, including South Carolina. (R. p. 125, lines 84:18-19.)

In addition to operating retail stores, Respondent licensed trademarks and trade names ("Intellectual Property") to RAC East and RAC Texas. (R. p. 125, lines 84:20-22; R. pp. 354, 383-90, 427.) Accordingly, Respondent had two primary sources of income: income from retail sales outside of South Carolina and royalty income from licensing Intellectual Property, which includes royalties generated by RAC East's sales in South Carolina. (R. pp. 253-54, lines 111:10-115:19.) Respondent's only income generated from within South Carolina was royalty income. (R. p. 254, line 115:1-2.) Except for Intellectual Property, RAC West has no property or payroll in South Carolina. (R. p. 354.) RAC West uses its own Intellectual Property. (R. p. 155, lines 202:14-15).

In addition to operating retail stores in Texas, RAC Texas manages and protects Respondent's Intellectual Property. (R. p. 152, lines 190:20-191:3.) Ms. Dawn Wolverton, RAC Texas's Vice-President, Assistant General Counsel, and Secretary, is "responsible for maintaining the company's portfolio of trademarks and trades names," which includes determining whether a desired name would be available for federal registration, filing the registration and leading the registration process, filing continuing use statements, and monitoring use of the Intellectual Property by others. (R. pp. 154-155, lines 197:25-198:5; lines 199:8-16; lines 200:8-202:2.) Additionally, although RAC West owns the Intellectual Property, RAC Texas is responsible for

---

Department refers to RAC East herein, it is generally including these two entities along with RAC East.

developing advertising and marketing strategies to create, maintain, and expand the RAC brand name. (R. p. 425.)

The retail businesses of RAC West and RAC East receive essentially the same management services from RAC Texas. (R. p. 152, lines 190:13-19.) The only difference between RAC West and RAC East is the fact that RAC West owns the Intellectual Property. (R. p. 152, lines 190:20-23.) RAC West does not even protect its own Intellectual Property, as that task is performed by RAC Texas. (R. p. 152, lines 190:24-191:3.)

RAC West and RAC East entered into a Trademark License Agreement in 2002, amended in 2004, under which RAC West, the owner of the Intellectual Property, granted a license to RAC East to use the Intellectual Property, including in South Carolina. (R. pp. 383-90.) In exchange, RAC East agreed to pay to RAC West a royalty of 3% of RAC East's net sales of licensed services. (R. p. 389.) Licensed services are rental service(s) for home appliances, furniture, home furnishings, and other goods. (R. p. 383.)

RAC West had tax nexus with South Carolina and filed South Carolina corporate income tax returns because it owned Intellectual Property located in South Carolina. (R. p. 131, lines 106:3-16.) RAC West apportioned its net income to South Carolina based on the standard three-factor apportionment formula for dealers in tangible personal property pursuant to Section 12-6-2250. (R. p. 354.) The three factors included payroll, property, and sales. (R. p. 133, lines 116:14-23.)

The Department then audited RAC West for tax years 2003 through 2005. (R. pp. 340-50.) During the audit, the Department's auditor informed Respondent that the three-factor formula may not be correct and suggested use of the single factor gross-receipts formula. (App. pp. 133-134; Transcript Day One pp. 116, line 24-117, line 10.)

The Department found that RAC West's only income in South Carolina was the royalty income that it generated through sales made in South Carolina by RAC East and that Respondent's retail operations had nothing to do with its trademark operations. (R. pp. 253, lines 111:10-112:9; R. p. 254, lines 115:1-2; 342.) For these and other reasons, the Department applied an alternative apportionment method pursuant to Section 12-6-2320(A) and on March 12, 2008, issued its Report of Field Audit. (R. pp. 340-50.)

On or about June 3, 2008, RAC West filed a protest of the Department's Report of Field Audit. (R. pp. 351-360.) On January 7, 2009, RAC West filed amended income tax returns using another standard apportionment formula (i.e., the four-factor formula).[3] (R. pp. 364-366; 372-374; 380-382.)

After adjusting the alternative apportionment formula proposed by the auditor, the Department issued its Determination on May 6, 2009. (R. pp. 29-37.) The Department found that RAC West's sole source of income from South Carolina consisted of royalty fees received from RAC East, (R. p. 34), that only 13% of Respondent's total revenues came from its trademark business, (R. p. 254, lines 113:20-115:16), and that Respondent in South Carolina owned only Intellectual Property as it had no employees or other property located in South Carolina. (R. p. 354.) The Department's auditor testified that Respondent's retail operations had "nothing" to do with Respondent's business activity in South Carolina. (R. p. 253, lines 112:6-12.) Accordingly, the Department determined that RAC West should not be using either statutory apportionment formula because neither fairly reflected RAC West's business activity in South Carolina. (R. pp. 31-34.) The Department determined that RAC West should be apportioning its net income to

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

South Carolina using a reasonable alternative apportionment method. (R. pp. 31, 34-36.) The Department used an alternative method under Section 12-6-2320(A)(4) that was based on RAC West's own formula: the 3% Trademark Licensing Agreement. (R. pp. 31, 35.) This alternative method resulted in an assessment of $204,183.00, consisting of $130,194.00 in income tax, $41,440.00 in interest, and $32,459.00 in penalties. (R. pp. 29-30.)

One month before the ALC hearing, Respondent amended its South Carolina income tax returns by again changing its method of apportionment from the standard multi-factor formula for dealers of tangible personal property under Section 12-6-2250 to the standard gross-receipts method for businesses whose primary income in South Carolina is from other than manufacturers and dealers in tangible personal property under Section 12-6-2290. (R. pp. 133, lines 116:10-117:16, R. pp. 361-63, 369-71, 377-79.) Therefore, Respondent's standard apportionment method in South Carolina was the gross-receipts ratio because its primary income from South Carolina came from royalties, although Respondent's out-of-state retail income dwarfed its royalty income by 87% to 13%, respectively. (R. pp. 254, lines 113:12-115:16.) With these amended tax returns, Respondent diluted the gross-receipts formula by including the out-of-state retail sales of RAC West in the denominator, while no retail sales were in the numerator. (R. p. 152, lines 189:20-190:3.)

At the ALC hearing, Dr. Glenn Harrison, the Department's expert on law and economics, testified that the gross-receipts formula used by Respondent (i.e., the ratio was the result of dividing royalty income from South Carolina by the sum of total royalty income and total retail income from all states) did not provide an accurate reflection of the economic connection of Respondent to South Carolina. (R. p. 274, lines 193:14-195:1.) He stated that including royalty receipts from South Carolina in the numerator of the gross-receipts formula while including both

total royalty and total retail receipts in the denominator was comparing unrelated activities, which is what he meant by saying it was like putting apples in the numerator and apples and oranges in the denominator. (R. p. 274, lines 194:3-4.) He concluded that such an apples and oranges approach devalued the gross-receipts ratio. (R. p. 274, lines 194:23-195:1.)

Dr. Harrison stated that the Department's alternative method was economically reasonable, (R. p. 274, lines 195:2-196:25), because excluding the retail operations from the alternative method was "absolutely essential" for the tax burden on the Respondent to fairly represent its economic nexus with South Carolina. (R. p. 274, lines 196:18-25.)

During the auditor's testimony, the Department focused on Respondent's financial activity in tax year 2004 to explain the Department's findings and reasoning. (R. pp. 253-254, lines 112:16-115:19.) Respondent had $424,004,077.00 of total revenue in 2004. (R. p. 254, lines 114:4-6.) Only $55,221,912.00 of RAC West's 2004 revenues were from royalty income. (R. p. 254, lines 114:12-16.) Accordingly, only 13% of Respondent's total revenues were from royalties, while 87% of Respondent's total revenues were from its out-of-state retail business, which had nothing to do with Respondent's business activity in South Carolina. (R. p. 254, lines 114:17-115:9.) The auditor testified further that these 2004 percentages were roughly the same in 2003 and 2005. (R. p. 254, lines 115:10-19.)

The auditor also testified that Respondent's final 2004 South Carolina amended income tax return showed gross receipts from South Carolina of $861,437.00, which was 0.2032% of Respondent's total 2004 revenues of $424,004,077.00. (R. pp. 253-254, lines 112:13-113:6; *see also* R. p. 371.) Schedule H-2 of Respondent's 2004 final amended South Carolina income tax return shows that the ratio of 0.2032% was the gross-receipts ratio that Respondent used to apportion net income to South Carolina. (R. p. 371.)

On its final 2004 South Carolina amended income tax return, Respondent reported that it had total adjusted net income of $19,840,800.00 and South Carolina taxable net income of only $40,317.00. (R. p. 369.) Accordingly, of the $861,437.00 in gross receipts from South Carolina in 2004, Respondent paid income tax on only 4.68% of royalty income generated in South Carolina, (R. p. 6), despite the fact that Respondent did not substantiate any deductions from its royalty income. (R. p. 254, lines 116:21-117:4.)

Respondent's 2003 and 2005 South Carolina amended income tax returns reflect similar results. (R. p. 254, lines 115:10-19; R. pp. 7, 361, 363, 377, 379.) In 2003, only 1.53% of Respondent's $830,247.00 of gross receipts from within South Carolina were taxed in South Carolina, and in 2005, none of Respondent's $844,348.00 of gross receipts from within South Carolina were taxed in South Carolina. (R. p. 7.)

Also at the ALC hearing, two of RAC West's witnesses made broad assertions of a value exchange between the Intellectual Property and retail sales in an attempt to show that RAC West's trademark and retail businesses were unitary. For example, Ms. Wolverton testified that as RAC West provides quality services, the value of its Intellectual Property increases. (R. p. 155, lines 202:7-203:19.) She continued by saying that as the retail stores in general perform better, the Intellectual Property becomes "more famous." (R. p. 155, lines 203:2-8.) She also said that as the Intellectual Property becomes more famous, the Intellectual Property may draw people into the retail stores. (R. p. 155, lines 203:9-16.)

However, the Intellectual Property was not strategically placed into RAC West to enhance the value of RAC West's retail business, as the Intellectual Property was already owned by the same company that owns it now when that company was acquired. (R. p. 132, lines 110:16-25.) Whatever effect on value RAC West's Intellectual Property had on all of the retail operations, and

vice versa, it is applicable to all retail operations of RAC West, RAC Texas, and RAC East, not merely on the retail operations of RAC West. (R. p. 155, lines 203:2-24.)

Rent-A-Center, Inc. engaged KPMG LLP (KPMG) to conduct a study to determine the arm's length pricing for transactions between affiliates, including the royalty payments from RAC East to RAC West for use of the Intellectual Property. (R. p. 411.) Specifically, in 2003, KPMG determined that an arm's length royalty payment from RAC East and RAC Texas to RAC West would be in the range of 2% to 4% of gross sales. (R. p. 441.) RAC West and RASC East entered into an agreement using a 3% royalty rate. (R. p. 389.)

Dr. Harrison testified that whether Respondent's retail and trademark businesses constitute a unitary business is a "red herring" because Respondent is able to separately identify the financial activities of the trademark and retail businesses. (R. p. 275, lines 197:1-198:15.) He added that it would be wrong from both an economic and an accounting perspective to assume that a business cannot separate its accounts even for unitary activities and that accounting methods are available to separate the financial activities of separate lines of business. (R. p. 275, lines 197:10-198:15; R. p. 276, lines 203:4-16.)

Regarding RAC West's ability to separately account for its retail and trademark businesses, Dr. Harrison also testified that he saw no evidence and heard no testimony during the administrative hearing that would lead him to believe that an economist could not separate RAC West's retail and trademark businesses and that such a division of revenues and expenses within a business is a standard activity of an economist in the field of industrial organization. (R. pp. 276-277, lines 20:4-16, 206:2-7.) He stated that companies use managerial or cost accounting when they want to determine how an operation like a retail store is performing. (R. pp. 275-276, line 199:18-201:2.)

Further, Respondent's Director of Tax testified that Respondent separately determines the profitability of its retail stores. (R. p. 159, lines 191:23-25.) In fact, under a management agreement with RAC Texas, the retail stores were guaranteed a 4.5% profit of each store's operating expenses, and the difference between the "actual profit of the store" and the guaranteed 4.5% profit was paid to RAC Texas as a management fee. (R. p. 137, lines 130:4-23; R. p. 162, lines 230:5-22.)

ARGUMENTS

This Court should grant the Department's Petition because this matter involves important and novel questions of law and because, other than the rule expressed regarding the two-part burden of proof on the proponent of an alternative apportionment method, the Court of Appeals should not have used the Supreme Court's decision in Carmax, 411 S.C. 79, 767 S.E.2d 195, to reverse factual findings of the trial court in this case. Rule 242 of the Appellate Court Rules includes a list of non-exclusive circumstances that weigh in favor of issuing a writ of certiorari, including where there are novel questions of law.

How the proponent of an alternative apportionment method under Section 12-6-2320(A) may meet its two-part burden of proof is a novel issue of law. The burden issue has been addressed only once in South Carolina; however, in the Carmax cases, the ALC and the Court of Appeals applied or announced incorrect burdens of proof. The ALC's error may have tainted its factual findings and the actual evidence presented because it applied the correct tests, but wrongly imposed the burden of proof on Carmax, instead of on the Department. Carmax, Final Order & Decision, No. 09-ALJ-17-0160-CC, pp. 6-7 (ALC, April 22, 2010). Accordingly, as Justice Pleicones stated,

> I agree with the Court of Appeals that we should remand this matter to the ALC for reconsideration. Whether the Department can meet

> its burdens are questions of fact which . . . should not be decided on certiorari. . . . The ALC placed the burden of proof on CarMax West, and accordingly its findings of fact and conclusions of law are premised in that error of law

Carmax, 411 S.C. at 92, 767 S.E.2d at 201.

Therefore, the Court of Appeals erred in the instant case when it made its ultimate conclusion that the Department did not show that the statutory gross-receipts formula used by Respondent did not fairly reflect the extent of Respondent's business activities in South Carolina because "DOR presented the same level of evidence in this case as in CarMax." (App. p. 13.) The factual analysis in the Carmax cases is at best questionable and should not control this case. It is important to take a fresh and clean look at how a proponent of an alternative apportionment method can satisfy its burdens.

I. THE COURT OF APPEALS ERRED BY FINDING THAT THE DEPARTMENT FAILED TO MEET ITS BURDEN OF PROOF TO SHOW THAT THE STATUTORY APPORTIONMENT FORMULA USED BY THE RESPONDENT DID NOT FAIRLY REFLECT THE EXTENT OF ITS BUSINESS ACTIVITY IN SOUTH CAROLINA.

The record is replete with evidence supporting the ALC's finding that the Department satisfied its burden to prove that the statutory gross-receipts apportionment formula used by Respondent did not fairly represent the extent of Respondent's business activity in South Carolina. Accordingly, This Court should reverse the Opinion of the Court of Appeals.

The Court of Appeals should have deferred to the ALC as the finder of fact, because sufficient evidence exists in the record for a reasonable person to make the same findings as the ALC made. (App. p. 6 (citing Risher v. S.C. Dep't of Health & Envtl. Control, 393 S.C. 198, 210, 712 S.E.2d 428, 435 (2011).) The ALC found that "the evidence in this case demonstrates that the standard formulas for apportionment (and, in particular, use of Section 12-6-2290) did not reasonably represent the proportion of trade or business that RAC West carried on in South

Carolina." (R. p. 14.) This is supported by sufficient evidence as the evidence was specific and more than mere bald assertions; however, the Court of Appeals relied upon only one statement by the Department's auditor and two statements by the Department's expert witness, (App. p. 13), and overlooked the additional and sufficient evidence in the record that supports the Department's position. By failing to recognize the sufficient evidence that supports the Department's position, the Court of Appeals overlooked, or misapprehended, the evidence presented at the contested case hearing resulting in the Court of Appeals erroneously finding that the Department presented the same insufficient evidence in this case that it presented in CarMax Auto Superstores W. Coast, Inc. v. S.C. Dep't of Revenue, 411 S.C. 79, 767 S.E.2d 195 (2014).[4]

The Court of Appeals improperly found that substantial evidence does not support the ALC's finding that the Department met its burden. (App. p. 13.) In its analysis, the Court of

[4]The Department submits that the Court should rely on CarMax solely for the legal conclusion regarding the burden of proof under Section 12-6-2320, and nothing more. The result in CarMax – finding that the Department had not met its burden of proof to show that the standard formula did not fairly represent the extent of CarMax's business activity in South Carolina – should not be used to draw any conclusion on the sufficiency of the Department's evidence here. Significantly, the trial court in CarMax imposed the burden of proof on the wrong party, requiring the taxpayer to show that the Department's alternative formula was inappropriate instead of placing the affirmative burden on the Department. As observed by Chief Justice Pleicones in dissent, "The ALC placed the burden of proof on CarMax West, and accordingly its findings of fact and conclusions of law are premised on that error of law." CarMax, 411 S.C. at 92, 767 S.E.2d at 201 (Pleicones, J., dissenting in part). The dissent further observed that "[i]t is therefore not surprising that as the majority states that 'the Department relied on CarMax West to refute [the Department's] use of an alternate formula,' or that the Department, lacking any burden of proof, largely offered evidence of **what** it did rather than **why** it did it." Id. While the Department acknowledges that the CarMax Court ultimately reviewed the record to determine that the Department's evidence was insufficient, the CarMax Court did not have the same perspective on the evidence there, as did the trial judge in the instant case. Here, the ALC imposed the proper burden of proof on the Department. (R. p. 10.) The trial judge here thus had the ability to weigh the testimony of witnesses, assess their credibility, and evaluate all other evidence from the perspective of the proper burden of proof. Using the correct burden of proof, the ALC here arrived at the factual conclusion that the Department met its burden of proof. The Department respectfully submits that these conclusions – that the standard formula does not fairly represent the extent of the taxpayer's activity in the State and that the Department's alternative methodology is reasonable – were supported by substantial evidence.

Appeals stated that the Department's auditor "did not point to any specific evidence" to show that Respondent's use of the gross-receipts formula did not fairly represent the extent of its business activity in South Carolina. (App. p. 13.) It further indicated that the Department's economic expert made mere "bald assertions" regarding Respondent's use of the gross-receipts formula. (App. p. 13.)

The Department, however, satisfied its burden of proof, as recognized by the finder of fact, by presenting sufficient evidence that the standard gross-receipts formula used by Respondent did not fairly represent the extent of Respondent's business activity in South Carolina. This case is not Carmax redux as the Court of Appeals found. Sufficient documentary and testimonial evidence supports the ALC's finding that the Department satisfied its burdens.

This evidence demonstrates that by including Respondent's out-of-state retail receipts in the denominator of the gross-receipts ratio, when Respondent conducted no retail activity in South Carolina, the gross-receipts ratio was devalued and distorted such that the resulting tax base did not fairly represent Respondent's business activity in South Carolina. The ALC found that "the facts clearly reflect the revenue from the operation of [Respondent's out-of-state] stores is unrelated to the trademark business RAC West operates in South Carolina" and that "the evidence does not show that RAC West's retail operations, which generates a very large portion of its gross receipts, contribute a comparable amount to RAC West's net income." (R. p. 13.)

Further, the evidence supports that Respondent operated only one business in South Carolina – its trademark licensing business – and that its trademark licensing business is unrelated to its out-of-state retail business. Through a trademark licensing agreement, Respondent licensed use of its trademarks to RAC East, Inc., a separate but affiliated company that operated retail stores in South Carolina. (R. pp. 383-390.)

Respondent's Director of Tax confirmed that Respondent had tax nexus with South Carolina solely because it owned Intellectual Property located in South Carolina. (R. p. 131, lines 106:3-9.) Respondent did not operate any retail stores in South Carolina; it operated retail stores only in the western part of the United States. (R. p. 125, lines 84:18-22.) Respondent had no management or employees in South Carolina and made no retail sales in South Carolina. (R. p. 131, lines 105:17-24.)

The Department's auditor added to the evidence showing that the Department met its burdens. He testified that Respondent had only two streams of income: (1) retail sales conducted entirely outside of South Carolina that made up 87% of Respondent's income, and (2) royalty income from trademark licensing agreements earned partially from within South Carolina that made up 13% of Respondent's income. (R. p. 248, lines 90:15-21; R. p. 254, lines 113:20-115:19.)

However, the Department's auditor also testified that Respondent used its Intellectual Property in South Carolina, that its only income generated from within South Carolina was royalty income, and that Respondent did not operate any retail stores in South Carolina. (R. p. 253, lines 111:10-21; R. p. 342-43.) The auditor testified that Respondent's out-of-state retail operations had "nothing" to do with its trademark activities in South Carolina. (R. p. 253, lines 112:6-12.)

Further, the record indicates that Respondent engaged in two business activities – retail and trademark – that have widely divergent profit margins and that the result of combining both activities into one gross-receipts formula is a dilution and distortion of Respondent's business activity in South Carolina such that the two business activities must not be combined into one standard apportionment formula. Respondent conducts a high profit margin trademark licensing business in South Carolina while it conducts a lower profit margin retail business in western states. The Department's auditor testified that Geoffrey-type companies (i.e., companies that own and

license trademarks) have a "very large income [and] very little expense," (R. p. 256, lines 122:6-10), and that expenses claimed by Respondent on its corporate income tax returns "did not occur in South Carolina nor did they bear any relationship to royalty income. (R. p. 342.) Therefore, Respondent's trademark business is a high profit margin business while its retail business, which has many expenses to offset its out-of-state sales, is a lower profit margin business.

Additionally, even though the Department asked for documentation of any trademark-related expenses incurred by Respondent, (R. pp. 254-255, lines 116:21-117:4), the record is void of Respondent even naming any trademark-related expenses that it incurred, much less substantiating any such deductions. However, the record includes statements from an RAC Texas employee stating that RAC Texas manages Respondent's trademark portfolio, indicating that Respondent incurs little or no expense related to its trademarks. (R. p. 154-55, lines 199:12-201:21.)

Therefore, Respondent operates only its high-margin trademark business in South Carolina from which it generates more net income from every dollar of revenue. Apportioning Respondent's total net income using a gross-receipts ratio that includes both the low-margin retail receipts that make up 87% of total receipts and the high-margin royalty receipts will not reflect the extent of Respondent's high-profit-margin activities in South Carolina. Separating these lines of businesses for apportionment purposes because of the differing profit margins, is supported by the decision in *Microsoft Corporation v. Franchise Tax Board*, 39 Cal.4th 750, 767-71, 139 P.3d 1169, 1180-83 (2006) (stating that a qualitative analysis is necessary because by applying the worldwide average margin to each state's gross receipts when the much lower margin treasury operations operate only in Washington State "would result in severely underestimating the amount of income attributable to every state except the state hosting the treasury department").

Based on evidence in the record, the ALC found that Respondent distorted and diluted the gross-receipts ratio by including both retail and royalty receipts in the denominator while including only Respondent's high-margin South Carolina royalty receipts in the numerator. (R. pp. 6-7.) For example, the ALC noted that while Respondent's total net income for 2004 was $19,840,800.00, the distorted gross-receipts ratio used by Respondent apportioned only $40,317.00 of that total net income to be taxed in South Carolina. (R. p. 6.) This is despite the fact that Respondent generated $861,437.00 from South Carolina in 2004 through its high-margin trademark licensing business. (R. pp. 6, 254, lines 113:1-3.) Due to the qualitative differences in Respondent's retail and trademark businesses, the gross-receipts formula dilutes and distorts the extent of Respondent's high-margin business in South Carolina because it results in a reduction of Respondent's South Carolina gross receipts from trademarks of $861.437.00 by 95% to arrive at a South Carolina taxable income amount of only $40,317.00. (R. p. 6.) Such a significant reduction in gross receipts from trademark licensing is absurd when the record is void of any expenses that Respondent incurred that should offset the South Carolina-based royalty income and the record indicates that RAC Texas manages and maintains Respondent's portfolio or trademarks and tradenames. The absurd result of using one gross-receipts formula that includes both the high-margin and the low-margin activities is even starker in 2005 and 2006. (R. p. 7.)

Further, the Department's expert in law and economics recognized and testified regarding the inherent problem of including the out-of-state retail sales in the denominator of the gross-receipts ratio while no retail sales are included in the numerator when Respondent conducts no retail operations in South Carolina. Dr. Harrison testified that using the standard gross-receipts ratio, which included retail sales in the denominator, "would not provide an accurate reflection of the economic connection of [Respondent] with South Carolina." (R. p. 274, lines 193:25-194:9.)

He called it mixing apples and oranges, (R. p. 274, lines 194:13-22), which is the same analogy used by the California Supreme Court in *Microsoft Corp.* when addressing the different profit margin activities within Microsoft's business, 39 Cal.4th at 768, 139 P.3d at 1180.

This case is not Carmax redux. Here the Department presented much more than a scintilla of evidence to support its assertion that Respondent's use of the gross-receipts formula did not fairly represent the extent of Respondent's business activity in South Carolina (and that its alternative method was reasonable). Importantly, the ALC here, as the trier of fact, imposed the proper burdens on the proper party (i.e., on the Department). The Department then presented sufficient evidence, which allows an appellate court to affirm the ALC's decision. Additionally, the ALC as the trier of fact, while imposing the proper burdens, made the factual determinations based on such sufficient evidence and its factual determinations should not have been overturned by the Court of Appeals as a reasonable person could make the same decision made by the ALC. Therefore, this Court should reverse the decision of the Court of Appeals.

II. THE COURT OF APPEALS ERRED BY NOT RULING ON WHETHER RESPONDENT'S RETAIL AND TRADEMARK ACTIVITIES ARE UNITARY ACTIVITIES CAUSING UNRELATED ACTIVITIES TO BE WRONGLY COMBINED INTO ONE GROSS-RECEIPTS FORMULA.

Although the above is sufficient for this Court to reverse the Court of Appeals, the decision of the Court of Appeals also should be reversed because the Court of Appeals failed to address whether Respondent's two lines of business were unitary, while the ALC found that Respondent's retail and trademarks activities were "unrelated." (R. p. 13.) As explained below, it is not proper, as Respondent did here, to combine non-unitary activities into one standard apportionment method.[5]

[5]It is proper however to use separate accounting even if a taxpayer's business activities are unitary because, for example, Section 12-6-2320(A) allows separate accounting as an alternative apportionment method without any mention of unitary or non-unitary businesses. (R. p. 16.)

"Under both the Due Process and the Commerce Clause of the [United States] Constitution, a state may not, when imposing an income-based tax, 'tax value earned outside its borders.'" *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 164 (1983). In addition to not taxing income earned outside of a taxing authority's state, the standard formulary apportionment methods used in a particular state should be applied only to activities that are unitary, so unrelated activities should not be apportioned using one combined formulary apportionment method. As the ALC found, the entire "unitary business" concept functions to determine whether certain taxpayer activities may be subject to income tax on a formulary apportionment basis. (R. p. 15.) The United States Supreme Court confirmed that formulary apportionment is applied to only unitary activities.

> The unitary business/formulary apportionment method is a very different approach to the problem of taxing businesses operating in more than one jurisdiction. It . . . calculates the local tax base by first defining the scope of the "unitary business" of which the taxed enterprise's activities in the taxing jurisdiction form one part, and then apportioning the total income of that "unitary business" between the taxing jurisdiction and the rest of the world on the basis of a formula taking into account objective measurers of the corporation's activities within and without the jurisdiction.

Container Corp., 463 U.S. at 165. South Carolina law also has recognized that formulary apportionment applies to unitary activities, but not to unrelated activities. *See* S.C. Code Ann. Regs. 117-710.1 (2012).

The ALC addressed the factors necessary in a unitary-business analysis and found that "the facts clearly reflect the revenue from the operation of those [out-of-state] stores is unrelated to the trademark business [Respondent] operates in South Carolina." (R. p. 13.) The test to determine whether a business is unitary is to determine if the business has the characteristics of unity of ownership, unity of management, and unity of operations (i.e., the "unities" definition), and if the activities of the business contribute to or depend on the other activities of the business (i.e., the

"contribution-dependence" definition). Eastman Kodak Co. v. S.C. Tax Comm'n, 308 S.C. 415, 418 S.E.2d 542 (1992).

As noted below, the record is again replete with substantial evidence supporting that Respondent's retail and trademark businesses are unrelated and non-unitary such that combining these unrelated activities into a single gross-receipts formula did not fairly represent the extent of Respondent's business activities in South Carolina. Respondent's trademark business, which is the only business that Respondent conducted in South Carolina, (R. pp. 152, lines 189:10-13), is not unitary with its primary business, its retail business. For example, unity of management does not exist between Respondent's retail and trademark businesses. (R. p. 17.) Respondent manages its retail stores, but not its trademarks and tradenames. Evidence demonstrates that Respondent has store managers who manage the day-to-day retail operations at each store, (R. pp. 125, lines 84:20-22), but RAC Texas, not Respondent, manages the day-to-day operations of its trademark business. (R. pp. 152, lines 190:24-191:3; R. p. 154-55, lines 199:12-201:21.) Ms. Wolverton of RAC Texas is "responsible for maintaining the company's portfolio of trademarks and trades names" including determining whether a desired name would be available for federal registration, filing the registration, and leading the registration process, filing continuing use statements, and monitoring use of the Intellectual Property by others. (R. p. 154, lines 199:12-16.) Additionally, although RAC West owns the Intellectual Property, Respondent's own economic consultant in its transfer pricing study stated that RAC Texas is responsible for developing advertising and marketing strategies to create, maintain, and expand the RAC brand name. (R. p. 425.) The facts that (1) another entity manages and maintains Respondent's portfolio of trademarks and tradenames, while it manages its own retail stores, (2) Respondent's economic consultant could separate Respondent's trademark licensing activities in order to determine the royalty fee, (R. p.

441), and (3) Res[pendent can determine the profitability of its retail stores, (R. p. 159, lines 191:23-25), demonstrate that Respondent does not have centralized management over both activities, and that Respondent's retail and trademark businesses can be separated (i.e., not unitary).

In addition to not meeting the unity of management test, Respondent does not meet the contribution-dependence test, meaning that its trademark and retail businesses are not unitary. First, Respondent's trademark business depends on retail sales made by its retail affiliates (i.e., RAC East and RAC Texas) and their customers, not from its own retail sales. (See, e.g., R. pp. 383-87.) Unlike the retail sales of RAC East, (R. pp. 383-387), the retail sales of Respondent do not generate any royalty income for its trademark business because Respondent does not charge itself a royalty fee. Second, as the ALC noted, Respondent did not prove that its retail and trademark operations have an inextricable link between the two businesses. (R. p. 8.) Respondent's expert placed a value on the trademark activities by determining an appropriate royalty percentage. (R. pp. 8, 441.) Respondent made Carmax-like bald assertions that such an inextricable link existed but offered no documentary, financial, or other meaningful evidence to support this claim, except for self-serving testimonial statements. Third, Respondent's assertion that as the customer service and performance of the retail stores increased the intellectual property become "more famous," (R. p. 155, lines 203:2-8), is irrelevant because notoriety does not necessarily cause an increase in value, and Respondent did not present any estimates of how much the value of the Intellectual Property increased or decreased in any year because of retail service or performance. Assuming, arguendo, that good retail service or performance increased the value of the intellectual property in any one of the tax years at issue, such an increase in the value of intellectual property is not a taxable event and has no relevance to Respondent's income tax returns

for 2003, 2004, or 2005 as Respondent did not change the royalty fee charged to its affiliates due to a change in value, which would have affected Respondent's income, nor did Respondent sell its intellectual property in a taxable transaction. The taxable event for Respondent in South Carolina is the earning royalty fees from RAC East. That taxable event is the centerpiece of the Department's alternative apportionment method. Respondent could affect the taxable event, if the value of the Intellectual Property increased or decreased, by increasing or decreasing the royalty percentage in the licensing agreement with RAC East. Fourth, Respondent did not strategically acquire the Intellectual Property to enhance the value of its retail business as it already owned the Intellectual Property when that company was acquired. (R. p. 132, lines 110:22-25.) Fifth, whatever value Respondent's Intellectual Property had on its retail operations and, vice versa, is applicable to all retail operations of RAC West, RAC Texas, and RAC East, not merely on the retail operations of RAC West. Therefore, Respondent's Intellectual Property equally serves the retail operations of RAC West, RAC East, and RAC Texas and does not provide any unique value to RAC West's retail business. Finally, although the retail operations of RAC East and Respondent are the same, (R. p. 152, lines 190:20-23), only Respondent owns the Intellectual Property. (R. p. 125, lines 84:20-21.) Therefore operating the retail stores, whether by RAC East, RAC Texas, or Respondent, is not dependent on also owning the trademark business; otherwise, RAC East's and RAC Texas' retail businesses would be failing because they do not own the Intellectual Property.

Still another example of Respondent's trademark business not being unitary with its retail business is the fact that Respondent's royalty income was identifiable, quantifiable, and separable. Its royalty income came from its retail affiliates, RAC East and RAC Texas, and was established through licensing agreements. (R. pp. 383-390.) In the agreement with RAC East, Respondent receives a royalty fee of 3% of RAC East's net sales. (R. p. 389.) KMPG was able to look

separately at Respondent's trademark business and determine an arm's length royalty fee. (R. pp. 409-477.) Since the royalty fee has been quantified and KPMG separately analyzed Respondent's trademark business, Respondent's trademark business can be separated from its retail business.

The present case is distinguishable from Exxon Corp. v. South Carolina Tax Commission, 273 S.C. 594, 258 S.E.2d 93 (1979) because Respondent's activities are not unitary. In Exxon, Humble Oil and Refining Company (Humble) operated a vertically integrated oil and gas company engaged in exploration and production of oil and gas, refining of crude oil, and the retail sales of petroleum products. Exxon, 273 S.C. at 596, 258 S.E.2d at 94. When filing income tax returns in South Carolina, Humble excluded from its tax base the portion of its income related to the exploration and production operations. Id. The Supreme Court affirmed the lower court's decision that Humble operated a single unitary business that included the exploration and production operations and that South Carolina income tax should be calculated by applying the apportionment ratio to Humble's entire corporate net income. Id., 273 S.C. at 595, 596, 602, 258 S.E.2d at 94, 97. The Supreme Court in Exxon used the unities and contribution-dependence definitions, but as discussed above, the facts of the instant case, unlike Exxon, show that unity of management and the requisite contribution-dependency between Respondent's retail and trademark businesses did not exist. Additionally and critically, Exxon does not prohibit the use of separate accounting as an alternative apportionment method, inasmuch, as that opinion predated the 1995 enactment of Section 12-6-2320(A) which allows separate accounting. Prior to 1995, South Carolina law did not have a statute that authorized the use of separate accounting as an alternative apportionment method.

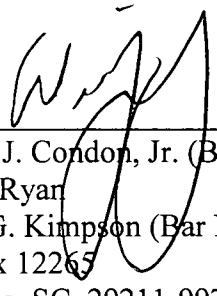
Based on the above, the ALC found that Respondent's retail and trademark businesses are unrelated; hence, they are not unitary. The record includes sufficient evidence to support the

ALC's finding. Therefore, based on how formulary apportionment formulas are intended to be applied to only unitary activities, this Court should reverse the Court of Appeals.

CONCLUSION

For the reasons specified herein, the South Carolina Department of Revenue respectfully requests that this Court grant its Petition for Writ of Certiorari to review the Court of Appeals' decision in this matter.

Respectfully submitted,



William J. Condon, Jr. (Bar No. 72632)
Sean G. Ryan
Milton G. Kimpson (Bar No. 7917)
P.O. Box 12265
Columbia, SC 29211-9979
(803) 898-5278
Attorneys for Petitioner
South Carolina Department of Revenue

Columbia, South Carolina
March 8, 2017

THE STATE OF SOUTH CAROLINA
In The Supreme Court

RECEIVED
MAR - 8 2017
S.C. SUPREME COURT

APPEAL FROM THE ADMINISTRATIVE LAW COURT

Ralph King Anderson, III, Chief Administrative Law Judge

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

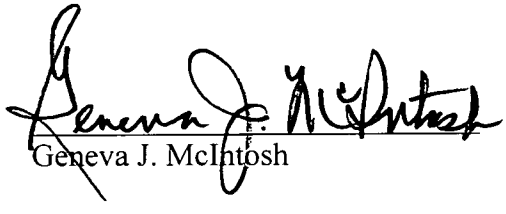
Rent-A-Center West, Inc.,.....Respondent,

v.

South Carolina Department of Revenue,.....Petitioner.

PROOF OF SERVICE

I, Tonie M. Miranda, do hereby certify that I have caused to be mailed postage pre-paid, a copy of the Department's Petition for Writ of Certiorari and the related Appendix in re: Rent-A-Center West, Inc., Respondent, v. South Carolina Department of Revenue, Petitioner, Appellate Case No. 2012-208608, Opinion No. 5447 filed October 26, 2016, Trial Court Case No. 09-ALJ-17-0204-CC, to John C. von Lehe, Jr., Esquire and Bryson M. Geer, Esquire, Nelson Mullins Riley & Scarborough, LLP, P.O. Box 1806, Charleston, SC 29402-1806 on this 8th day of March, 2017.



Geneva J. McIntosh