THE STATE OF SOUTH CAROLINA
In The Supreme Court

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S.C. SUPREME COURT

APPEAL FROM ADMINISTRATIVE LAW COURT

Ralph King Anderson, III, Administrative Law Judge

Appellate Case No. 2017-000265

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

v.

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

RENT-A-CENTER WEST, INC.'S RETURN TO THE SOUTH CAROLINA DEPARTMENT OF REVENUE'S PETITION FOR WRIT OF CERTIORARI

John C. von Lehe, Jr.
SC Bar No. 5719
E-Mail: john.vonlehe@nelsonmullins.com
Bryson M. Geer
SC Bar No. 13606
E-Mail: bryson.geer@nelsonmullins.com
151 Meeting Street / Sixth Floor
Post Office Box 1806 (29402-1806)
Charleston, SC 29401-2239
(843) 853-5200

Attorneys for Rent-A-Center West, Inc.

Charleston, South Carolina
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INTRODUCTION

In Opinion No. 2016-UP-5447 (S.C. Ct. App. filed October 26, 2016) (Shearouse Adv. Sh. No. 41 at 42) (the "Opinion"), a Panel of the South Carolina Court of Appeals unanimously reversed the judgment below, which had ruled in favor of the South Carolina Department of Revenue ("SCDOR"). The Administrative Law Court ("ALC") had erroneously found that SCDOR had met its burden to show that the standard apportionment method did not represent the business activity of Rent-A-Center West, Inc. ("RAC West") in South Carolina and that SCDOR's alternative method was reasonable. See Order, R. pp. 3-24. The Court of Appeals reversed this decision concluding that SCDOR had presented the same insufficient level of evidence as it did in CarMax Auto Superstores West Coast, Inc. v. S.C. Dept. of Rev., 411 S.C. 79, 767 S.E.2d 195 (2014) and thus had not met its burden to show that the standard apportionment method did not represent RAC West's business activity in this State. See Opinion of the Court of Appeals, App. at 13.

SCDOR now petitions this Court for a writ of certiorari (the "Petition"). As shown herein, SCDOR has failed to offer this Court any grounds that warrant certiorari as provided by Rule 242(b) of the South Carolina Appellate Court Rules. SCDOR asserts that the basis for granting certiorari would be that a novel issue of law is involved, but as will be discussed below, this Court previously addressed the exact issues involved in this case in CarMax. Thus, SCDOR is simply asking this Court to revisit the same issues it already decided in CarMax. Accordingly, SCDOR's Certiorari Petition should be denied.

COUNTER-STATEMENT OF THE QUESTIONS PRESENTED FOR REVIEW

I. Did the Court of Appeals Correctly Reverse the ALC's Ruling Because SCDOR Failed to Meet its Burden of Proof to Show that the Standard Statutory Apportionment Method Did Not Fairly Reflect RAC West's Business Activity in South Carolina?

II. Did SCDOR Preserve its Unitary Business Argument for Review, and if so, did the Court of Appeals Correctly Not Reach the Question of Whether RAC West Was a Unitary Business Where SCDOR Failed to Meet its Threshold Burden?

COUNTER-STATEMENT OF THE CASE

I. Summary of Procedural History

This case involves a protest by RAC West of an assessment of corporate income taxes by SCDOR for the income tax years ending in 2003-2005. SCDOR audited RAC West's initial returns filed for this time period, which were filed using the statutory three-factor apportionment formula, and issued an additional assessment claiming that RAC West owed $216,300.00 in income tax, interest and penalties and subsequently issued a Department Determination upholding the same. See Field Audit for RAC West, R. pp. 340-350; SCDOR Determination for RAC West. R. pp. 29-37. RAC West then timely requested a contested case hearing before the ALC pursuant to S.C. Code Ann. §12-60-460. Thereafter, and prior to the hearing with the ALC, RAC West filed amended tax returns based on the statutory single-factor apportionment formula and paid $1,326.00 in additional taxes owed under that method.

Following a hearing, the ALC issued a Final Order (the "Order") finding for SCDOR on all issues except the penalty, which the ALC dismissed, on January 6, 2012. See Order, R. pp. 3-24. The ALC erroneously concluded that SCDOR met its burden to show that the standard apportionment method did not represent RAC West's business activity in South Carolina and that SCDOR's alternative method did. Id.

Following an unsuccessful Motion for Reconsideration, RAC West timely filed a Notice of Appeal.

Thereafter, because the parties believed that some or all of the issues in this case might be decided by a similar matter involving another taxpayer (CarMax), the parties obtained a stay of this matter until that case could be decided. The Supreme Court issued its decision on December 23, 2013, wherein it held that SCDOR had failed as a matter of law to meet its burden to show that the standard apportionment method did not fairly reflect CarMax's business activity in South Carolina. CarMax Auto Superstores West Coast, Inc. v. S.C. Dept. of Rev., 411 S.C. 79, 767 S.E.2d 195 (2014).

After full briefing by the parties and oral arguments in this matter, the Court of Appeals issued its Opinion reversing the ALC on or about October 26, 2016. The Court of Appeals correctly held that based on the evidence in the record, SCDOR had failed to meet its burden to show that the standard apportionment method did not fairly reflect RAC West's business activities in South Carolina. (See Opinion of the Court of Appeals, App. at 13.) Because SCDOR failed to prove this threshold issue, the Court did not reach certain issues raised by RAC West, including, *inter alia*, whether the ALC erred in failing to find that RAC West operated a unitary business. Id., App. at p. 14, n. 4. On November 28, 2016, SCDOR petitioned the Court of Appeals for a rehearing (App. at pp. 16-34), which RAC West opposed (see Ex. A, RAC West's Return to SCDOR's Pet. for Reh'g) and which the Court of Appeals denied. (*See* Order Denying Pet. for Reh'g; App. at p. 15).

II. Summary of Relevant Facts

A. General Background on RAC West

The Rent-A-Center ("RAC") business is a rent-to-own business that rents and sells items such as appliances, furniture, electronics, computers and televisions. R. p. 125 at 83:24-84-2. RAC stores are located in all 50 states. R. p. 125 at 84:10-12. The ownership of these stores is split between three entities: the taxpayer, RAC West, owns and operates retail stores in western states; Rent-A-Center East, Inc. ("RAC East") owns and operates retail stores in eastern states (including South Carolina), and Rent-A-Center Texas, LP ("RAC Texas") owns and operates retail stores in Texas. R. p. 125 at 84:18-25.

In addition to owning and operating retail stores, RAC West owns certain intellectual property (the "Rent-A-Center" trade names and trademarks) ("IP") that it uses in all of its stores and licenses to RAC Texas and RAC East, which, in return, pay RAC West a royalty fee. R. p. 125 at 84:20-21 and p. 126 at 85:6-8.[1] At issue in this case is the proper method of reporting RAC West's income in South Carolina as a result of its licensing of IP to RAC East for use by the RAC East stores in South Carolina.

Beyond receiving these royalty fees, RAC West has no activities in this State. R. p. 131 at 106:3-6. It has no physical presence in South Carolina as it has no employees, facilities or tangible property in this State. R. p. 131 at 105:17-22. It also makes no sales in South Carolina and receives *de minimus*, if any, services or benefits from the State. R. p. 131 at 105:23-106:2.

[1] RAC West licenses the IP to RAC East pursuant to a licensing agreement, which sets the royalty fee for the license to 3% of the net sales of the RAC East stores. Trademark License Agreement dated 12/31/2002, R. pp. 383-390. RAC West and RAC East set this fee based on a transfer pricing study (R. p. 130 at 104:13-18 and p. 162 at 230:23-231:25), and SCDOR stipulated at trial that it did not dispute that the amount of this fee was reasonable. R. p. 259 at 134:5-6 and 9-10.

Additionally, RAC West presented evidence regarding the unitary relationship between its two interrelated business activities of owning and licensing IP and owning and operating retail stores in western states (see Final Brief of Appellant, App. pp. 44-45) and raised the unitary business issue before both the ALC and the Court of Appeals (see e.g. id. at pp. 28-43). SCDOR, on the other hand, argued before the ALC and in its Final Brief before the Court of Appeals, that whether RAC West was unitary was irrelevant. See e.g. Final Brief of Respondent, App. at at pp. 130-31. SCDOR's expert economist stated at trial that whether RAC was unitary was a "red herring," and SCDOR argued that the unitary issue was not "the primary issue that [RAC West] makes it." Id. at p. 130. The first mention by SCDOR that whether RAC West was unitary was relevant is found in its Petition for Rehearing before the Court of Appeals. See SCDOR Pet. for Reh'g, App. pp. 10-15.

B. Tax Returns, Audit, Protest and Determination

RAC West has reported its taxable net income to this State using the standard statutory gross receipts apportionment method. See R. p. 134 at 117:17-118:7; S.C. Code Ann. §12-6-2290; Sample SCDOR Corp. Income Tax Instruction, R. pp. 479-499; RAC West Am. Tax Returns 2003-2005, R. pp. 361-382. The standard method begins with a corporation's total net income and then apportions it to this State to determine the portion to be taxed by this State. S.C. Code Ann. §12-6-2290; Sample SCDOR Corporate Income Tax Instruction, R. pp. 479-499. The reported portion in this case was based on the gross receipts apportionment statute, which uses an apportionment fraction in which the numerator is comprised of gross receipts from South Carolina and the denominator is total gross receipts of the corporation. Id. RAC

West's gross receipts from South Carolina consisted of royalties paid by RAC East (on its rentals of items to South Carolina customers), and the total gross receipts were all of RAC West's receipts, i.e. the total of its royalties, retail rentals and other income. R. p. 134 at 117:17-118:7; RAC West Am. Tax Returns 2003-2005, R. pp. 361-382. In other words, RAC West followed the literal wording of the gross receipts apportionment statute.

SCDOR objected to the standard method on the basis that inclusion of the retail sales in the denominator diluted or distorted RAC West's income in South Carolina.[2] SCDOR then computed a tax based solely on the gross royalties paid by RAC East to RAC West. This method completely ignores corporate net income as is graphically illustrated by the fact that SCDOR assessed a tax liability against RAC West in 2005 when the corporate net income was a loss. See Order, R. p. 7; RAC West Audit Report, R. p. 342.

ARGUMENT

The South Carolina Appellate Court Rules provide that a "writ of certiorari is not a matter of right, but of sound judicial discretion, and will be granted only where there are special and important reasons." Rule 242(b), SCACR; see also State v. Lyles, 381 S.C. 442, 443, 673 S.E.2d 811, 812 (2009) (holding that the Court will grant certiorari "only where special reasons justify the exercise of that power") (citations omitted). Typically, the granting of certiorari is limited to cases involving: (1) novel questions of law; (2) a dissent in the decision of the Court of Appeals; (3) a conflict

[2] SCDOR never argued that RAC West's retail sales or licensing of IP were not "business activities."

between the decision of the Court of Appeals and a prior decision of this Court; (4) substantial constitutional issues; or (5) a federal question and the decision by the Court of Appeals conflicts with a decision of the Supreme Court of the United States. Rule 242(b), SCACR; see also Lyles, 381 S.C. at 444 n. 2, 673 S.E.2d at 812 n. 2. As will be discussed below, none of the grounds for granting certiorari are present in this case. Moreover, SCDOR's arguments lack any merit, and the Court of Appeals properly rejected them. Accordingly, SCDOR's Petition should be denied.

I. NO NOVEL ISSUES OF LAW ARE AT ISSUE IN THIS APPEAL.

In its Petition, SCDOR claims that novel issues of law justify a writ of certiorari in this case. See SCDOR's Petition at p. 11. However, the issue here is not novel as it was squarely addressed by this Court in CarMax. As in this case, the issue in CarMax was whether SCDOR had met its burden to show that the standard apportionment formula fairly represented the taxpayer's business activity in South Carolina. In CarMax, this Court held that the burden of proof in a case where one party wishes to deviate from the standard apportionment formula is upon that party. CarMax, 411 S.C. at 89, 767 S.E.2d at 200. It also found that the evidence presented by SCDOR in that case was insufficient as a matter of law to meet its burden. Id., 411 S.C. at 91, 767 S.E.2d at 201. As will be discussed in more detail below, this Court ruled that testimony from an auditor concerning the business structure of the taxpayer and the fact that the taxpayer's method yielded a significantly lower tax than that of a related company were insufficient to support the ALC's determination that the taxpayer's income was diluted by the standard statutory apportionment method. Id., 411 S.C. at 90, 767 S.E.2d at 201. This Court also noted that SCDOR presented no other evidence

beyond this other than "bald assertions by its witnesses that it satisfied this threshold question" and that it "merely 'describe[d] what it did rather than cite any evidence justifying what it did.'" Id., 411 S.C. at 90-91, 767 S.E.2d at 200-201.

The Court of Appeals' ruling here follows CarMax to the letter in reaching its conclusion that SCDOR failed to meet its burden here. As previously stated, the Court of Appeals concluded that SCDOR presented the same level of evidence as it did in CarMax, including unsupported allegations by SCDOR witnesses about the business structure of the company and that the management services fee was too high and bald assertions by its expert witness that using the standard method was like "having apples in the numerator, while having apples and oranges in the denominator" and that "excluding the retail operations from the calculations was essential to 'come up with a tax burden that fairly represented the economic nexus of the entity with South Carolina.'" Id. This "apples and oranges" argument was made by the same expert in CarMax. Because the issues examined in CarMax are almost identical to those raised by SCDOR here, no novel issue is present in this case that would justify granting certiorari.

In an effort to try to minimize or limit the impact of CarMax, SCDOR claims that "[t]he factual analysis in the Carmax cases is at best questionable and should not control this case." Petition at p. 12. In support of this, it points to the dissent in CarMax, which concluded that the case should have been remanded to the ALC to place the burden of proof on SCDOR and then apply the facts to the law. Id. at pp. 11-12. Because the Supreme Court did not remand the case, but instead, with the consent of both parties, ruled on the sufficiency of the evidence, SCDOR asserts that CarMax

should only be relied upon for its holding that the burden of proof is on the party asserting an alternative method and that this Court's ruling on the insufficiency of the evidence presented by SCDOR should be ignored.

SCDOR cites no authority, and RAC West is not aware of any, that would support this contention that findings and conclusions of this Court should be ignored based on a single dissent. Moreover, the focus of the dissent was that the case should be remanded to the ALC to apply the law (with which the dissent agreed) to the facts versus the Supreme Court doing so. This concern about which court should apply the law to the facts is only of relevance to the parties in that matter, who both agreed to have this Court do so. It has no impact whatsoever on the weight of the Court's ruling that the evidence presented was insufficient as a matter of law. Accordingly, the Court of Appeals properly recognized CarMax as binding precedent and applied the analysis therein to the facts in this case, which are substantially identical to those in CarMax.

SCDOR does not argue that any of the other grounds for granting certiorari apply in this case, and none are applicable. Accordingly, because there is no novel issue of law, SCDOR's Petition should be denied.

II. THE COURT OF APPEALS PROPERLY DECIDED THE TWO ISSUES RAISED BY SCDOR IN ITS PETITION.

SCDOR raises two issues in its Petition. First, it claims that the Court of Appeals erred in reversing the ALC's ruling and finding that SCDOR failed to meet its burden of proof to show that the standard statutory apportionment formula did not fairly reflect the extent of RAC West's business activity in South Carolina. Petition at p. 12. In addition, it argues that the Court of Appeals erred by not ruling on whether RAC West's retail and trademark activities are unitary activities thus allegedly allowing non-unitary activities to be wrongly combined. Id. at p. 18. Neither argument has any merit, and, therefore, this Court should deny SCDOR's Petition.

A. South Carolina Law on Corporate Income Tax for Multi-State Taxpayers

As this Court is aware, under South Carolina law, a multi-state taxpayer that does business both within and without this State is subject to a 5% corporate income tax "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). The primary disagreement between the parties in this case centers on the interpretation of the phrase "proportion of the trade or business carried on within this State." RAC West contends that the phrase means the proportion of the taxpayer's business activities in South Carolina as compared to the entirety of the taxpayer's business activities in all states. SCDOR, on the other hand, appears to argue that it means a taxpayer's business line performed in South Carolina compared to its income from that same business line in other states. See SCDOR Cert Petition at pp. 14-15.

The starting point in interpreting a statute is the text of the statute itself. Hodges v. Rainey, 341 S.C 79, 85, 533 S.E.2d 578, 581 (2000). Additionally, the plain meaning rule requires that "words must be given their plain and ordinary meaning without resort to subtle or forced construction to limit or expand that statute's operation." State v. Leopard, 349 S.C. 467, 471, 563 S.E.2d 342, 344 (Ct. App. 2002). Finally, "statutes dealing with the same subject matter are in *pari materia* and must be construed together, if possible, to produce a single, harmonious result." Brown v. James, 389 S.C. 41, 53, 697 S.E.2d 604, 611 n.13 (Ct. App. 2010).

RAC West's view that the tax base must reasonably represent the proportion of a multi-state taxpayer's business activities in this state versus its business activities in all states is supported by the plain language of the statute itself as well as the statutory scheme as a whole, with which this section should be read *in pari materia*. The General Assembly's language in this statute focuses on the **proportion** of a taxpayer's business within South Carolina and makes no mention of the **type** of income stream that is being taxed. Other code sections that should be read in conjunction with the apportionment statute also support this interpretation, including, but not limited to, S.C. Code Ann. §12-6-580 (which provides that federal taxable income is the starting point for determining a multi-state taxpayer's income, which by definition includes all income streams of a taxpayer) and S.C. Code Ann. §12-6-2290 (also known as the "gross receipts" statute and which apportions net income by dividing "gross receipts from within this State" by "total gross receipts from everywhere"). See also Lockwood Greene Eng. v. S.C. Tax Comm'n, 293 S.C. 447, 449, 361 S.E.2d 346, 347 (Ct. App. 1987) (stating that the allocation statutes provide apportionment formulas that determine

the proportion that represents a multi-state taxpayer's business that is carried on in South Carolina).

SCDOR cites no law in support of its position that the "proportion" referenced in S.C. Code Ann. § 12-6-2210(B) refers only to a taxpayer's business line in South Carolina but instead points to the alternative apportionment statute as providing it with a way to avoid the statutory language. Although that statute does provide separate accounting as a possible option in appropriate circumstances (see S.C. Code Ann. §12-6-2320(A)) (which are not present in this case), the tax base referred to in §12-6-2210(B) is clearly referring to the proportion of the taxpayer's total business that is conducted in South Carolina.

For the type of income that is at issue here, the parties agree that the single-factor "gross receipts" statute is the proper method if the standard statutory method is to be applied. S.C. Code Ann. § 12-6-2290; R. p. 268 at 172:12-18 (testimony of auditor that single-factor formula would be the correct method). Under this statute, the taxpayer's "gross receipts from within this State" are divided by the taxpayer's "total gross receipts from everywhere." S.C. Code Ann. § 12-6-2290.

As both parties agree, an alternative method of apportionment is only authorized in certain circumstances, which are set forth in S.C. Code Ann. §12-6-2320(A):

> If the allocation and apportionment provisions of this chapter do not fairly represent the extent of the taxpayer's business activity in this State, the taxpayer may petition for, or the department may require, in respect to all or any part of the taxpayer's business activity, if reasonable:
>
> (1) separate accounting;
>
> (2) the exclusion of one or more of the factors;

(3) the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in the State; or

(4) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

Thus, an alternative method may only be used where (a) the standard method does not fairly represent the taxpayer's in-state business activities, and (b) the alternative method (here, a flat tax on gross receipts) is reasonable. S.C. Code Ann. §12-6-2320(A). In addition, the party seeking to deviate from the standard statutory formula bears the burden of proving both elements by a preponderance of the evidence. CarMax, 411 S.C. at 89, 767 S.E.2d at 200. Thus, SCDOR, as the proponent of an alternative method, had the burden of proof on the two elements, which must be proven in sequence.

As previously mentioned, this Court recently examined the first prong of this test (which is the issue here) in the CarMax case, wherein it held that SCDOR had not met its burden to show that the standard formula did not fairly represent CarMax West's business activities in this State. Id., 411 S.C. at 90, 767 S.E.2d at 200. The ALC in CarMax had relied on testimony from an auditor regarding the business structure of the taxpayer and the fact that the taxpayer's method yielded a significantly lower tax than that of a related company to support its determination that the taxpayer's income was diluted by the standard statutory apportionment method. Id., 411 S.C. at 90, 767 S.E.2d at 201. The ALC had also considered the same "apples and oranges" allegation made in this case by the same expert witness. CarMax v. S.C. Dept. of Rev., Docket no. 09-ALJ-17-0160-CC, at p. 9, n. 7 (Admin. Law Ct. April 22, 2010). In affirming

as modified the Court of Appeals decision reversing the ALC, this Court noted that "the Department merely 'describe[d] what it did rather than cite any evidence justifying what it did.'" CarMax, 411 S.C. at 90, 767 S.E.2d at 200. It also found that "[t]his was the extent of the evidence offered by the Department to prove the contention that the statutory formula did not fairly represent CarMax West's business activity in South Carolina, other than bald assertions by its witnesses that it satisfied this threshold question." Id., 411 S.C. at 90-91, 767 S.E.2d at 201. The Court then held that such findings, even if true, "do not provide a sound evidentiary basis to support the conclusion that the statutory formula did not fairly represent CarMax West's business activity in South Carolina." Id., 411 S.C. at 91, 767 S.E.2d at 201 (citing St. Johnsbury Trucking Co., 385 A.2d at 217 ("Merely because the use of an alternative form of computation produces a higher business activity attributable to New Hampshire, is not in and of itself a sufficient reason for deviating from the legislatively mandated formula")). In other words, simply because SCDOR's chosen method produces a higher income figure than the standard method is not a reason to reject the standard method.

This Court examined a similar issue in Eastman Kodak. In that case, SCDOR's predecessor objected to Eastman Kodak's inclusion of the income from its safe harbor lease transactions in the denominator of the apportionment formula because only a very small percentage of the leased assets were located in South Carolina. 308 S.C. at 419, 418 S.E.2d at 544. However, as recognized by the Court of Appeals in its Opinion in this case, this Court disagreed and found that the apportionment formula properly reflected the taxpayer's business activities in South Carolina when it only had the minor South Carolina leasing operations in the numerator of the formula. Id.; see also Opinion

of the Court of Appeals, App. at p. 13. As RAC West's tax policy expert testified and as the Court of Appeals found, this is how apportionment is supposed to work. Using a pizza pie analogy, the tax policy expert explained that formulary apportionment takes the total pizza (i.e. the total corporate income of a business in all states) and determines the slice of the pizza that the taxing state should get. R. p. 238 at 49:3-7 and 52:8-18; Appellant's Final Brief, App. at pp. 58-59.

B. This Court Properly Ruled that SCDOR Failed to Meet its Burden to Establish that the Standard Apportionment Method Did Not Fairly Represent RAC West's Business Activities in this State.

The issue in this appeal is whether SCDOR met the first prong of its two-prong burden to establish that the standard apportionment method (which seeks to determine the portion of RAC West's total net income that should be apportioned to South Carolina) did not fairly represent RAC West's business activities in this State. In its Opinion, the Court of Appeals concluded that SCDOR failed to do so because it produced the same insufficient level of evidence as was submitted in CarMax. Opinion of Court of Appeals, App. at p. 13. As previously stated, the Court of Appeals specifically noted the auditor's testimony regarding its business structure and a management services fee that he stated was "too high" as well as SCDOR's experts "apples and oranges" testimony and his assertion that exclusion of the retail sales was necessary to fairly reflect RAC West's nexus with this State and concluded that these were bald assertions that constituted insufficient evidence to satisfy SCDOR's burden. Id. Additionally, the record shows that no documentary evidence (such as, for example, management fee studies) was offered in support of the auditor's assertion regarding the management fees. In fact, SCDOR stipulated at trial that it did not dispute

that the amount of this fee was reasonable (see R. p. 259 at 134:5-6 and 9-10) and chose not to challenge the deduction for those expenses taken by RAC East, which the auditor acknowledged would have addressed his concerns. See R. p. 256.

SCDOR's Petition claims that the Court of Appeals erred in reaching this conclusion and that this error resulted from the Court overlooking or failing to consider the following purported evidence and assertions in the record:

- testimony of SCDOR's expert economist that using the standard apportionment method would not provide an accurate reflection of RAC West's business activities in South Carolina because it was mixing apples and oranges (Petition at pp. 17-18)

- testimony of the auditor that RAC West's "out-of-state retail operations had 'nothing' to do with its trademark activities in South Carolina" (Id. at p. 15)

- testimony that RAC West did not operate any retail stores or have any management or employees in South Carolina, which SCDOR claims shows that "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" (Id. at pp. 14-15)

- the fact that RAC West's net income for 2004 totaled $19,840,800 and its gross receipts from its trademark business in South Carolina totaled $861,437, but the standard method only apportioned $40,317 of RAC West's net income to South Carolina (Id. at p. 17)

- the fact that retail sales comprised 87% of RAC West's income while royalty income totaled 13% of RAC West's income (Id. at p. 15)

- purported evidence that the retail sales and trademark activities have "widely divergent profit margins" and that "the result of combining both activities into one gross-receipts formula is a dilution and distortion of [RAC West's] business activity in South Carolina...." (Id. at pp. 15-16)

As will be discussed below, the above are either unsupported assertions, do not support SCDOR's position, and/or were not preserved for review.

1. The Court of Appeals properly rejected SCDOR's "apples and oranges" argument.

Most of the evidence and arguments that SCDOR claims the Court of Appeals overlooked relate to its "apples and oranges" argument, which the Court of Appeals considered and properly rejected. The gist of this argument (which was conveyed by the very same expert witness in CarMax) is that RAC West's royalty income should not be "mixed" with its retail sales income because no retail sales income was earned in South Carolina and thus the ALC should separate these two types of income. R. p. 123 at 74:18-75:22. SCDOR's expert economist offered an "apples and oranges" metaphor to support this notion with the apples in this case being the royalty payments and the oranges being the retail sales. He contended that one should not mix the apples with the oranges because only apples are in South Carolina. See R. p. 274 at 193:14-194:22.[3]

CarMax argued (as RAC West does here) that including the out-of-state sales does not cause the apportionment formula to be diluted and therefore unfairly represent the extent of its business in South Carolina. To the contrary, the formula correctly responds to the fact that there are no retail sales in South Carolina and that fact

[3] As additional support for its argument that RAC West's retail and IP income are "apples and oranges," SCDOR also inaccurately asserted that RAC West's "out-of-state retail operations had 'nothing' to do with its trademark activities in South Carolina." Petition at p. 15. Whether this (with all due respect, clearly erroneous conclusion) is true or not, it relates primarily to the unitary question not reached by the Court of Appeals as directed by CarMax. See infra §II(C). It does not address the threshold question of what proof was offered by SCDOR upon which the ALC could have reached its conclusion that RAC West's minimal activities in this State are not fairly represented by the standard statutory method. Moreover, how anyone could argue that a trademark has nothing to do with the product being sold under that trademark is, frankly, incredulous.

is correctly recognized by including the sales in the denominator with none in the numerator.

As the Court of Appeals recognized, this result is also directly supported by Eastman Kodak, which stated as follows: "'The fact that a very small percentage of the leased assets are located in South Carolina is accounted for in the numerator of the apportionment formula . . . [and t]herefore the apportionment formula reflects a 'reasonable representation' of Kodak's business in this state.'" Opinion of the Court of Appeals, App. at p. 12, quoting Eastman Kodak, 308 S.C. at 419, 418 S.E.2d at 544.

SCDOR also pointed to testimony that retail sales accounted for 87% of RAC West's total corporate income while royalties accounted for only 13%. How this relates to the issue at hand is a mystery as SCDOR never argued that the retail sales were not a valid business activity, and SCDOR has given no explanation as to why these figures are relevant to measuring the taxpayer's business activity in South Carolina. Perhaps, this is another iteration of the "apples and oranges" argument, i.e. the two business lines account for very different percentages of income and therefore should not be combined. However, the fact that RAC West's royalty receipts are a relatively low percentage of its income proves nothing and could be true of any taxpayer with multiple lines of business. And just because a company generates only one type of income in a particular state (royalty income here) and another type of income in another state (retail sales income here) does not mean that they should be separated for tax purposes. Similar arguments were made in Exxon with the apples being the oil production and refineries and the oranges being the gas pumps and stations. The South Carolina Supreme Court rejected this type of reasoning and held that Exxon's unitary business

income could not be separated based on the fact that Exxon had only marketing activities in this State. Exxon, 273 S.C. 594, 258 S.E.2d 93. See also Exxon v. Wisconsin Dept. of Rev., 447 U.S. 207, 223-24 (1980).

In sum, SCDOR's "apples and oranges" argument has no merit, and, thus, the Court of Appeals properly rejected it and correctly held that SCDOR failed to present any evidence to show why the standard method was not a fair reflection of RAC West's business activities in South Carolina.

2. The Court of Appeals properly rejected SCDOR's arguments that it met its burden by showing that the standard method produces a tax that is a low percentage of RAC West's gross receipts or by showing that the alternative method produces a higher tax.

SCDOR points to the ALC's finding that RAC West's total net income for 2004 was $19,840,800 and its South Carolina trademark receipts were $861,437 but that the standard method only apportioned $40,317 of the net income to South Carolina. The implied arguments here are that the amount of tax is too low of a percentage of the gross receipts and that the amount of the tax under the standard method is much lower than the tax under the alternative method. The Court of Appeals properly rejected that SCDOR met its burden by showing either that the standard method produces a tax that is a low percentage of RAC West's gross receipts or by showing that the alternative method produces a higher tax.

The obvious error with the former argument is that the formula is not taxing a percentage of **gross receipts** but instead is designed to tax a portion of the taxpayer's **net income** with the portion being determined based on the level of activity in this State. If a taxpayer has a high activity level in South Carolina, then the tax will be

correspondingly high, whereas if the activity level is low, then the amount of tax will be low. As the gross receipts statute indicates and as RAC West's tax policy expert testified, that is exactly how formulary apportionment works for multi-state taxpayers.[4]

The latter argument that the standard method produces a lower taxable amount than the alternative method is the exact same argument rejected in CarMax. The ALC in this case compared RAC West's computation using the standard formula to SCDOR's alternative computation and observed that the latter produces a higher tax. If this was a reliable method, then every formula SCDOR comes up with showing more tax should be accepted. SCDOR merely showing what it did is not evidence of anything, much less distortion, and showing that its method produces a higher tax, as this Court recognized in CarMax, is insufficient as a matter of law to establish that the standard statutory method does not reasonably reflect a taxpayer's business activities in this State. CarMax, 411 S.C. at 91, 767 S.E.2d at 201, citing St. Johnsbury Trucking Co., 385 A.2d at 217 ("Merely because the use of an alternative form of computation produces a higher business activity attributable to New Hampshire, is not in and of itself a sufficient reason for deviating from the legislatively mandated formula.").

3. The fact that RAC West does not operate retail stores or have any management or employees in South Carolina supports the position of RAC West, not SCDOR.

[4] As previously stated, RAC West's tax policy expert's pizza pie analogy illustrates this point well. Formulary apportionment takes the total pizza (i.e. total corporate income of a business in all states) and determines the slice of the pizza that the taxing state should get. R. p. 238 at 49:3-5. Separate accounting, on the other hand, "just want[s] to tax the pepperoni." R. p. 238 at 49:5-7. It seeks to tax only the "high profit item" and ignores the entire pizza. R. p. 238 at 49:19-22.

SCDOR also claims that the Court of Appeals overlooked the fact that RAC West did not operate any retail stores nor did it have any management or employees in South Carolina and that this shows devaluation or distortion of the gross receipts ratio. Petition at pp. 14-15. However, these facts support the position of RAC West, not SCDOR. All RAC West does in this State is receive royalties from a related company doing business in South Carolina, and even these royalties are primarily the result of activities that take place out-of-state. See supra pp. 4-5. RAC West has no physical presence here. Id. Despite this minimal presence, the royalties from South Carolina have not been ignored but have been placed in the numerator of the apportionment formula. The higher the royalties from South Carolina are, the higher the apportionment ratio will be resulting in an increased portion of the South Carolina share of the income and resulting tax. The fact that RAC West's activities in this State are minimal cannot be ignored. The standard method has allocated a fair share of RAC West's total income to South Carolina when compared to its minimal activities here.[5]

4. SCDOR's argument regarding divergent profit margins was not preserved for review and, even if considered, is without merit.

SCDOR claimed for the first time in this case in its Petition for Rehearing before the Court of Appeals that RAC West's retail sales and trademark activities have widely divergent profit margins and that combining these activities is a dilution and

[5] It is also noteworthy that RAC West did not create its own novel method in an attempt to distort its income. Instead it used the standard method ***required*** by statute. The retail sales from western states that SCDOR claims were included to distort the ratio are specifically ***required*** by the statute to be included. The only way RAC West could have avoided using this method is by petitioning for an exception under S.C. Code §12-6-2320(A), which it had no reason under existing law to think would be appropriate.

distortion of RAC West's business activity in South Carolina. SCDOR Pet. for Reh'g., App. at pp. 23-25. This argument has not been preserved for review, and even if considered, it is without merit.

First, under Rule 242 of the South Carolina Appellate Court Rules, "[o]nly those questions raised in the Court of Appeals and in the petition for rehearing shall be included in the petition for writ of certiorari as a question presented to the Supreme Court." See SCACR, Rule 242; Kleckley v. Northwestern Nat. Cas. Co., 338 S.C. 131, 138, 526 S.E.2d 218, 221 (2000) (holding that issue not preserved for review when it was raised for the first time in the petition for rehearing); see also Mazloom v. Mazloom, 392 S.C. 403, 709 S.E.2d 661 (2011); Camp v. Springs Mtg. Corp., 310 S.C. 514, 426 S.E.2d 304 (1993). Because this issue was not raised in SCDOR's Final Brief before the Court of Appeals, it has not been preserved for review.

Moreover, even if this argument had been preserved, it lacks merit. Although not argued by SCDOR before the ALC, the ALC's Order stated that "the evidence does not show that RAC West's retail operations, which generate a very large portion of its South Carolina gross receipts, contribute a comparable amount to RAC West's net income" and then erroneously concluded that including RAC West's income from its retail sales would dilute its gross receipts and distort its economic activity in this State. Order, R. p. 11. The ALC implies that RAC West's retail business is less profitable than its royalty business. However, the ALC did not reach this conclusion based on any evidence in the record (there was none) but on the basis that the evidence did not show that this conclusion was *not* accurate. Id. The ALC then cited a California case (which was not cited in SCDOR's Final Brief but only in its Petition for Rehearing) holding

that a taxpayer's investment income from short-term securities distorted the results of the standard apportionment formula because the investments produced less than 2% of the company's business income but 73% of its gross receipts. Id. (citing Microsoft Corp. v. Franchise Tax Bd., 139 P.3d 1169, 1178-79 (Cal. 2006)). Thus, the ALC appears to have concluded that because RAC West did not prove that its retail business is as profitable as its royalty business, that amounts to proof of distortion in this case.

However, as the Court of Appeals properly held, it was not RAC West's burden to prove anything; SCDOR bore the burden of showing that the standard formula did not reasonably represent RAC West's business activities in South Carolina. If SCDOR wanted to try to establish this by showing that the royalty business was more profitable than the retail business, then it could have chosen to do so; however, it presented no such evidence. See Ex. A, RAC West Return to Petition for Reh'g at pp. 15-17 (for additional discussion of the merits of this argument).

C. SCDOR's Unitary Business Argument Was Not Preserved for Review, and, in any event, the Court of Appeals Did Not Need to Reach this Issue under CarMax.

SCDOR claims that the Court of Appeals erred by failing to consider whether RAC West's two lines of business (retail sales and licensing of IP) were unitary. Petition at p. 18. It states that the ALC failed to address this issue but points to the ALC's finding that the revenue from the two business lines was "unrelated" (id. at p. 19) as support for its claim that the two business lines are non-unitary, which it then argues supports its contention that the standard apportionment method did not fairly reflect RAC West's business activities in this State. Id. at pp. 18-20.

First, as with the divergent profit margins argument, this argument has not been preserved for review. SCDOR made no argument in its Final Brief before the Court of Appeals that whether RAC West was unitary was relevant, and, in fact, pointed to the testimony of its expert economist that whether RAC was unitary was a "red herring." Appellant's Final Brief, App. at pp. 130-31 (also stating that whether the business is unitary "is not the primary issue that Appellant makes it" and arguing that even if the business is unitary, it can still be separated). SCDOR asserted this new argument for the first time in its Petition for Rehearing. Petition for Reh'g, App. at pp. 10-15.

As previously stated, Rule 242, SCACR, requires that an issue be raised both in briefing before the Court of Appeals and in the petition for rehearing in order to be included in the petition for writ of certiorari before the Supreme Court. Kleckley, 338 S.C. at 138, 526 S.E.2d at 221 (holding issue not preserved for review when it was raised for the first time in the petition for rehearing); see also supra, section II(B)(4) at p. 22 (for additional cases supporting this rule). Because SCDOR did not raise this issue in its Final Brief before the Court of Appeals, it is not properly preserved for review by this Court on certiorari.

Moreover, even if SCDOR's unitary business argument had been preserved for review, this Court need not reach it because SCDOR failed to establish the threshold issue of whether the standard method fairly reflected RAC West's business activities in South Carolina. CarMax, 411 S.C. at 91, 767 S.E.2d at 201 and n. 11. Therefore, it was appropriate for the Court of Appeals not to reach SCDOR's unitary business argument.

CONCLUSION

Based on the foregoing, RAC West respectfully requests that this Court deny SCDOR's Petition for Writ of Certiorari.

NELSON MULLINS RILEY & SCARBOROUGH LLP

By: Bryson M. Geer by Matt Bogan w/ express permission

John C. von Lehe, Jr.
SC Bar No. 5719
E-Mail: john.vonlehe@nelsonmullins.com
Bryson M. Geer
SC Bar No. 13606
E-Mail: bryson.geer@nelsonmullins.com
151 Meeting Street / Sixth Floor
Post Office Box 1806 (29402-1806)
Charleston, SC 29401-2239
(843) 853-5200

Attorneys for Rent-A-Center West, Inc.

Charleston, South Carolina
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