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THE STATE OF SOUTH CAROLINA
In The Court of Appeals

APPEAL FROM THE ADMINISTRATIVE LAW COURT

Ralph King Anderson, III, Chief Administrative Law Judge

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

DIRECTV, Inc. and its Subsidiaries, Appellant,
v.
South Carolina Department of Revenue, Respondent.

PETITION FOR REHEARING

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SC Court of Appeals

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Pursuant to Rule 221(a) of the South Carolina Appellate Court Rules, Appellant, DIRECTV, Inc. and its Subsidiaries ("DIRECTV"), hereby files this Petition for Rehearing of the above-referenced matter, which resulted in Opinion number 5513 filed August 30, 2017 (the "Opinion"). This Petition for Rehearing is based on the ground that the Court overlooked or misapprehended some factual or legal matters in this case and that the opinion conflicts with existing South Carolina law.

FACTUAL BACKGROUND

The central issue in this case is the proportion of DIRECTV's income producing activity that takes place in South Carolina versus the proportion that takes place in other states. The factual background needed to address this issue relates primarily to DIRECTV's business activities both within and without this State. The following is a brief summary of the evidence and the factual and expert testimony on these issues.

I. Factual Testimony and Evidence

DIRECTV is a California corporation with its headquarters and principal place of business in California. Transcript of ALC Hearing ("Tr."); R. p. 176:3-12. It provides direct-to-home ("DTH") digital television entertainment and is engaged in acquiring, producing, promoting, and distributing high-quality digital entertainment programming primarily via satellite to residential and commercial subscribers throughout the United States, including South Carolina. Tr.; R. pp. 172:21- 174:23; pp. 186:3- 187:18.

Almost all of the activities related to the provision of its programming services occur outside of South Carolina. Expert Report of Dr. Brian J. Cody ("Cody Rpt."), R. pp. 743-769; Tr., R. pp. 172:16- 204:11. DIRECTV did not maintain any offices in South Carolina

during the Period at Issue,¹ and almost all of the employees and assets involved in the provision of its programming services were located outside of South Carolina. Cody Rpt., R. pp. 743-769; Tr., R. pp. 172:16- 204:11; 486:16- 487:1; 487:17- 488:8. In fact, during the Period at Issue, only two of DIRECTV's employees worked in South Carolina. Tr., R. p. 486:16- 487:1.

The principal income producing activities of DIRECTV's business are: (1) content development (both original and acquired programming); (2) broadcast operations (including delivery of signal); (3) marketing and sales; and (4) customer service. Tr., R. pp. 174:17-23; 328:20- 329:16. The key factual testimony and evidence on these income producing activities (sometimes referred to in the testimony as "value drivers") will be briefly summarized below.

A. Content Development

DIRECTV's content development activities include the following:

- Acquisition of content from third-party providers such as movie studios, broadcast television networks (*e.g.*, ABC, FOX and NBC), local broadcast stations and providers of cable programming (*e.g.*, HBO, STARZ and ESPN). Tr., R. p. 177:8- 178:6.
- Provision of premier sporting experience through exclusive arrangements with sports leagues such as the NFL, whereby DIRECTV subscribers are able to watch almost every NFL game. Tr., R. p. 177:18- 178:1; 180:7- 182:16
- Production of original programming, including musical specials, original series such as "Friday Night Lights" (a television series about high school football) and original sporting events such as pay-per-view boxing and DIRECTV's own branded version of ultimate fighting called "Bare Knuckle Boxing." Tr., R. p. 178:7-24. DIRECTV also produces original content that enhances content acquired from third-parties. Tr., R. pp. 177:8-178:6 and 179:3-20; 180:7- 181:18. For example, DIRECTV developed the "Masters

¹ The Period at Issue involves DIRECTV income tax periods ended December 31, 2006 through December 31, 2011 and license fee periods ended December 31, 2010 through December 31, 2012.

Experience” to enhance traditional network coverage of the Masters golf tournament by placing additional cameras throughout the golf course, providing subscribers with the ability to watch play at particular holes and/or follow particular groups of players throughout their round. Tr., R. p. 179:3-20.

- Development of original programming and negotiating agreements to acquire programming with sports leagues, movie studios, national broadcast networks, local television stations and cable networks. Tr., R. p. 183:9-11. Employees responsible for all content development (including production of original content and negotiation of agreements for acquired content) are located in California. Tr., R. p. 183:9-11.

B. Broadcast Operations

DIRECTV’s broadcast operation activities include the following:

- Acquisition of content from third-parties in several ways, including by satellite, fiber-optic cable, and over-the-air broadcast. Tr., R. pp. 183:18- 187:18 The signals for national programming content are collected at national “broadcast centers” in California and Colorado, which contain facilities to receive, process and transmit the programming content signals. Tr., R. pp. 190:23- 193:12.
- Collection of programming from local broadcast television stations through local collection facilities (“LCFs”), which are unmanned facilities throughout the country consisting of antennae and other receiving equipment. Tr., R. p. 186:3- 187:18. The LCFs roughly correspond to each of the 210 Nielsen assigned designated market areas (“DMAs”) in the United States. *Id.* DIRECTV collects over 1500 local channels at each LCF. Tr., R. p. 186:3- 187:18. There are seven DMAs covering South Carolina, including the DMAs located in Charlotte, North Carolina, Augusta, Georgia, and Savannah, Georgia. Tr., R. p. 189:1-12. During the Period at Issue, only four LCFs were in South Carolina. Tr., R. pp. 187:19-25; 189:4-12.
- Gathering of content at the LCFs, which is then collected at uplink facilities owned by DIRECTV and located in Arizona, Georgia, Minnesota, New Hampshire, Virginia and Washington. Tr., R. p. 187:3-18. The uplink facilities and broadcast centers transmit the programming content signals to the satellites in geo-stationary orbit above the earth. Tr., R. pp. 187:10-18; 194:11- 195:23. Each satellite occupies a federally assigned orbital slot. Cody Rpt., R. p. 755. Those orbital slots are a “vital crown jewel” of the business because they are centrally located and provide a clear view of the entire United States, which permits programming to be delivered by beams covering the entire United States (“CONUS” beams). Tr., R. p. 196:4-21. National programming is transmitted by these so-called CONUS beams. Tr., R. p. 194:15- 195:5. Local programming is transmitted in narrow beams that may cover multiple DMAs. Tr., R. p. 194:15- 195:23.

- Transmission via satellites of the signals received from the broadcast centers and regional uplink facilities directly to customers, who receive the signals by a small “satellite dish” mounted on or near their homes. Tr., R. p. 196:22- 197:20. The signals are then relayed from the dish to a “set-top box,” which delivers the signals to the customers’ television sets. Tr., R. p. 197:14-20.

C. Marketing and Sales Activities

DIRECTV’s marketing and sales activities include the following:

- Communication of DIRECTV’s programming services to premium subscribers who want the highest-end video experience and/or a sports-centric experience. Tr., R. p. 201:11-22.
- Engagement in national advertising campaigns using the same production value and writing that usually go into feature length films. Tr., R. p. 201:23- 202:12. DIRECTV’s campaigns are very distinctive to show its unique brand with the goal being to encourage customers to call and place an order for television services. Tr., R. p. 199:4-10 and p. 201:11-202:12. Employees performing marketing and sales activities are located in California. Tr., R. p. 176:14-20.

D. Customer Service Activities

DIRECTV’s customer service activities include the following:

- Provision of the best possible customer care. Tr., R. p. 174:13-16. The call centers take customer orders and facilitate the installation of equipment. Tr., R. p. 200:6- 201:1. Both third party home service providers (“HSPs”) and HSPs that were acquired by DIRECTV were used to install dishes and set-top boxes in customers’ homes. Customer care activities are headquartered in California and organized from a center in Colorado. Tr., R. p. 198:17-21. During the Period at Issue, both internal call centers as well as third-party call centers provided customer service support, none of which were in South Carolina. Tr., R. p. 198:22- 200:5. Additionally, no DIRECTV “in-house” installers were operating in South Carolina during the Period at Issue. Tr., R. p. 482:20- 483:12-15.

II. Expert Testimony and Reports

A. Dr. Brian J. Cody, Expert Economist

DIRECTV’s expert economist, Dr. Brian J. Cody, performed a two-step analysis of DIRECTV’s business activities: (1) identifying from an economic perspective the income

producing activities of DIRECTV by analyzing its “primary value drivers;” and (2) determining the location of those income producing activities using a formula based on DIRECTV’s payroll and assets. Cody Rpt., R. p. 743; Tr., R. p. 327:13-19.

1. Identify Income Producing Activities

To identify DIRECTV’s income producing activities, Dr. Cody examined “important functions, risks and assets that are employed in the business” to determine “what is really creating the value that consumers ultimately pay for. . . .” Tr., R. p. 351:6-13. He found that there are four primary income producing activities, or in his terminology, “value drivers”, that influence a customer’s decision to subscribe to DIRECTV’s programming services: (1) content development (both original and acquired programming); (2) marketing; (3) broadcast operations (including delivery of signal); and (4) customer service. Cody Rpt., R. pp. 749 and 760; Tr., R. p. 329:2-16. He concluded that these primary value drivers are DIRECTV’s income producing activities because they are “the activities that DIRECTV engages in in order to convert potential customers into subscribers and to retain and drive additional income from existing subscribers.” Tr., R. pp. 342:1-3; 344:6-11; 351:3-9.²

a. Content Development

In discussing his conclusion that content is a primary value driver, Dr. Cody explained that “[c]ontent is what the subscriber ultimately receives from DIRECTV” and that “as I was doing my research and I looked at DIRECTV’s ability to charge premium prices, it really kept

² Dr. Cody’s conclusion is consistent with testimony from DIRECTV’s Rule 30(b)(6) witness, who testified that DIRECTV considered its income producing activities to be the “assets and the employees that perform the service which puts the video into the television of its customers.” Tr., R. p. 502:15-18.

bringing me back to that premium content that was there.” Tr., R. p. 329:23- 330:23. To highlight the significance of content on DIRECTV’s value, Dr. Cody pointed out that AT&T’s acquisition of DIRECTV was contingent upon the renewal of DIRECTV’s exclusive deal with the NFL for Sunday Ticket. Cody Rpt., R. p. 750; Tr., R. p. 330:24- 331:16. He explained that content distinguishes DIRECTV in a highly competitive industry and allows it to charge premium prices. Tr., R. p. 332:8-18.

b. Marketing Services

Dr. Cody noted that DIRECTV’s marketing focus is to attracting new customers through increased investment in unique content and advanced broadcasting technology. Cody Rpt., R. p. 751. He found that DIRECTV’s marketing services are a primary value driver because those activities attract new customers and also produce additional income from existing customers who upgrade their accounts, as well as entice consumers to switch to DIRECTV or upgrade their accounts. *Id.*, R. pp. 750-751. The marketing services have “a direct impact on the amount of money that customers are willing to pay.” Tr., R. p. 336:1-6.

c. Broadcast Operations

As Dr. Cody explained, DIRECTV’s broadcast operations are a value driver because acquiring customers is heavily dependent on being able to deploy “reliable technology to deliver content to a customer’s television set(s) or mobile device(s).” Cody Rpt., R. p. 750. This is accomplished through DIRECTV’s satellite networks (which digitally deliver content to subscribers), the broadcast centers and uplink facilities (which receive, process and transmit programming content) and the optimally located orbital slots (which allow DIRECTV to provide high quality signals across the United States). *Id.* at 751.

d. Customer Service

Finally, Dr. Cody identified customer service as a primary value driver because such activities improve customer retention and attract new subscribers. Cody Rpt., R. p. 752. He found that customer service also helps generate additional income from existing customers who are more likely to upgrade their accounts because they are happy with DIRECTV's service. Tr., R. p. 339:5-22.

2. Identify Location of Income Producing Activities

After identifying DIRECTV's income producing activities, Dr. Cody determined the location where those activities took place by using a formula based on payroll and assets, two widely accepted and economically reasonable measures of economic activity. Tr., R. p. 352:7- 354:18. This method uses a combination of (1) DIRECTV's total payroll expense; and (2) the net book value of certain of DIRECTV's assets as proxies to determine the portion of the income producing activities occurring inside and outside of South Carolina (the "Payroll and Assets Method"). Tr., R. p. 352:7- 353:24. Dr. Cody explained that it was reasonable to use payroll as a proxy because for "each of those value-generating or income producing activities I described, there's a very large labor content, [such as] negotiating contracts, building and maintaining [a] broadcast network, marketing, and providing customer service." Tr., R. p. 352:25- 353:14. He also noted that *Lockwood Greene Engineers, Inc. v. South Carolina Tax Commission*, 293 S.C. 447, 361 S.E.2d 346 (Ct. App. 1987) used payroll as a proxy to determine where the taxpayer's income generating activities took place. Tr., R. p. 353:15-19. However, because "[p]ayroll alone for a company like DIRECTV . . . misses the asset intensity," Dr. Cody also looked at the assets of the company. Tr., R. p. 354:3-6. He

explained that DIRECTV has broadcast centers, fiber optic networks, large call centers, set-top boxes and local collection facilities, “[s]o assets are clearly an important part . . . of the whole operation” and “[s]o I felt it was appropriate to take assets into account when I was determining the location of those income producing activities.” Tr., R. p. 354:7-15. Dr. Cody’s conclusions using the Payroll and Assets Method are summarized below:

Year	Portion of income producing activities occurring in SC: Payroll and Assets Method
2006	0.85 %
2007	0.86 %
2008	0.87 %
2009	0.87 %
2010	0.83 %
2011	0.81 %
Weighted Average	0.85 %

Cody Rpt., R. pp. 762-763.³

B. Professor Richard D. Pomp, Tax Policy Expert

DIRECTV’s tax policy expert, Professor Richard D. Pomp, explained that the term “income producing activity” that appears in S.C. Code Ann. § 12-6-2295(A)(5) is taken from Section 17 of the Uniform Division of Income for Tax Purposes Act (“UDITPA”), which was created in 1957 by the Uniform Law Commission as a model statute for the division of income for income tax purposes, but that S.C. Code Ann. § 12-6-2295(A)(5) makes two “positive” improvements to the test used in UDITPA Section 17. Tr., R. pp. 213:8-13; 226:12-22 ;

³ Dr. Cody also examined the Payroll Method alone, which produced a lower portion of income producing activities occurring in South Carolina, but he believed that the Payroll and Assets Method was more “economically reasonable” as explained above. Tr., R. p. 354:3-6.

227:10- 231:17; 234:11- 236:1; Pet. Ex. No. 16, R. pp. 770-781. First, South Carolina adopts a proportional approach that sources receipts based upon the relative amount of income producing activities occurring in South Carolina versus other states. Tr., R. pp. 226:12-227:9; 234:25- 235:23. “[W]e’re looking to try to figure out the extent to which income producing activity is performed within South Carolina. . . . And we are told here’s what we do. We’ve got to figure out the extent to which the income producing activity is performed within South Carolina.” Tr., R. p. 226:23- 227:9. Second, instead of dictating one method (*e.g.*, “cost of performance”) for determining the amount and location of income producing activities, S.C. Code Ann. § 12-6-2295(A)(5) provides “flexibility” in determining the relative amount of income producing activities in the State. Tr., R. p. 234:16-24.

Professor Pomp rejected the Department’s claim that there is only one income producing activity (delivery of the signal) as an artifice to apply a market-based sourcing method based entirely on customer location without explicitly adopting a market-based method. Tr., R. p. 248:8-21. He further explained:

And what I say is, look, opinions can differ on how to measure the extent to which income producing activities take place in South Carolina, but answering that question by simply ignoring the outside activities is unacceptable. In other words, you might want to quibble about how we’re going to take into account those income producing activities of getting content and programming. But to say they have no value at all, to say they’re not income producing activity is where you and I disagree.

Tr., R. p. 293:9-20.

LEGAL ARGUMENT

The Court appears to have overlooked or misapprehended some factual or legal matters in this case, and the opinion conflicts with existing South Carolina law. Thus, the Court should grant DIRECTV's request for a rehearing and/or issue a new opinion in the case.

I. **THIS COURT'S CONCLUSION THAT DIRECTV'S INCOME PRODUCING ACTIVITIES CONSIST SOLELY OF THE DELIVERY OF THE SIGNAL INTO ITS CUSTOMERS' HOMES OVERLOOKS OR MISAPPREHENDS CERTAIN FACTUAL AND LEGAL ISSUES AND CONFLICTS WITH SOUTH CAROLINA LAW.**

Even after noting the lack of evidence presented by the Department and acknowledging that the Department's approach was incorrect and too "simplistic," the ALC nevertheless adopted the Department's position that DIRECTV's only income producing activity is the delivery of the signal into the homes of customers. Amended Final Order, R. p. 51. This Court affirmed this untenable conclusion (Opinion at pp. 11-15), which gives no weight to DIRECTV's extensive income producing activities that occur out-of-state and no weight to the fact that the Department failed to present credible evidence to support its position as DIRECTV contends is required under *Cloyd*. See *infra* Legal Argument, § II. This conclusion overlooks or misapprehends certain factual and legal issues and conflicts with South Carolina law.

More specifically, the ALC rejected entirely the evidence presented by DIRECTV because it found that: (1) "Dr. Cody's proxies in identifying DIRECTV's income producing activities are so far from perfect as to be of no practical value;" (2) "DIRECTV did not sufficiently explain the effect of its value drivers on income production in this State" and its

“evidence is just too nebulous to properly identify whether DIRECTV’s value drivers are income producing and the extent to which such production occurs;” (3) the activities identified by DIRECTV are “‘preparatory’ activities [that] are too attenuated to the production of income to be considered ‘income producing activity’” as defined by the South Carolina Supreme Court’s decision in *Mercury Motor*; and (4) DIRECTV failed to establish the extent to which the activities it identified as income producing activities “influenced customers’ decision[s] to subscribe to DIRECTV.” Amended Final Order, R. pp. 41-44.

It is unclear whether this Court agreed with all of the ALC’s reasons; the Opinion appears to rely primarily on its conclusion that “substantial evidence supports the ALC’s findings that DIRECTV’s income producing activity is the delivery of signal to its customers nationwide, and accordingly, the delivery of the signal to South Carolina customers is represented by 100% of its South Carolina subscription receipts.” Opinion at p. 13. This Court further found that “DIRECTV’s reliance on *Lockwood Greene* for the development of its proxy method is unfounded” because although that case did apply a “place of activity” test, its facts are distinguishable as DIRECTV customers are paying “for the end result of the personnel’s work- the delivery of the signal that allows customers to enjoy the digital entertainment for which they pay DIRECTV” versus the engineering customers in *Lockwood Greene*, whom this Court concluded were paying for the time and expertise of the engineers. *Id.* Finally, this Court agreed with the ALC that under *Mercury Motor*, the activities of DIRECTV prior to delivery of the signal constituted preparatory activities that were too attenuated to be considered income producing activities. *Id.* at p. 15.

DIRECTV respectfully submits that the ALC and this Court’s conclusions are

erroneous as a matter of law because they (1) misinterpret S.C. Code Ann. §§ 12-6-2290 and 12-6-2295(A)(5) as requiring sourcing on a market basis (*i.e.*, location of the customer); (2) misinterpret South Carolina case law (*i.e.* *Lockwood Greene* and *Mercury Motor*); and (3) overlook the substantial evidence showing that DIRECTV's income producing activity is not solely the delivery of the signal.

A. Legal Overview

When determining how to apportion a multi-state taxpayer's gross receipts, South Carolina law provides that receipts from services must be allocated to South Carolina if the entire income producing activity is within this State. However, "if the income producing activity is performed partly within and partly without this State, sales are attributable to this State to the extent the income producing activity is performed within this State." S.C. Code Ann. § 12-6-2295(A)(5). Thus, the statutory language establishes a two-step test: (1) identify the income producing activities; and (2) determine the portion of those activities performed in South Carolina. In other words, if a taxpayer's business activities producing income occur in multiple states, only the portion performed in South Carolina will be attributable to South Carolina.

The statute in question, S.C. Code Ann. § 12-6-2295(A)(5), is a codification of the *Lockwood Greene* decision. *Lockwood Greene* is the only published decision interpreting and applying S.C. Code Ann. § 12-6-2290 and its phrase "gross receipts from within this State." The issue in *Lockwood Greene* involved receipts of an engineering firm based in South Carolina but providing services to customers out-of-state. The taxpayer argued that the phrase "gross receipts from within this State" should be determined based on the "origin of payment,"

which looks to the location of the taxpayer's customers making payments (also referred to as a "market approach"), while the Department argued that the phrase should be determined based on the "place of activity," which looks to the place where the income producing activities are performed. *Lockwood Greene*, 293 S.C. at 448, 361 S.E.2d at 347. This Court held that "gross receipts from within the State" should be determined based on the "place of activity," and that the place of activity should be determined by comparing Lockwood Greene's payroll expense for South Carolina employees to the firm's total payroll expense for all employees. *Lockwood Greene*, 293 S.C. at 448-49, 361 S.E.2d at 347. It reasoned that the customers were paying for the time and expertise of the highly trained engineers. *Id.*

B. This Court's Conclusion that DIRECTV's Income Producing Activity is Limited to the Delivery of the Signal into its Customers' Homes is Contrary to South Carolina Law, and No Substantial Evidence in the Record Supports this Conclusion.

This Court and the ALC's conclusion that the delivery of the signal is the only income-producing activity is contrary to South Carolina case law, including *Lockwood Greene*, *Mercury Motor* and S.C. Code Ann. § 12-6-2295(A)(5), and is clearly erroneous in light of the substantial evidence in the record.

1. This Court's Decision is Contrary to the Holding in *Lockwood Greene*.

The ALC and this Court rejected the "place of activity" test applied in *Lockwood Greene*. This Court explained its conclusion by saying that "the service DIRECTV provides is entirely different from *Lockwood Greene* and DIRECTV's source of income does not derive from its engineers, but rather from its subscriptions to its programming packages." Opinion at p. 13. It further stated that "DIRECTV customers are paying DIRECTV for the end result of

the personnel's work- the delivery of the signal that allows customers to enjoy the digital entertainment for which they pay DIRECTV" (*id.*), thereby ignoring all out-of-state income producing activities, which among other things, produced or acquired the programming content that the subscribers received.

First, in making these statements, the Court appears to be overlooking the voluminous facts in the record that show that DIRECTV customers are not merely paying for a signal. If DIRECTV supplied a signal, but the only programming offered was, for example, cartoon channels, and no original programming, premium sports packages or unique offerings such as NFL Sunday Ticket or the Masters Experience, customers would obviously not pay the same amount for subscription packages. The signal is clearly not the only thing for which South Carolina customers are paying, and to say that the business activity of creating and/or securing these premium programming options, marketing them and providing customer support related thereto does not produce income is simply wrong and unsupported by any evidence in the record. This Court appears to acknowledge the importance of content when it points out that "DIRECTV's source of income . . . derive[s] . . . from subscriptions **to its programming packages**" (Opinion at p. 13) (emphasis added)) and when it states that the delivery of the signal "allows customers to enjoy the **digital entertainment for which they pay DIRECTV.**" *Id.* (emphasis added).

Additionally, the fact that there may be some distinctions between engineers and DIRECTV does not mean that the "place of activity" test in *Lockwood Greene* should not be applied. Different companies may have different income producing activities, but *Lockwood Greene* requires the Court to examine all such activities. *Lockwood Greene* concluded that a

payroll factor was appropriate. In this case, as Dr. Cody explained, a payroll and assets method is more reasonable. *See supra* Factual Background, § II. What is not reasonable is ignoring income producing activities that do not take place in this State.

Moreover, even if *Lockwood Greene* could be distinguished, that does not end the inquiry. As previously stated, this decision was subsequently codified in S.C. Code Ann. § 12-6-2295(A)(5), which made it clear that all service providers are to be treated uniformly and have their income apportioned based on “income producing activity.” S.C. Code Ann. § 12-6-2295(A)(5). To the extent the question of how gross receipts of service providers were to be apportioned under S.C. Code Ann. § 12-6-2290 was unclear, the new statute set the record straight. *See infra* Legal Argument, § I(B)(3) (for full discussion of S.C. Code Ann. § 12-6-2295(A)(5)). All service providers are to have their gross receipts from South Carolina determined based on the proportion of income producing activities taking place in this State and those activities that take place out-of-state, i.e. the “place of activity” test and not based on the location of the payor, which is the result achieved by ignoring the out-of-state income producing activities.

2. This Court’s Decision is Contrary to the Holding in *Mercury Motor*.

This Court’s Opinion is also contrary to the law set forth in *Mercury Motor Express, Inc. v. South Carolina Tax Commission*, 244 S.C. 134, 135 S.E.2d 756 (1964), which does not say that income producing activity prior to payment is to be ignored. In *Mercury Motor*, a freight company challenged the State’s apportionment formula for motor carriers on the ground that application of a mileage-based formula produced a discriminatory result that taxed income earned outside of South Carolina and was therefore unconstitutional. In support of its

argument, the taxpayer explained that whereas the statutory formula apportioned 17% of its income to the State (reflecting that 17% of its mileage was in the State), revenue from freight either originating in or delivered to South Carolina accounted for only 1% of its gross revenue. *Mercury Motor*, 244 S.C. at 139, 135 S.E.2d at 758. The taxpayer asserted that the statutory mileage-based formula produced an unconstitutional result because it was not engaged in activities that contributed to its net income when its trucks traveled through South Carolina. Instead, the taxpayer argued that only the pick-up or delivery of freight in the State produced income. *Id.* at 138-39, 135 S.E.2d 758.

The Supreme Court rejected that narrow construction of income producing activities:

The [taxpayer] operates a unitary business and its gross income and, therefore, its net income, is derived from a series of transactions Here the series of transactions consists of the solicitation of freight, the picking up of freight, the hauling of freight, the delivery of the same and the collections of charges therefor. Each transaction in the series contributes to the earnings and net income of the [taxpayer], and, while each transaction is necessarily incidental to the production of its income, the transaction which primarily earns the income is the hauling of the freight. It seems to us to follow that as the trucks of the [taxpayer] move along, through and over the highways of the State of South Carolina, the [taxpayer] is engaged in income producing activity actually done and performed within the borders of the State of South Carolina.

There is nothing in the record to even indicate that the trucks of the [taxpayer], while traveling seventeen per cent of its total mileage within the State of South Carolina, are failing to contribute to [taxpayer's] income, or that, while so traveling, they are earning a lesser percentage of [taxpayer's] net income than seventeen per cent.

Id. at 141, 135 S.E.2d at 759-60.

In the case at hand, the ALC found that all of DIRECTV's activities, other than the beaming of satellite signals to the homes of customers, are "preparatory" activities that "have no bearing on a customer's decision to subscribe to, *i.e.*, solicit, [DIRECTV's] services, nor do they occur as a result of that decision to subscribe." Amended Final Order, R. p. 43. As a result, the ALC concluded that such activities were "too attenuated to the production of income to be considered income producing activit[ies]" under the analysis applied by the South Carolina Supreme Court in *Mercury Motor*. Amended Final Order, R. pp. 43-44. This Court agreed and concluded that the primary income producing activity was the delivery of the signal "because this activity actually generates income" and the activities prior to delivery of the signal "while important . . . in that it can help lead to income" are "'too attenuated' to be considered income producing" Opinion at p. 15.

However, the distinction drawn by the ALC between "preparatory" activities and "incidental" and "primary" activities, both of which the ALC acknowledged are income producing activities, is not supported by *Mercury Motor*. The solicitation, picking up, hauling and delivery of freight and the collection of charges therefor that the Supreme Court identified as income producing activities in *Mercury Motor* are no different than DIRECTV's activities of content development, marketing and broadcast operations (transmission and delivery).

Moreover, the ALC and this Court's distinction between "preparatory" and other activities reflects a fundamental misunderstanding of the nature of DIRECTV's business as established by the substantial evidence in the record. DIRECTV does not operate a static business for which a distinction can be made between "preparatory" pre-solicitation activities and "incidental" and "primary" solicitation and post-solicitation activities. DIRECTV is

constantly engaged in acquiring, developing and improving its content, broadcasting operations, marketing and customer service, and each of these activities are conducted to generate revenue by attracting new subscribers and retaining and upgrading current subscribers.

As in *Mercury Motor*, the series of transactions engaged in by DIRECTV to provide its programming service contributes to the generation of gross receipts and ultimately to the net income to be apportioned under S.C. Code Ann. § 12-6-2290 and § 12-6-2295(A)(5). Thus, as the Supreme Court in *Mercury Motor* rejected the taxpayer's argument that the only income producing activity was the pick-up or delivery of freight for which the company was actually paid, this Court should reject the ALC's conclusion that the delivery of DIRECTV's signal in South Carolina is the only income producing activity and that DIRECTV's content development, marketing, broadcast operations and customer service are "too attenuated" to be considered income producing activities. As previously stated, if DIRECTV only offered cartoon programs and not all of its unique original programming, sports packages and other premium programming, it would obviously not be able to command a premium price for its subscription packages. The signal is clearly not the only thing South Carolina customers are paying for and the business activities that create and/or secure these premium programming options most certainly produce income. A holding that none of these activities produces income would be analogous to saying that a manufacturer that makes a product and delivers it to its customer only has one income producing activity- delivery of the product- because the customer only wants the end product. This is not the law in South Carolina.

3. This Court's Decision is Contrary to S.C. Code Ann. § 12-6-2295(A)(5).

In holding that DIRECTV's income producing activity is the delivery of the signal into the homes of DIRECTV's customers, the ALC committed two errors of law in interpreting S.C. Code Ann. § 12-6-2295(A)(5) as requiring (1) an analysis of a customer's subjective intent and (2) a market-based sourcing methodology. It is unclear whether this Court considered the former conclusion (that a customer's subjective intent must be analyzed), but it clearly agreed on the latter conclusion (that market-based sourcing was required).

First, in rejecting the substantial factual and economic evidence presented by DIRECTV, the ALC repeatedly noted that DIRECTV failed to produce evidence with respect to its customers' subjective intent. For example, the ALC found that: (1) although DIRECTV's evidence "did reflect that its advertising probably produced some income, the evidence did not reflect what portion of DIRECTV's cost was either attributable to South Carolina customers or may have influenced South Carolina customers to subscribe to DIRECTV;" (2) "the Court was left to speculate as to the extent to which DIRECTV's content and programming, acquisition and distribution thereof, advertising, and customer service in installing and maintaining its equipment within this State influenced customers' decision to subscribe to DIRECTV;" and (3) "[e]ven as to local programming, though it is almost completely geared towards South Carolina residents, DIRECTV failed to prove what impact the availability of local programming has on South Carolina customers' decision to subscribe to DIRECTV." Amended Final Order, R. pp. 41-42 and 44.

The ALC's interpretation of S.C. Code Ann. §§ 12-6-2290 and 12-6-2295(A)(5) is inconsistent with the plain language of the statutes, which require the focus to be on the

activities of the *taxpayer* and not on the subjective intent of third parties (*i.e.*, DIRECTV's customers). The ALC's interpretation is also inconsistent with both *Mercury Motor* and *Lockwood Greene*, in which the courts focused exclusively on the activities of the *taxpayers*. A standard such as the one adopted by the ALC that requires a taxpayer to prove the subjective intent of third parties is completely unworkable and imposes an impossibly high burden on taxpayers. To the extent this Court's decision was based on this flawed interpretation of the ALC, this Court should reconsider these conclusions.

Second, although the ALC's holding (and this Court's affirmance of the same) is based on a purported identification of DIRECTV's income producing activity, the ALC and this Court, in reality, have done nothing more than interpret S.C. Code Ann. § 12-6-2295(A)(5) as requiring market based sourcing. Although couched in terms of "income producing activities," the ALC and this Court's holding will result in sourcing revenue to the location of the taxpayer's customer in *every* instance. *See* Amended Final Order, R. p. 51.

This result is inconsistent with the plain language of the statute, which requires sourcing revenue based on the taxpayer's income producing activities. Although many states have done so, South Carolina is not among the states that have adopted statutes sourcing revenue on a market-basis. *See, e.g.*, Mass. Gen. Laws, ch. 63, § 38(f) ("Sales, other than sales of tangible personal property are in the Commonwealth if the corporation's market for the sale is in the Commonwealth."); Minn. Stat. § 290.191, subd. 5(j) ("Receipts from the performance of services must be attributed to the state where the services are received."); Neb. Rev. Stat. § 77-2734.14(3)(a) ("Sales of a service are in this state if the sales are derived from a buyer within this state."); 72 Pa. Stat. § 7401(3)2(a)(16.1)(C)(I) ("Sales from the sale of

service, if the service is delivered to a location in this State.”).⁴

The decision by the ALC and this Court that the end-product sale is the only income producing activity of an enterprise makes South Carolina a market based state, when the law, including *Mercury Motor* and S.C. Code Ann. § 12-6-2295(A)(5) says precisely the opposite. The effect of making South Carolina a market based state will have grave consequences when a service industry has a substantial investment and employees in this State because the only gross receipts that will be attributed to South Carolina will be the subscription receipts from South Carolina customers. Even if the taxpayer has thousands of employees performing services in this State and millions of dollars of assets in this State being used to provide those services, under this Court’s approach, only the receipts from sales to South Carolina customers would be captured.

In sum, by looking to the location of DIRECTV’s customer instead of the income producing activity of DIRECTV, the ALC and this Court have misinterpreted S.C. Code Ann. § 12-6-2295(A)(5) and thereby committed an error of law.

C. The Court’s Conclusion that DIRECTV’s Income Producing Activity is Limited to the Delivery of the Signal into the Homes of its Customers is Not Supported by Substantial Evidence, and this Court may have Overlooked the Evidence Presented by DIRECTV.

This Court’s conclusion that DIRECTV’s only income producing activity is the delivery of the signal into the homes of customers and that such activity occurs entirely within South

⁴ Moreover, when the Legislature has intended to source receipts on a destination basis, it has explicitly done so, as it has done with respect to sales of tangible personal property. S.C. Code Ann. § 12-6-2280(B) (providing that the term “sales in this State” includes sales of goods, merchandise, or property received by a purchaser in South Carolina).

Carolina is not supported by substantial evidence. In arriving at this conclusion, this Court may have overlooked the evidence presented by DIRECTV on this issue.

First, DIRECTV presented substantial factual and economic evidence to establish its income producing activities. DIRECTV's Rule 30(b)(6) witness provided detailed testimony regarding the activities necessary to produce DIRECTV's programming services, which include (1) procuring and developing premium quality video entertainment, including the development of original programming and acquisition of programming from third-parties, (2) operation of local collection facilities, uplink centers, broadcast centers, and satellites that are used to collect and deliver the programming services to customers, and (3) customer service and marketing activities that allow DIRECTV to maintain and enhance its brand and brand awareness. Tr., R. pp. 170:14- 207:25. Dr. Cody explained that the income producing activities of DIRECTV are "the activities that DIRECTV engages in in order to convert potential customers into subscribers and to retain and drive additional income from existing subscribers." Tr., R. p. 344:6-11. He then identified those income producing activities as (1) content development, (2) broadcasting operations, (3) marketing, and (4) customer service because these activities are "what is really creating the value that consumers ultimately pay for." Cody Rpt., R. pp. 749 and 760; Tr., R. pp. 329:2-16; 351:3-9. Similarly, testimony from DIRECTV's Rule 30(b)(6) witness established that the company considered its income producing activities to be the "assets and the employees that perform the service which puts the video into the television of its customers." Tr., R. p. 502:14-18.

In contrast, the Department presented no evidence of DIRECTV's income producing activities. In fact, the record establishes that the Department looked solely to the location of

the customer to source DIRECTV's subscription revenue. Tr., R. pp. 425:4-6; 437:20-23; 472:13-17. Simply put, there is no credible evidence in the record that DIRECTV's *only* income producing activity is the delivery of the signal into customers' homes as the ALC so noted. Amended Final Order, R. p. 40 (stating that the ALC "does not adopt the view of the Department that income-producing activity of businesses within the direct broadcast services industry is completely limited to the delivery of a signal into the customer's home and onto the customer's television" and agreeing with Professor Pomp that "opinions can differ on how to measure the extent to which income-producing activities take place in South Carolina, *but answering that question by simply ignoring the outside activities is unacceptable.*") (emphasis added).

In addition, even if delivery of the signal was the only income producing activity, which DIRECTV asserts is not the case, the ALC and this Court's finding that the delivery of the signal into the homes of South Carolina customers occurs entirely within this State is, likewise, entirely inconsistent with the evidence. The record unequivocally establishes that delivery of the signal occurs both inside and outside of South Carolina. *See* Tr., R. pp. 170:14- 207:25 (describing the collecting of programming and the transmission to broadcast centers, uplink facilities, satellites and customers). This Court appears to have overlooked this uncontested factual testimony.

In sum, this Court's conclusion that DIRECTV's only income producing activity is the delivery of the signal into the homes of customers and that this activity occurs solely in South Carolina is not supported by substantial evidence and, in fact, is entirely inconsistent with the evidence in the record. DIRECTV respectfully requests that this Court consider this evidence.

D. This Court's Conclusion that DIRECTV Failed to Establish the Portion of its Income Producing Activities Conducted in South Carolina is Contrary to South Carolina Law and is Not Supported by Substantial Evidence, and this Court may have Misapprehended or Overlooked the Evidence Presented by DIRECTV in Reaching this Conclusion.

This Court's conclusion that DIRECTV failed to establish the portion of its income producing activities conducted in South Carolina is contrary to S.C. Code Ann. § 12-6-2295(A)(5) and is not supported by substantial evidence. In arriving at this conclusion, this Court may have misapprehended or overlooked the evidence presented by DIRECTV on this issue. At the trial level, the ALC rejected the Payroll and Assets Method applied by Dr. Cody to determine the portion of DIRECTV's income producing activities performed in South Carolina on the basis that (1) "the approach proposed by Dr. Cody unduly emphasizes what amounts to 'costs of performance'" and (2) the Payroll and Assets Method is "too nebulous" and "does not provide a reasonable approximation of the income producing activities performed by DIRECTV in South Carolina, and the value attributable to such activities." Amended Final Order, R. p. 47.

This Court makes no mention of any concerns that Dr. Cody's approach emphasizes "costs of performance" (which it does not as it looks to both payroll and assets). It simply concludes that Dr. Cody's method "is not a reasonable approximation of DIRECTV's business activity in South Carolina. Opinion at pp. 13-14. More specifically, this Court found that the payroll and assets method, which sourced .85% of DIRECTV's total subscription revenue to South Carolina, cannot reasonably represent DIRECTV's business activity in South Carolina because during the Period at Issue, DIRECTV only had two employees in South Carolina and

its assets consisted of only four local collection facilities and the equipment purchased or leased by its customers. *Id.* at p. 14.

However, this is precisely the point of the apportionment statute. It is because DIRECTV has few employees and minimal assets in South Carolina that the percentage of gross receipts is a correspondingly small number. The goal of the “place of activity” test in *Lockwood Greene* and the income producing activity language in S.C. Code Ann. § 12-6-2295(A)(5) is to measure the income producing activities in this State as compared to those activities in other states and then apportion a proportional amount of the taxpayer’s gross receipts to this State. If the Court finds this to be inequitable in some way, then that is a problem that should be addressed by the Legislature, which has chosen to measure business activity by looking at income producing activity.

Rather than using a cost of performance methodology, Dr. Cody testified that he employed two common proxies using data from DIRECTV’s financial records to source DIRECTV’s income producing activities: (1) payroll expense inside and outside of South Carolina; and (2) the net book value of assets inside and outside of South Carolina. Tr., R. p. 352:7-21. Dr. Cody explained that payroll and assets are proxies that “provide a practical and actually a very well-trod path for allocating and determining the location of income producing activities,” and that payroll and asset proxies also reflect the fundamental economics of DIRECTV’s operations. Tr., R. pp. 352:13-17; 619:14-21.⁵ His method is also consistent

⁵ See also DIRECTV’s Amended Final Brief at pp. 35-37 (discussing history of allocation and apportionment law in the United States, including adoption by states of formulas to apportion values and income as a means of reaching a reasonable and reliable approximation of the value and income of an enterprise within the state and concept that “[a]lthough exactness in

with *Lockwood Greene*, which found that “an engineering firm’s business carried on in a state is *reasonably measured* by the services rendered by its personnel in the state.” *Id.* at 449, 361 S.E.2d at 347 (emphasis added).

However, Dr. Cody decided not to place primary reliance on the payroll formula because he felt that, in contrast to the engineering firm at issue in *Lockwood Greene*, the income producing activities of DIRECTV were better reflected by use of a formula that also took assets into consideration (the “Payroll and Assets Method”) as tangible assets such as the LCFs, set-top boxes, and regional uplink facilities play an important role in the generation of DIRECTV’s subscription revenue. Tr., R. pp. 352:7- 354:18. Based on this formula, Dr. Cody determined that, on average, 0.85% of DIRECTV’s income producing activities were performed in South Carolina and thus, that 0.85% of its total subscription revenue for the Period at Issue was attributable to South Carolina. Cody Rpt., R. p. 763.

The Payroll and Assets Method used by Dr. Cody provides a reasonable approximation of the value of the income producing activities performed by DIRECTV in South Carolina. This is in sharp contrast to the approach advanced by the Department, adopted by the ALC and affirmed by this Court, which simply looks to the location of the customer without making any attempt to determine the activities actually conducted by DIRECTV inside and outside of South Carolina, or the value attributable to such activities.

If this Court finds that the Payroll and Assets Method is not sufficient under the relevant statutes to determine the portion of DIRECTV’s income producing activities

apportionment is desirable, all that is required is a reasonable approximation.” *Covington Fabrics Corp. v. S.C. Tax Comm’n*, 264 S.C. 59, 66, 212 S.E.2d 574, 577 (1975)).

performed in South Carolina, this Court should not simply reject that method, which is consistent with the only published authority addressing the issue, and adopt the admittedly flawed approach used by the Department and adopted by the ALC. Instead, at the very least, this Court should articulate an appropriate standard and remand the case for additional proceedings consistent with that standard.

II. THIS COURT’S CONCLUSIONS REGARDING THE BURDEN OF PROOF CONFLICT WITH EXISTING SOUTH CAROLINA LAW AND MISAPPREHEND OR OVERLOOK THE EVIDENCE PRESENTED BY DIRECTV.

This Court held that the burden of proof set forth in *Cloyd* does not apply to cases involving corporate income taxes or apportionment cases and that even if it applied, DIRECTV did not meet its burden. Opinion at pp. 16-18. These conclusions conflict with existing South Carolina law and misapprehend or overlook the evidence presented by DIRECTV on this issue.

The standard of proof in administrative proceedings is a preponderance of the evidence. *See Anonymous v. State Bd. of Med. Exam’rs*, 329 S.C. 371, 375, 496 S.E.2d 17, 19 (1998). In general, the party asserting the affirmative issue in an adjudicatory administrative proceeding has the burden of proof. *See Leventis v. S.C. Dep’t of Health & Envtl. Control*, 340 S.C. 118, 132, 530 S.E.2d 643, 651 (Ct. App. 2000) (explaining that “the complaining party bears the burden of proof”); *see also DISH DBS Corp. v. S.C. Dep’t of Revenue*, No. 14-ALJ-17-0285-CC (S.C. Admin. Law Ct. Feb. 10, 2015) (“Petitioner requested a contested case hearing and, therefore, has the burden of proof to show by a preponderance of the evidence that the Department’s tax assessment was incorrect.”). Thus, DIRECTV has the

burden of proof to show by a preponderance of the evidence that it is entitled to a refund for the 2006 through 2008 tax years and that the Department's tax assessment for the 2009 through 2011 tax years was incorrect. *Id.*; *Scarborough v. S.C. Dep't of Revenue*, No. 08-ALJ-17-0563-CC (S.C. Admin. Law Ct. Mar. 23, 2009).

Although a tax assessment is initially presumed correct, once a taxpayer establishes that an assessment is incorrect, either by proving the actual valuation or through other evidence establishing that the assessment is incorrect, the presumption of correctness is removed and the taxpayer is entitled to appropriate relief. *See Cloyd v. Mabry*, 295 S.C. 86, 88-89, 367 S.E.2d 171, 173 (Ct. App. 1988) (explaining that “[a] taxpayer contesting an assessment has the burden of showing that the valuation of the taxing authority is incorrect” and that, although “[o]rdinarily, this will be done by proving the actual value . . . [t]he taxpayer may, however, show by other evidence that the assessing authority's valuation is incorrect” and “[i]f he does so, the presumption of correctness is then removed and the taxpayer is entitled to appropriate relief”); *see also Anonymous Taxpayer v. S.C. Dep't of Revenue*, No. 07-ALJ-17-0189-CC (S.C. Admin. Law Ct. Aug. 23, 2007), *Lawton v. S.C. Dep't of Revenue*, No. 08-ALJ-17-0118-CC (S.C. Admin. Law Ct. Sept. 5, 2008) and *Travelscape, LLC v. S.C. Dep't of Revenue*, No. 08-ALJ-17-0076-CC (S.C. Admin. Law Ct. Feb. 12, 2009) (involving personal income tax (*Anonymous* and *Lawton*) and sales and accommodation tax (*Travelscape*) assessments and each citing to the burden of proof set forth in *Cloyd*).

This Court found that *Cloyd* did not apply because although it has been recited in cases involving property taxes, personal income taxes, sales taxes and accommodations taxes, it has not previously been applied in a corporate income tax or apportionment of corporate income

taxes cases. Opinion at p. 17. It thus found that “because the facts of *Cloyd* are far too removed from the facts of the instant case, the application of the *Cloyd* burden of proof is inapplicable here.” *Id.* The Court provided no policy rationale or other reason why once a taxpayer has shown that a corporate income tax assessed is incorrect, it should not be entitled to appropriate relief just as a taxpayer who is assessed with an incorrect property tax, personal income tax, sales tax or accommodations tax would be. A corporate taxpayer should be equally entitled to appropriate relief.

This Court also stated that “even if we applied *Cloyd*, we find that DIRECTV failed to satisfy its burden of proof because it did not demonstrate an actual value for its income producing activities and did not present other evidence proving the DOR incorrectly included 100% of DIRECTV’s subscription receipts from South Carolina customers in the numerator of the gross receipts ratio.” Opinion at p. 17. This is completely counter to the language in *Cloyd* which states that “[o]rdinarily, this will be done by proving the actual value . . . [t]he taxpayer may, however, show by other evidence that the assessing authority’s valuation is incorrect” and “[i]f he does so, the presumption of correctness is then removed and the taxpayer is entitled to appropriate relief.” *Cloyd*, 295 S.C. at 88-89, 367 S.E.2d at 173.

Moreover, DIRECTV met its burden as the ALC acknowledged that the assessment was incorrect. For example, the ALC expressly stated that it “does not adopt the view of the Department that income producing activity of businesses within the direct broadcast services industry is completely limited to the delivery of a signal into the customer’s home and onto the customer’s television.” Amended Final Order, R. p. 40. Similarly, the ALC agreed with Professor Pomp that “opinions can differ on how to measure the extent to which income

producing activities take place in South Carolina, *but answering that question by simply ignoring the outside activities is unacceptable.*” *Id.* (emphasis added).

Additionally, DIRECTV presented substantial factual and economic evidence regarding its income producing activities and the location from which those activities were conducted, and the Department presented no credible evidence as to DIRECTV’s income producing activities, including that it made no attempt to even determine them and based the assessment solely on customer location and that its tax policy expert testified that the Department was “taking a market state approach to the attribution of receipts.” *See supra* Legal Argument, § I(C) at pp. 20-21 and (D) at pp. 23-24.

Both the ALC and this Court appear to have disregarded the substantial evidence in the record with respect to how DIRECTV’s programming services are developed and delivered and default to the Department’s simplistic and obviously erroneous conclusion that the only income producing activity is the delivery of the signal to the customer, a conclusion that the ALC acknowledged is incorrect. Instead, the ALC should have fashioned an appropriate remedy based on the evidence in the record or ordered a supplemental hearing requesting that the parties present additional evidence so that the ALC could determine the actual revenue properly attributable to South Carolina under the ALC’s construction of the statute and grant the appropriate relief as required by *Cloyd*. *See Cloyd*, 295 S.C. 86, 367 S.E.2d 171.

III. THIS COURT’S CONCLUSION THAT THE IMPOSITION OF SUBSTANTIAL UNDERSTATEMENT PENALTIES WAS PROPER IS CONTRARY TO SOUTH CAROLINA LAW AND IS NOT SUPPORTED BY SUBSTANTIAL EVIDENCE.

This Court’s conclusion that the imposition of substantial understatement penalties was proper is contrary to South Carolina law and is not supported by substantial evidence.

As this Court acknowledged, under South Carolina law, substantial understatement penalties may not be imposed for tax treatment of items where there "is or was substantial authority for that treatment" or where the relevant facts affecting the tax treatment "are adequately disclosed in the return" and there is a "reasonable basis for the tax treatment of the item. . . ." S.C. Code Ann. §12-54-155(B)(2)(b). Additionally, no penalty may be imposed where there was "reasonable cause" for an understatement and the taxpayer acted in good faith. S.C. Code Ann. §12-54-155(D)(1).

This Court agreed with the ALC's finding that a substantial understatement penalty was owed despite the ALC's finding that "DIRECTV acted in good faith with respect to bringing its claim regarding the portions of the understated tax amounts" and its finding that it "acted with sufficient belief" because the ALC found that "DIRECTV did not have 'reasonable cause' . . . for the underpaid taxes, i.e., DIRECTV's method of calculating subscription receipts was unreasonable." *See* Opinion at p. 20; Amended Final Order, R. p. 51 (emphasis in original). This Court also agreed with the ALC's explanation for this conclusion, i.e. that DIRECTV did not have substantial authority for its position based on the holdings of *Lockwood Greene* and *Mercury Motor*. The primary rationale given for this ruling appears to be that (1) DIRECTV initially filed returns sourcing its receipts as the Department claims it should and only relied on *Lockwood Greene* and *Mercury Motor* (which pre-date DIRECTV's original filings) in its amended returns; and (2) that "**regardless of their holding**" (i.e. the holdings of these two cases), "established law dictates the purpose of the apportionment statutes is to apportion corporate income upon a basis that reasonably represents the corporation's business activity in South Carolina." *Id.* (emphasis added).

First, it is not disputed that a taxpayer has a right to file an amended return and should

do so once it is aware that the original return contains inaccurate or incomplete information. No negative inference should be made by the Court based on the taxpayer amending its returns.

Moreover, the relevant apportionment statutes and the holdings of both *Lockwood Green* and *Mercury Motor* cannot be ignored when evaluating whether the penalty should be upheld. As discussed in prior briefing before this Court and above, existing South Carolina law supports DIRECTV's position in every respect, and thus, DIRECTV had substantial authority for its position and there was a reasonable basis for its tax treatment of the subscription receipts.

Section 12-6-2290(A)(5) of the South Carolina Code, which this Court does not mention in its discussion of the penalty, codified *Lockwood Greene* (which outlined a "place of activity" test to determine "income producing activity" and endorsed a method based on a payroll proxy) and speaks to "income producing activity." *Mercury Motor* states that each transaction in a series of activities engaged in by a taxpayer to conduct its business contributes to its earnings and net income, and the Court did not consider the "final act" of delivering the package to the customer's residence in that case to be the primary income producing activity. Neither case focuses on the location of the customer (*i.e.* market based sourcing), which some states have adopted by statute. Moreover, the Department has no published guidance to alert taxpayers to any policy that is interpreting the existing law, and even its own auditor was not aware of such a policy. If South Carolina had adopted market based sourcing or the Department had published guidelines that set forth its position, then it would be clear to taxpayers how their income should be apportioned and failure to follow such guidance could potentially justify a penalty against a taxpayer (although no penalty would be justified if the policy was contrary to South Carolina law). But where a statute and the existing case law, by their plain

words, state one view, and the court construes those words to mean the opposite view, it is simply incredible that a penalty could be imposed. Furthermore, this Court's opinion seems to say that taxpayers should ignore the specific language of the statute and the holdings of binding precedent based on a more general statement regarding the overarching policy of apportionment statutes being "to apportion corporate income upon a basis that reasonably represents the corporation's business activity in South Carolina." Opinion at p. 20. However, the more specific language of the statute- "income producing activity" and the holdings of existing case law (i.e. *Lockwood Greene* outlining "place of activity" test and endorsing method based on a payroll proxy and *Mercury Motor* stating that each activity contributed to taxpayer's earnings and net income and that "final act" of delivering package to customer's residence was not the primary income producing activity), which tells taxpayers more specifically how to reach that policy goal, cannot be ignored and taxpayers are entitled to rely upon them.

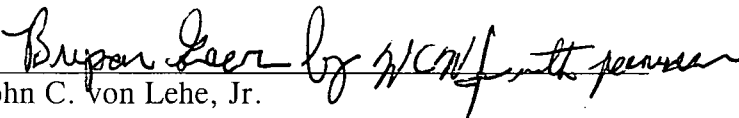
Moreover, the ALC expressly found that the Department's method was *incorrect* and that DIRECTV did, in fact, have income producing activities outside of South Carolina. If a taxpayer protesting an assessment deemed erroneous by the lower court and proposing an alternative method that closely tracks the existing law does not qualify as having substantial authority for its position and a reasonable basis for its tax treatment, then it is difficult to see how any taxpayer could ever meet that standard.

Based on the above, the substantial understatement penalty should be abated in its entirety.

CONCLUSION

As set forth above, DIRECTV respectfully requests that this Court grant its Petition for Rehearing as the Court's Opinion in this matter overlooked or misapprehended several factual and legal matters and also conflicts with existing state law, and thus, a rehearing and/or entry of a new Opinion is warranted.

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Charleston, South Carolina
September 29, 2017

THE STATE OF SOUTH CAROLINA
In The Court of Appeals

APPEAL FROM ADMINISTRATIVE LAW COURT

Ralph King Anderson, III, Administrative Law Judge

Case No. 14-ALJ-17-0158-CC

Appellate Case No. 2015-001509

DIRECTV, Inc. & Subsidiaries, Appellant,
v.
South Carolina Department of Revenue Respondent.

PROOF OF SERVICE

I the undersigned Administrative Assistant of the law firm of Nelson Mullins Riley & Scarborough, LLP, attorneys for DIRECTV, Inc. & Subsidiaries, do hereby certify that I have served all counsel in this action with a copy of the pleading(s) hereinbelow specified by mailing a copy of the same by electronic mail and U.S. Mail, to the following address(es):

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SC Court of Appeals



Lisa P. Whitehurst, Administrative Assistant

September 29, 2017



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September 29, 2017

Hand Delivered

The Honorable Jenny Abbott Kitchings
Clerk of Court
SC Court of Appeals
PO Box 11629
Columbia, SC 29211

RE: DIRECTV, Inc. v. South Carolina Department of Revenue
Appellate Case No. 2015-001509
Our File No.: 43370/09000

RECEIVED

SEP 29 2017

Dear Ms. Kitchings:

SC Court of Appeals

Enclosed for filing are the originals and seven (7) copies of the following:

1. Appellant DIRECTV's Petition for Rehearing; and
2. Proof of service for Petition for Rehearing.

We have also enclosed the required \$25.00 filing fee. Please return the clocked in copies of each to me in the self-addressed, postage paid envelope provided.

By copy of this letter the Petition for Rehearing and the Proof of Service are being served upon the Respondent.

Thank you for your assistance with this matter, and please do not hesitate to contact us with any questions or concerns.

With kind regards,

Bryson M. Geer

BMG:gh

The Honorable Jenny Abbott Kitchings
September 29, 2017
Page 2

Enclosure

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