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.

APPELLANT'S REPLY IN SUPPORT OF PETITION FOR REHEARING

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Appellant, DIRECTV, Inc. and its Subsidiaries ("DIRECTV"), respectfully submits this Reply in Support of its Petition for Rehearing ("Petition") and in response to Respondent South Carolina Department of Revenue's ("SCDOR") Return to DIRECTV's Petition ("SCDOR's Return"). For the reasons presented in the Petition and below, the Court should grant the Petition.

ARGUMENT

SCDOR's Return states that DIRECTV's Petition is based on "three flawed positions." SCDOR Return at p. 3. The three alleged "flaws" are (1) DIRECTV's interpretation of S.C. Code Ann. § 12-6-2295(A)(5) because it "excludes determining the location of the IPA" (i.e. "income producing activity") "instead of identifying, locating, and then measuring DIRECTV's IPA in South Carolina; (2) DIRECTV's interpretation of S.C. Code Ann. § 12-6-2295(A)(5) as codifying the holding of *Lockwood Greene Engineers, Inc. v. South Carolina Tax Comm'n*, 293 S.C. 447, 361 S.E.2d 346 (Ct. App. 1987); and (3) DIRECTV's failure to "focus on the transaction that created the gross receipts in South Carolina" which SCDOR says led the ALC and this Court to find DIRECTV's evidence unpersuasive (versus that it failed to consider this evidence). *Id.* As will be discussed in more detail below, these assertions are either inaccurate or do not justify a finding in favor of SCDOR. In addition, SCDOR's Return, although denying it, nevertheless, is simply advocating that this Court adopt an approach that is tantamount to a market approach (a/k/a "location of the payor" or "origin of the payment") despite clear statutory language to the contrary. The Return also continues to argue that the penalty was properly upheld when there is no justifiable basis to support one being imposed in this case.

I. DIRECTV Located the Relevant Income Producing Activities.

SCDOR's first assertion in its Return is that DIRECTV failed to locate its income

producing activity ("IPA"). This is not correct, and, respectfully, SCDOR's assertion in this regard reflects a misunderstanding of the apportionment statute. S.C. Code Ann. § 12-6-2295(A)(5) provides that the term "gross receipts" as used in Code Ann. § 12-6-2290 includes, but is not limited to, the following items if they have not been separately allocated:

> receipts from services if the entire income-producing activity is within this State. **If the income-producing activity is performed partly within and partly without this State, sales are attributable to this State to the extent the income-producing activity is performed within this State.**

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

Both parties and the Administrative Law Court ("ALC") agree that DIRECTV has IPA both within and without South Carolina. The issue, therefore, is the extent to which "the income-producing activity is performed within this State." *Id.* There is no question about what DIRECTV's IPAs are and where they are located. As discussed in detail in its Final Amended Brief, DIRECTV identified precisely what it did in this State versus other states and the IPAs in this State were limited.[1] In fact, the parties agree on the limited extent of DIRECTV employees and assets in South Carolina. SCDOR Return at pp. 4-5 (stating that DIRECTV only has two employees in South Carolina and its only assets here are four collection facilities and the equipment (i.e. the set-top boxes) its customers lease or purchase). Likewise, SCDOR did not

[1] More specifically, DIRECTV presented substantial factual and economic evidence regarding its IPAs, including (i) detailed testimony regarding the activities necessary to produce DIRECTV's content (Tr., R. pp. 170:14- 208:5), (ii) testimony that its IPAs are 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), and (iii) testimony and report by economist identifying DIRECTV's IPAs and locating/determining the portion of those activities conducted here using a formula based on payroll and assets, which he testified resulted in a reasonable approximation of the value attributable to those activities here (Tr., R. p. 352:7- 354:18). *See also* DIRECTV's Final Amended Brief at pp. 25-27.

dispute the substantial DIRECTV employees and assets responsible for creating the premium product that DIRECTV's customers are purchasing nor did it contest that these employees and assets are located out of state. Instead, SCDOR contends that these activities do not produce income and thus neither SCDOR nor the ALC considered these activities in arriving at the portion of the subscription receipts that are earned here.

However, this interpretation is inconsistent with the apportionment statute. More specifically, ignoring all of the IPAs that created the product at issue- such as development of premium television content- directly contradicts the "partly within and partly without" statutory language. This language is identical to that used in S.C. Code Ann. §12-6-2210(B), which is the general apportionment statute at the introduction to Article 17 "Allocation and Apportionment." This language focuses on the activities of the taxpayer as a whole and seeks to determine the portion of that total business activity that should be attributed to South Carolina. SCDOR wants to ignore DIRECTV's core business activities and instead only look at the origin of the payment from its customers here in South Carolina. This improperly shifts focus from DIRECTV's activities to its customers' activities.

The only way to interpret the apportionment statute as written in a way that reaches the market result that SCDOR seeks here is to argue that delivery of the signal is somehow the only "meaningful" IPA (or, in other words, the only one to be considered). But such a holding makes no sense. Consider the following scenarios: (1) a car is detailed and serviced in South Carolina; and (2) a car is picked up from South Carolina, taken to Georgia to be detailed and serviced, and then delivered back to a South Carolina customer. Under SCDOR's position and the ALC's decision, in both scenarios the entire IPA is determined to be in South Carolina. Such a result

defies logic and produces an absurd result and thus should not be upheld by this Court. *See also infra* §IV (as to how SCDOR's position is also contrary to *Lockwood Greene*, which rejected the origin of payment approach, and *Mercury Motor*, which required apportionment of receipts).

SCDOR also claims that DIRECTV's use of payroll and assets proxies to locate its IPA in South Carolina is unreasonable because it only has two employees in South Carolina and its only assets here are four collection facilities and the equipment its customers lease or purchase. SCDOR Return at pp. 4-5.[2] It is precisely because DIRECTV has few employees and assets here that the payroll and assets proxies are reasonable. Fewer assets and employees mean fewer demands on South Carolina infrastructure such as roads, police and fire services and the courts, and, thus, a lower tax burden is appropriate. Consider if DIRECTV was based in South Carolina and thus had thousands of employees and millions of dollars of assets in this State. Under SCDOR's approach, this would all be ignored despite the fact that such an increase in workforce and assets would place much greater demands on South Carolina resources. This simply makes no sense under a statute that focuses on "income producing activity" and not customer location. *See* S.C. Code Ann. § 12-6-2295(A)(5).

II. S.C. Code Ann. § 12-6-2295(A)(5) Codified the Holding of *Lockwood Greene* and Does Not Distinguish between Different Types of Service Providers.

SCDOR asserts that S.C. Code Ann. § 12-6-2295(A)(5) does not codify *Lockwood Greene.* SCDOR Return at p. 3. While the two use slightly different language- "place of activity" in *Lockwood Greene* versus "extent income producing activity is performed" in the

[2] SCDOR also incorrectly refers to the asset and payroll proxies as "cost elements." SCDOR Return at p. 4. However, they are not cost elements but rather, as shown by the testimony and evidence, are proxies for the IPAs of DIRECTV. *See supra* §I. DIRECTV agrees that South Carolina is not a cost of performance state where receipts would be apportioned based on costs.

apportionment statute, they are speaking to the same element— i.e. the portion of the taxpayer's activity in this State that produces income in this State. In fact, if anything, S.C. Code Ann. § 12-6-2295(A)(5) actually goes further than the holding of *Lockwood Greene* as it makes no distinction regarding different types of service providers. Instead, it dictates that all service providers who have IPA both in this State and in other states should apportion their income by attributing sales to South Carolina only to the extent that the IPA is performed within this State. S.C. Code Ann. § 12-6-2295(A)(5). Thus, SCDOR's argument that it may treat different service providers differently no longer has support in the law after the apportionment statute was enacted as its express and clear language would control over the language in *Lockwood Greene* (which was decided prior to the apportionment statute). Whatever the result would have been under *Lockwood Greene*, it is clear that a conclusion that the "delivery of the signal" is the only IPA that should be considered flies in the face of the language in S.C. Code Ann. § 12-6-2295(A)(5) and ignores DIRECTV's other IPA, which occurred out of state.

III. The ALC and this Court Failed to Appropriately Consider the Evidence Presented by DIRECTV in Reaching their Conclusions that Delivery of the Signal was DIRECTV's Only IPA in South Carolina.

The ALC and this Court's finding that the delivery of the signal into the homes of South Carolina customers was the only IPA in South Carolina is entirely inconsistent with the evidence in the record. In its Return, SCDOR argues that this evidence was not overlooked, but rather the Court simply found it unpersuasive. SCDOR Return at pp. 3 and 8-10.

The evidence in this case could not have been fully and properly considered and yet still reach the conclusion that the entire IPA of DIRECTV is delivery of the signal. First, even SCDOR's expert witness testified that delivery of the signal is not an IPA. *See* Tr. R. pp. at

543:23- 545:10 (testifying that delivery of the signal is a cost and not an IPA and that the only IPAs in this case are the customer's actions in "turning on the box, watching the TV, and paying the bill"). Additionally, SCDOR is mistaken as to what DIRECTV's customers are paying for; it is not delivery of a signal but rather access to premium content. SCDOR's misunderstanding on this point leads it to completely discount all of the activities that produce the premium product that is delivered to the South Carolina customers' televisions. No customer would pay the monthly fees charged by DIRECTV if they only received a test signal or what is available on free television. DIRECTV's premium product with its original programming, premium programming (such as HBO, ESPN and Starz), sports packages and unique offerings such as NFL Sunday Ticket and the Masters Experience is what induces customers to subscribe and generates income. *See* Amended Final Brief at pp. 4-5 (for a more detailed discussion of DIRECTV's content related activities).[3] No one would pay DIRECTV's monthly fees if the satellite and broadcast operations did not ensure a clear, high-end video experience. *See* Amended Final Brief at pp. 5-6 (for a more detailed discussion of DIRECTV's broadcast operations). And the evidence is also clear that the marketing/sales activities as well as the customer service activities generate additional income from new and existing customers. *See* Amended Final Brief at pp. 7-8 (for a more detailed discussion of DIRECTV's marketing, sales and customer service activities). DIRECTV customers are paying for a premium product, and that product is created, acquired, developed, produced, broadcast, marketed and serviced outside the state. These out of state IPAs are directly associated with the production of the receipt and

[3] To highlight the significance of content on DIRECTV's value, 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. pp. 330:24- 331:16.

cannot logically be called "too attenuated."

IV. The ALC's Conclusion that the Final Act of Delivery of the Signal is the Only IPA Adopts a Market-Based Approach that is Contrary to South Carolina Law.

By accepting SCDOR's method, which looks only to the location of the customer (or, as it now characterizes it, the "final act" of delivering the signal into the homes of the customers), the Court has adopted the "market approach" (a/k/a the "origin of payment" approach), which is contrary to S.C. Code Ann. § 12-6-2295(A)(5), *Lockwood Greene* and *Mercury Motor*. Although referencing the statute, which requires that the focus be on the "extent the income producing activity is performed within this state," SCDOR continues to ignore the plain language of the statute, abandon the "place of activity" test in *Lockwood Greene* and discount the apportionment analysis and logic set forth in *Mercury Motor*. DIRECTV has previously discussed how this interpretation is counter to S.C. Code Ann. § 12-6-2295(A)(5) (*see supra* §I) and will now address the two cases.

A. Concluding that Delivery of the Signal is the Only IPA is Contrary to *Mercury Motor*.

Concluding that the delivery of the signal is the only IPA is counter to *Mercury Motor*, and SCDOR's interpretation of this decision in the Return is flawed. *Mercury Motor* does *not* say "that only the hauling of freight was the IPA while excluding the other incidental activities" as SCDOR suggests. Instead, the Court states as follows:

> The appellant 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 appellant*. . . .

Mercury Motor, 244 S.C. at 141, 135 S.E.2d at 759-60 (emphasis added). The Court is acknowledging that *all* of the transactions in the series, both within and without the State, contribute to the production of income. *Id.* It goes on to say that "while each transaction is necessarily incidental to the production of its income, the transaction which primarily earns the income is the hauling of the freight." *Id.* This makes perfect sense where the only issue before the Court was whether it was unconstitutional to take into account the income related to the hauling of freight. The Court did not consider or address whether it would be appropriate to ignore some income producing activities when applying a statutory apportionment method based strictly on the "income producing activities" of a taxpayer. In fact, to the extent the opinion can be read to discount "incidental" activities, that would appear to include *delivery of the freight*[4] which would be akin to *delivery of the signal* into the customers' home here. SCDOR and the ALC's interpretation would recognize only the "delivery of the freight" at the customer's location and would completely disregard the hauling of the freight both within and without the State. This is completely contrary to *Mercury Motor.*

Moreover, even if this Court determined on some basis that delivery of the signal was the primary or only IPA, the evidence establishes that this would include a multitude of activities, including collecting of programming and transmission of programming to broadcast centers, uplink facilities, satellites and customers. *See* Tr., R. pp. 170:14- 207:25. SCDOR's Return does not even attempt to explain how these activities can be ignored even if one assumed that delivery of the signal is the only IPA.

[4] Hauling of the freight over the highways in South Carolina, not delivery of the freight in another state, was considered to be the primary IPA in *Mercury Motor*. *Mercury Motor,* 244 S.C. at 141, 135 S.E.2d at 759-60.

B. Interpreting Delivery of the Signal as the Only IPA is also Contrary to *Lockwood Greene.*

Interpreting delivery of the signal as the only IPA is also contrary to *Lockwood Greene*, which rejects an "origin of payment" test and instead adopts a "place of activity" test that is virtually identical to the IPA language of the apportionment statute. SCDOR claims that *Lockwood Greene* "stands solely for the proposition that the Department may source revenues of service providers such as engineering, law and accounting firms to the place of activity, but may source income from other service industries, such as finance companies and media broadcasters, to the location of the borrower and the advertisers, respectively." SCDOR Return at p. 3. It also states that *Lockwood Greene* "approved of SCDOR's use of different methods when addressing different service industries." *Id.* at p. 4.

SCDOR's assertions regarding treatment of different taxpayers is based solely on dictum. The taxpayer in *Lockwood Greene* argued that a "place of activity" test should not be imposed because the Tax Commission had been inconsistent in interpreting the apportionment statute as its guidelines called for an "origin of payment" approach to be applied to media broadcasters and finance companies. *Lockwood Greene*, 293 S.C. at 450, 362 S.E.2d at 348. The Court of Appeals disagreed and adopted the "place of activity" test. In rejecting the taxpayer's argument based on the guidelines, the Court said it was not persuaded that an engineering firm was comparable to a media broadcaster or finance company but instead was more similar to a law firm, accounting firm, entertainment and sports company or hospital management company, for which the Tax Commission guidelines focus on whether the services are performed in South Carolina. The Court was not considering finance companies or media broadcasters as neither such taxpayer was

before it,[5] and, thus, to the extent it could be read to be commenting on these businesses, such a statement is dictum.[6] *Id.* In no way, shape or form does *Lockwood Greene* hold that an "origin of payment" test must be applied to certain taxpayers. Thus, this dictum cited by SCDOR should be ignored and cannot be used to support the adoption of an "origin of payment" test or a finding that delivery of the signal is the only IPA in this case.

C. Concluding that Delivery of the Signal is the Only IPA Improperly Requires a Market-Based Approach.

SCDOR argues in its Return that concluding that the delivery of the signal is the only IPA in this case does not interpret S.C. Code Ann. 12-6-2250(A)(5) as requiring market-based sourcing and that the IPA here "just happened to occur in the homes of its South Carolina customers." SCDOR Return at p. 7. It also states that SCDOR's witnesses testified that the Department "examines the specific activities of each applicable service industry to determine where the taxpayer's income should be sourced. *Id.* at p. 8. However, it neglected to reference the following testimony and evidence, which refutes SCDOR's implication that it conducted any such analysis in this case and shows that, instead, it simply interpreted the apportionment statute to require market-based sourcing by assigning 100% of the subscription receipts to the location of the customer:

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[5] Moreover, DIRECTV is neither a finance company nor a media broadcaster. By way of clarification, a "media broadcaster" is a term that applies to network television companies, whose primary income comes from advertising fees.

[6] When asked for these "guidelines" in discovery, SCDOR could find nothing, its audit supervisor testified they were not in writing and its auditor testified he was not aware of them. Tr., R. p. 438:6- 439:7. Moreover, SCDOR admits that these alleged guidelines were never updated after 1983, pre-dated the existence of businesses like DIRECTV and do not address subscription revenue, the satellite industry or even cable companies. (R. p. 470:20- 472:10) Under these circumstances, the ALC correctly declined to give deference to such guidelines (*see* Am. Final Order, R. p. 46 at n. 19), and this Court should likewise give them no weight.

- SCDOR auditor's testimony that he conducted no background research and did not interview any DIRECTV employees to determine how DIRECTV's business operated. Tr., R. p. 422:13- 423:3.

- SCDOR's auditor and his supervisor's testimony that the audit determination was based solely on "customer location." Tr., R. pp. 425:4-6; 437:20-23.

- SCDOR witness's testimony that audit determination was based solely on customer location, that DIRECTV's activities conducted outside of the state were not relevant, and that "[w]e're only looking at what they would charge their South Carolina customer." Tr., R. p. 468:6-9; 472:22- 473:22.

- SCDOR's Report of Field Audit for the 2009 through 2011 tax years, which states that "market base sourcing" was used. Field Audit Report, R. pp. 902-909.

- Testimony of SCDOR's tax policy expert that SCDOR was "taking a market state approach to the attribution of receipts." Tr., R. pp. 577:10-18; 578:23-25; 580:7-21.

- Testimony of SCDOR's economist that the only IPAs are the customer's actions of "turning on the box, watching the TV, and paying the bill." He also stated that all prior activity by DIRECTV, including content development, broadcast services, marketing, customer service and *even delivery of the signal*, constitute costs, which he stated could not be considered IPAs. Tr. R. pp. at 543:23- 545:10.

The result sought by SCDOR in this case was clear- source 100% of DIRECTV's receipts to the customers' locations in South Carolina. With an apportionment statute that requires the focus to be on IPA, this could only be accomplished by completely discounting all out of state IPAs and calling delivery of the signal the only IPA (although as previously discussed, even this does not occur only in South Carolina). However, not even SCDOR's own witnesses support this theory. As set forth above, its employees looked solely to customer location, its expert economist said the signal cannot be an IPA and that the IPA is based on the customer's location (from which he is using the TV and paying the bills), and its expert in tax policy agreed that SCDOR was taking a market-based approach. If it walks like a duck and talks like a duck, it

might be a duck. SCDOR and the ALC decided the IPA here based solely on customer location, which is contrary to the statutes and improperly disregards the fact that what DIRECTV customers are purchasing is access to content, not simply delivery of a signal.

SCDOR also tried to buttress its position by arguing that DIRECTV had substantial receipts here and implying that it should have a correspondingly substantial tax bill and perhaps also implying that the General Fund was being shorted if DIRECTV's receipts were not sourced here. However, it is important to note that market-based sourcing is not on its face pro or anti-taxpayer or pro or anti-general fund. It is pro-taxpayer for businesses located here with substantial customers in other states (as in *Lockwood Greene*). On the other hand, it is anti-taxpayer with respect to out of state taxpayers with substantial customers here (as in this case). Stated differently, market-based sourcing will sometimes be pro-General Fund and generate a large tax (as it would here) and other times will be anti-General Fund (as with *Lockwood Greene*). Additionally, whether a state has a market-based statute or an activities-based statute can also impact whether and which businesses decide to invest in this State, locate their headquarters here, target customers here, etc. However, the decision as to whether South Carolina is market-based or activity-based lies with the Legislature, which can examine the pros and cons and decide which approach best supports the economic policies and goals of the State. The South Carolina Legislature has chosen to focus on IPAs and not customer location, or as SCDOR refers to it, "delivery of the signal." Thus, the Court should not interpret an IPA statute to reach a market-based approach.[7]

[7] DIRECTV would also note that SCDOR could have attempted to impose a market-based sourcing method under the alternative apportionment statute if it believed that the IPA rule under

V. SCDOR's Argument on the Burden of Proof is Unavailing and, in any event, the Primary Issue in this Case is a Legal One.

SCDOR criticizes DIRECTV's burden of proof argument and claims that even if *Cloyd*'s statement that once a taxpayer shows an assessment is incorrect, then it is entitled to appropriate relief is a correct statement of the law, the proper remedy is not dismissal. *See* SCDOR Return at p. 11. However, SCDOR fails to say what appropriate relief would be and instead tries to impose additional hoops for the taxpayer to jump through to obtain appropriate relief. Moreover, the burden of proof is almost beside the point in this case where there really are no factual issues, only legal ones. The key issue is whether South Carolina law (1) requires an apportionment of receipts and dictates that receipts be attributed to South Carolina only to the extent the IPA occurs in this State (as DIRECTV asserts), or (2) does not require apportionment of receipts but instead requires 100% of the receipts to be attributed to South Carolina based on the customer's location, i.e. where the final act of delivery to the customer occurs (as SCDOR claims). For these issues involving how the apportionment statute should be interpreted, the burden of proof is irrelevant.

VI. The Imposition of Substantial Understatement Penalties was Not Proper.

As previously argued in DIRECTV's Petition, any understatements must be reduced by the amount for which there was (1) "substantial authority" for the treatment, (2) "adequate disclosure" of the relevant facts and a "reasonable basis" for the tax treatment; or (3) there was "reasonable cause" for an understatement and the taxpayer acted in "good faith." *See* S.C. Code Ann. §12-54-155(B)(2)(b); S.C. Code Ann. §12-54-155(D)(1). *See* DIRECTV's Petition at p. 31. DIRECTV submits that it meets all three bases, even though only one is needed to justify reducing the

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the gross receipts apportionment statute did not accurately reflect DIRECTV's business activities here and that market-based sourcing did. However, SCDOR chose not to do so.

penalty. The ALC in this case already determined that the substantial understatement penalty should be reduced by 25% because it found that DIRECTV acted in good faith and "appropriately disclosed relevant facts affecting subscription receipts" (*see* Am. Final Order, R. p. 51), so DIRECTV will only address whether it had substantial authority, a reasonable basis or reasonable cause.

SCDOR's Return claims that the statute, *Lockwood Greene* and *Mercury Motor* do not stand for the propositions that DIRECTV claims. DIRECTV will not repeat all of its arguments above and in its Petition but would point out the following important points for this Court to consider in evaluating whether it had substantial authority, a reasonable basis or reasonable cause to report its income as it did:

- *Lockwood Greene* requires apportionment based on "place of activity." It contrasts this with the "origin of payment" approach, which focuses on the location of the customer. It approves of the use of a payroll proxy to locate the taxpayer's activities. Its discussion of SCDOR's use of the "origin of payment" approach for certain other taxpayers like finance companies and media broadcasters (neither of which DIRECTV is) is contained in dictum and merely states that such a policy does not dictate the same result here.

- S.C. Code Ann. 12-6-2295(A)(5), which was enacted after *Lockwood Greene* and thus controls to the extent there are differences between the two, expressly requires apportionment based on "income producing activities." It does not state or imply in any way that apportionment of receipts is based on the location of the customer or the location of the final step in delivering a product.

- *Mercury Motor* acknowledges that *all* of the transactions in the series of taxpayer activities contribute to the production of its income. It holds it is not unconstitutional to take into account the income related to the hauling of freight because that transaction primarily earns the income. It does not consider or address whether it would be appropriate to ignore some IPAs (such as incidental ones) when applying a statutory apportionment method. To the extent it can be read to discount "incidental" activities, that would include *delivery of the freight*, which would be akin to *delivery of the signal* into the customers' homes here.

- SCDOR has published no guidance (regulations, policy documents or otherwise) to alert taxpayers to any policy that interprets the apportionment statute to require market-based sourcing for subscription revenue, and, in fact, its own auditor testified in his deposition that he was not even aware of such a policy or practice. Tr., R.p. 303:1-8.

In this case, a penalty is at issue for only the last three years of returns (2009-2011). DIRECTV filed its 2009 and 2010 returns based on set-top box rental receipts and its 2011 returns based on payroll. The set-top box rentals are the only income at issue that is earned in South Carolina and are the most obvious reflection of the IPAs in this State. They illustrate the footprint of DIRECTV in South Carolina and its minimal IPAs here. The 2011 return using a payroll proxy tracks *Lockwood Greene* to the letter and is also a reasonable reflection of DIRECTV's IPA here. Such positions are supported by substantial authority, a reasonable basis or reasonable cause.

To consider this issue from a different perspective, imagine if DIRECTV was based in South Carolina with thousands of employees and millions in assets and attempted to files its returns by apportioning only its receipts from South Carolina customers to this State. It is hard to imagine that it could show substantial authority for such a position when (1) the statute says "income producing activity;" (2) *Lockwood Greene* speaks to "place of activity" and endorses a payroll proxy; and (3) *Mercury Motor* views delivery of the freight (akin to delivery of the signal here) as incidental. Surely, two completely opposite filing positions cannot both result in a penalty being justified. Filing on a basis that takes into account the activities of the taxpayer in this State (versus one that looks only to the customer's location or the delivery of the product) is the position that is consistent with the law.[8]

Because the existing law supported its position in this case and there was no guidance published by SCDOR to the contrary, DIRECTV had substantial authority, reasonable cause and a reasonable basis for its tax treatment. Thus, the substantial understatement penalties for 2009-

[8] Even the Texas case framed by SCDOR in earlier briefing as reaching the result it seeks here (though it was distinguishable) did not uphold the imposition of a penalty on the taxpayer based, in part, on fact that the case involved a complex and novel issue. *Anonymous Taxpayer v. Texas Cptr of Pub. Accts*, 2013 WL 3490605 (Tex. Cptr. Pub. Acct., May 17, 2013). *See also Ameritech*, 2010 WL 2519583, slip op. at 12 (concluding that although taxpayer's view that its IPAs to produce its directories were performed out of state was incorrect, it was still reasonable).

2011 should be dismissed.

CONCLUSION

As set forth above and in its Petition previously filed, 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 South Carolina law, and thus, a rehearing and/or entry of a new Opinion is warranted.

Respectfully submitted,

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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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October 30, 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

Dear Ms. Kitchings:

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

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

By copy of this letter the Reply in Support 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 Geer

by MEC w/ express permission

Bryson M. Geer

BMG:gh
Enclosure

cc: Nicole Wooten, Esq. (Nicole.Wooten@dor.sc.gov)
William J. Condon, Jr., Esq. (William.Condon@dor.sc.gov)
Jason P. Luther, Esq. (Jason.Luther@dor.sc.gov)